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EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
Washington, D.C. 20503-0001

Wednesday, February 10, 1999

LEGISLATIVE REFERRAL MEMORANDUM

TO: Legislative Liaison Officer - See Distribution below

FROM: John D. Burnim (for) Assistant Director for Legislative Reference

OMB CONTACT: Annette E. Rooney

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SUBJECT: US Trade Representative Testimony on HR434 African Growth and
Opportunity Act

DEADLINE: 4:30 P.M. Wednesday, February 10, 1999

In accordance with OMB Circular A-19, OMB requests the views of your agency on the above subject before advising on its relationship to the program of the President. Please advise us if this item will affect direct spending or receipts for purposes of the "Pay-As-You-Go" provisions of Title XIII of the Omnibus Budget Reconciliation Act of 1990.

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African Growth and Opportunity Act

RESPONSE TO LEGISLATIVE REFERRAL MEMORANDUM

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our country.

Three weeks ago, President Clinton called for the initiation of a new multilateral negotiating Round able to meet the demands of the 21st century. This will begin at the World Trade Organization's Third Ministerial Conference, chaired by the United States -- and the largest trade event ever held in the United States -- and it will shape world trade in the next century. Our multilateral agenda will be accompanied by the regional, bilateral and sectoral negotiations we have underway in each part of the world; and by enforcement of our rights under WTO dispute settlement, the North American Free Trade Agreement and through our domestic trade laws.

We hope and expect to carry out this agenda in the tradition of bipartisanship and close consultation between the Executive and Legislative branches which have characterized many years of American trade policy. My testimony will touch on each of these points, including trade negotiating authority, which we believe will help us achieve our goals. But let me begin by discussing the context in which we develop and execute our policy agenda.

TRADE POLICY PRINCIPLES

Trade policy forms part of both our national economic policy and our approach to the world beyond our borders.

At home, engagement in world trade, based on fair rules and the rule of law, offers American firms, agricultural producers and workers larger markets. Almost 80% of world economic consumption takes place outside the U.S., and if America is to continue to grow and remain competitive in the future, trade policy must ensure that Americans have fair access to these markets. Trade also offers American consumers a greater choice of products at competitive prices and higher quality.

Overseas, trade helps increase world prosperity, advances the rule of law, and helps to strengthen international peace. As President Franklin Roosevelt said in 1944:

&A basic essential to peace, permanent peace, is a decent standard of living for all individual men and women and children in all nations. Freedom from fear is eternally linked with freedom from want. [And] it has been shown time and time again that if the standard of living in any country goes up, so does its purchasing power -- and that such a rise encourages a better standard of living in neighboring countries with whom it trades.⁸

These principles have formed the basis of American trade policy since the end of World War II. We have advanced them on a bipartisan basis through a strong working partnership between the Executive Branch and Congress through ten Administrations, ever since the creation of the General Agreement on Tariffs and Trade in 1948. The Clinton Administration's trade policy, we believe, is firmly in this tradition: such advances as the passage of the North American Free Trade Agreement, the Uruguay Round, our 35 bilateral trade agreements with Japan -- a total of 270 trade

agreements -- would not have happened without the advice, support and contribution of the Trade Subcommittee and Congress as a whole.

TRADE AND THE US ECONOMY

The results of these policies have contributed immeasurably to the peace and prosperity America now enjoys. We have the most dynamic, creative and competitive economy in the world, and are ideally placed to succeed in the next century.

Since 1992, we have had uninterrupted growth -- our economy has expanded from \$7.1 trillion to \$8.5 trillion in real terms (1998 dollars) and last month, the present economic expansion became America's longest in history.

We have created jobs. Employment in America has risen from 109.5 to 127.2 million jobs, a net gain of nearly 18 million, as unemployment rates fell from 7.4% to 4.3%.

And we have raised wages. Since 1992, average wages have reversed a twenty-year decline and have grown by 6.0% in real terms, to \$449 a week on average. This family prosperity is reflected, for example, in record rates of home ownership.

Altogether, we have achieved an historic combination of high growth, low unemployment, low inflation, low interest rates and rising wages unmatched in decades. The reasons for this are many. They include improved support for education and job training and an uninterrupted reduction in the federal deficit beginning in 1993 and culminating with the budget surpluses of the past two years. But trade and participation in the world economy have played an irreplaceable role.

And overseas, as trade has grown and international trade rules have strengthened, the hopes of the wartime generation have been in many ways realized.

Peace among the world's great nations has grown more secure.

Prosperity has blossomed -- as world exports have grown from \$60 billion to \$6.5 trillion in constant dollars since 1960, world economic production has quadrupled and real per capita income has more than doubled, from under \$3100 to over \$6300 last year.

As a consequence, people have better lives. In 1955, the world average life expectancy at birth was 48 years; now it is 65. Where the worldwide infant mortality rate was 148 per thousand, today it is 59.

And faith in markets under the rule of law has been vindicated: those nations which shut off the free flow of goods, services and information have tended to stagnate while those which remained open to the world have tended to prosper. One need only examine the ghastly experiment which has taken place on the Korean peninsula -- as South Korea has risen to become one of the world's leading industrial powers, while North Korea is afflicted by chronic hunger -- to show how stark is the contrast. And there is no stronger vindication of our work than the fact that Russia, China and 16 other economies have abandoned central planning and seek WTO

membership.

Our Administration has had the good fortune to build upon this foundation. Since 1992, we have negotiated 270 separate trade agreements which have helped open markets and create opportunity for Americans. These include five which have fundamentally transformed world trade: the North American Free Trade Agreement, which cemented our strategic trade relationship with our immediate neighbors; the Uruguay Round, which created the World Trade Organization with a binding dispute settlement mechanism and extended international trade rules to new areas through agreements on agriculture, services, intellectual property; and three multilateral agreements on information technology, financial services and basic telecommunications.

US TRADE TODAY

As a result, America's trade has flourished. Last year we exported \$932 billion in goods and services -- a 51% increase from the 1992 level of \$617 billion, despite a slowing in export growth due to the financial crisis. Our goods exports were very evenly divided among four major markets, meaning that we have critical trade interests in each part of the world:

Canada	Asia-Pacific	Latin America	European Union
\$156 billion	\$166 billion	\$143 billion	\$150 billion

Measured by country, our largest five goods export markets were Canada at \$156 billion, followed by Mexico at \$71 billion, Japan at \$57 billion, the United Kingdom at \$40 billion and Germany at \$25 billion.

Service export figures are only partially available for 1998. Our full-year 1997 service exports, divided regionally, were more heavily weighted to Asia and Europe but still indicate critical interests in each region:

Canada	Asia-Pacific	Latin America	European Union
\$20.5 billion	\$73.6 billion	\$34.2 billion	\$74.8 billion

In 1997, our six largest service export markets were Japan with \$34 billion, the United Kingdom with \$23.7 billion, Canada at \$20.5 billion, Germany at \$13.5 billion, France at \$9.4 billion and Mexico at \$9.3 billion.

Altogether, the United States was the world's largest exporter in 1998. We were also the largest exporter of the goods and services supporting the highest-wage jobs: agricultural products, advanced technology products and capital goods. Our goods exports now support 11.6 million American jobs.

The United States was also the world's largest importer, at \$1.1 trillion in goods and services imports in 1998. Imports play an important role in our economy, by raising living standards for consumers (especially lower-income Americans), dampening inflation, ensuring the widest possible choice of products at the best prices, and providing essential inputs for

U.S. industries, many of which then export their goods at equally competitive prices. However, open markets depend on fair trade rules, and we are and will be vigilant in enforcing our laws against import surges, subsidies, dumping, or other measures intended to artificially boost exports or protect foreign markets.

TRADE AGENDA IN 1999

This brings me to our agenda for the years to come. As in the past, we hope to base our work on the foundation of a bipartisan consensus and a strong working relationship between the Administration and Congress. Generally speaking, our trade policy seeks the following goals.

- Address the trade effects of the financial crisis which now directly affects nearly 40% of the world.
- Continue our progress toward open and fair world markets through a new negotiating Round, as well as our role as host and Chair of the WTO,s Third Ministerial Conference, regional negotiations and bilateral talks.
- Advance the rule of law and defend US rights by ensuring full compliance with trade agreements and strongly enforcing our trade laws.
- Encourage the full participation of all economies, including economies in transition and developing nations, in the world trading system on a commercially meaningful basis;
- Ensure that the trading system helps lay the foundation for the 21st-century economy by offering maximum incentives for scientific and technological progress.
- Ensure that trade policy complements our efforts to protect the world environment and promote core labor standards overseas; and
- Advance basic American values including transparency and accessibility to citizens and involvement of civil society in the institutions of international trade.

TRADE NEGOTIATING AUTHORITY

As we pursue this agenda, the Administration will consult with the Subcommittee and Congress on the renewal of traditional trade negotiating authority. The President, in his State of the Union address, called for a new consensus on trade. He said we must find the common ground on which business, workers, farmers, environmentalists and government can stand together. This commitment to common ground has been a hallmark of the Subcommittee,s approach to trade policy over the years. I want to personally thank you, Mr. Chairman, along with each member of the Subcommittee, for your commitment and hard work toward this goal in the last Congress.

Consistent with that approach, we believe negotiating authority should bolster the traditional bipartisan support for trade policy and allow us to pursue an agenda that reflects consensus goals. It is a tool which can help us negotiate with greater credibility and effectiveness on behalf of

American economic interests, and thus contribute to our goal of opening markets, increasing growth and raising living standards.

TRADE EFFECTS OF FINANCIAL CRISIS

Let me now address our agenda in detail. I will begin with the trade effects of the financial crisis affecting Asia, Russia and parts of Latin America.

This crisis has now lasted a year and a half, and its effects on our trade interests have been severe. Countries which have implemented IMF reform programs have seen a number of good results, including currency stability and returning investor confidence. However, real economies continue to suffer. Six major economies -- Hong Kong, Indonesia, Malaysia, South Korea, Russia and Thailand -- are likely to have contracted by 6% or more last year.

As a result of this crisis, the American trade imbalance has widened. This reflects largely a sharp drop of about \$30 billion in American exports to the Pacific Rim, and a consequent break with the pattern of rapid U.S. export growth of the past few years. Our overall import growth last year (with the principal exception of the steel sector, in which imports rose very rapidly in the second half of 1998, affecting thousands of jobs) remained consistent with growth rates in previous years. Thus the larger deficit largely reflects predictable macroeconomic factors.

Our trade policy response begins by ensuring that our trading partners continue to live by commitments at the WTO and in our regional and bilateral agreements. The strength of the trading system is an enormous advantage here -- despite the worst financial crisis in fifty years, the world has resisted the temptation to relapse into protectionism. This has greatly reduced the potential damage to our economy, and particularly to American manufacturing exporters and agricultural producers. In addition, other markets -- particularly our NAFTA partners Canada and Mexico, to whom U.S. goods exports grew by \$13 billion last year -- have in part compensated, thanks to the more open North American market NAFTA has created, for some but not all of these lost exports. An ambitious trade agenda will further strengthen our effort to ensure that the crisis does not cause the world to move backward.

We continue with a policy response covering several areas:

IMF Recovery Packages -- We have supported reform packages with the IMF at the center in affected countries. Several of these contain trade conditionalities which we vigorously monitor.

Restored Growth in Japan -- A return to growth in Japan, Asia's largest economy, is essential for the economic health of the region. The Administration's view is that this will require fiscal stimulus that continues until solid growth is restored, financial reform, and deregulation and market-opening. USTR's responsibilities lie in this last area. In addition to an aggressive bilateral agenda, the agreement we reached in Japan last May sets out concrete deregulatory measures in telecommunications, housing, medical devices, pharmaceuticals and

financial services sectors, and measures to strengthen competition policy enforcement and transparency. When fully implemented, these will create opportunities for exporters and workers in America, other Pacific economies and Japan. We are now discussing new measures in these sectors and energy as well.

Steel -- The President's January 7 Steel Report to the Congress lays out a seven point action plan on the steel import surge. Among other points, the plan projects a roll-back of imports from Japan -- the key cause of the import surge -- to pre-crisis levels, and states that the Administration is prepared, if necessary, to self-initiate trade cases to ensure that this roll-back takes place. The plan also outlines actions taken by the Commerce Department to expedite ongoing dumping investigations and apply any dumping margins retroactively. In addition, the Administration expresses strong support for an effective safeguards mechanism; and commits us to continue to assess the effectiveness of steps taken to date, and working closely with the industry, labor, and members of Congress, to assess additional steps. To assist in this ongoing review, we also announced that preliminary steel import data will be released, thus enabling the industry's business planners to react to imports on a more timely basis.

I. GROWTH AND HIGHER LIVING STANDARDS

Let me now turn to our negotiating agenda. In this agenda, we seek enduring goals -- growth, higher living standards, the rule of law, a rising quality of life, better protection of health, safety and the environment, and the advance of basic values. As President Clinton said in the State of the Union address, we need to find new methods of negotiating and address a broader array of issues to secure these goals in the next century.

1. New Round and WTO Ministerial Conference

This is the basis of President Clinton's call for a new, accelerated negotiating Round for the 21st century. The Round would begin at the WTO's Third Ministerial Conference, which I will chair and which will be held in Seattle from November 30th to December 3rd. This will be the largest trade event ever held in America, bringing government leaders, Trade Ministers, business leaders, non-governmental organizations and others interested in trade policy from around the world. It is an extraordinary opportunity for us to shape at least the next decade of multilateral trade negotiations and to highlight our economic dynamism to the world.

The Round President Clinton has called for would be somewhat different from previous Rounds, in that we should be able to pursue three dimensions simultaneously: first, a negotiating agenda to be completed on an accelerated timetable; second, institutional reforms and capacity-building at the WTO; and third, ongoing results in priority areas.

To begin with, we would hope to advance a number of important initiatives in the months leading up to the Ministerial Conference and at the event itself. They include:

-- An e-Commerce and Information Technology Agreement II -- adding new products to the

sectors already covered by the first ITA.

-- Extension of last May's multilateral declaration not to assess customs duties on electronic commerce, to make sure that the Internet remains an electronic duty-free zone.

-- An agreement on transparency in procurement to create more predictable and competitive bidding, reducing the opportunity for bribery and corruption and helping ensure more effective allocation of resources.

-- Build consensus on the sectoral liberalization initiative begun in the Asia-Pacific Economic Cooperation forum. This would eliminate tariffs and in some cases liberalize services in chemicals; energy equipment and services; environmental goods and services; fish and fishery products; gems and jewelry; medical and scientific instruments; toys; and forest products. Meaningful participation by Japan in the fishery and forest products sectors would be essential to success.

The second dimension of institutional reform would promote transparency, allow the WTO to facilitate trade and participation for less developed nations, help it coordinate more effectively with international bodies in other fields, and continue to strengthen public confidence in the WTO as an institution. Here we would hope to take up such issues as:

-- Trade facilitation. Most of the world's regional trading arrangements -- ASEAN, APEC, the European Union, Mercosur, NAFTA, the proposed FTAA -- contain a critical element of trade facilitation, often beginning with customs reform to reduce transaction costs and make trade more efficient. The WTO can help accomplish this on a much broader scale.

-- Capacity-building. We need to narrow the growing disparity between the rich countries and the poor countries. We have to ensure that the WTO can work effectively with member economies and other international institutions, particularly with respect to the least developed nations, to ensure that they have both access to markets and technical assistance to meet the kinds of obligations that will help them grow. This and other issues will be addressed at a High-Level Meeting on Trade and Development this March.

-- Addressing the intersection between trade and environmental policies. As trade promotes growth overseas, we must at the same time ensure clean air, clean water and protection of our natural heritage, as well as effective approaches to broader questions like biodiversity and climate change. We have already scheduled a High-Level Meeting of trade and environment experts in March, which we anticipate will provide fresh and valuable input to our work in this area and help frame a vision for future work.

-- Addressing the intersection between trade and labor. Again, as in our domestic economy, growth can and should be accompanied by safer workplaces, elimination of exploitive child labor and respect for core labor standards. The WTO in particular can work in more coordination with the International Labor Organization on some of these issues. As the President has announced, the US will provide funds for a new multilateral

program in the ILO to provide technical assistance for international labor rights initiatives, and through our own Department of Labor will help our trading partners strengthen labor law enforcement. These and other such efforts should be a focus of renewed cooperation with the ILO.

-- Coordination with the international financial institutions, in a world where the separation of trade from financial policy has become entirely artificial. The WTO must work more effectively with the IMF and World Bank to achieve their common goals of a more stable, predictable and prosperous world.

-- Transparency. We will also seek reform, openness and accountability in the WTO itself. Dispute settlement must be transparent and open to the public. Citizens must have access to panel reports and documents. Civil society must be able to contribute to the work of the WTO, to ensure both that the WTO can hear from many points of view including labor, environmental, consumer and other groups, and that its work will rest on the broadest possible consensus.

With respect to the expedited negotiating agenda of this Round, we are now consulting with Congress, industry, and other interested parties on a detailed negotiating agenda for talks which would begin after the Ministerial. While the final scope of the agenda is yet to be determined, we believe that at a minimum they should include such issues as:

-- Agriculture, where we envision broad reductions in tariffs, the elimination of export subsidies, and further reductions in trade-distorting domestic supports linked to production. We must seek transparency and improved disciplines on state trading enterprises, seek reform of the EU's Common Agricultural Policy, and ensure that the world's agricultural producers can use safe, scientifically proven biotechnology techniques without fear of trade discrimination.

-- Services, in which we hope to see specific commitments for broad liberalization and market access in a range of sectors, including but not limited to audiovisual services, construction, express delivery, financial services, professional services, telecommunications, travel and tourism, and others.

-- Government procurement, in which purchases are over \$3.1 trillion per year, much of it in sectors where America sets the world standard: high technology, telecommunications, construction, engineering, aerospace and so forth. At present, only 26 of the 133 WTO Members belong to the plurilateral WTO Government Procurement Agreement. We thus look to bring more countries under existing disciplines.

-- Intellectual property, where our efforts to ensure full compliance with the existing provisions of the Uruguay Round will be combined with campaigns against piracy in newly developed optical media technologies such as CDs, CD-ROMs, digital video discs and others; and end-user piracy of software.

-- Industrial tariff and non-tariff barriers, where we will seek to continue our progress in reducing bound and applied tariff levels, and

continue to address non-tariff measures in industrial sectors.

-- A forward work-program on newer issues for the multilateral system to consider, including considering how competition and investment policies meet the test of assuring fair and open trade and how the WTO can help to create an international pro-competitive regulatory climate, particularly in services, and further advance our efforts against bribery and corruption.

Outside the context of the Round, we are pursuing the accession of 31 economies to the World Trade Organization: Latvia, whose accession is complete and awaiting ratification; and Albania, Algeria, Andorra, Armenia, Azerbaijan, Belarus, Cambodia, China, Croatia, Estonia, FYR of Macedonia, Georgia, Jordan, Kazakhstan, Laos, Lithuania, Moldova, Nepal, Oman, Russia, Samoa, Saudi Arabia, Seychelles, Sudan, Taiwan, Tonga, Ukraine, Uzbekistan, Vanuatu and Vietnam. In all cases we seek a commercially meaningful accession with the greatest possible commitments to all WTO agreements, including the most recent ones.

We are also exploring ways to more fully integrate the least developed countries, particularly in Africa, into the system. This includes both seeking deeper commitments, and technical assistance in fulfilling those commitments, and legislation to improve trade relations with Africa.

Finally, we will shortly be deciding on entry into force of the 1997 WTO financial services negotiations. As you may recall, these extended negotiations concluded on an interim basis in 1995 because we were dissatisfied with offers from important trading partners, especially in developing and emerging markets. In contrast, in the negotiations that concluded in December 1997, we obtained broader and deeper commitments, in banking, insurance, and securities, from a wide range of developed and developing countries, including the key emerging markets of primary interest to U.S. industry. These countries had until January 29, 1999, to complete any necessary domestic procedures and formally notify the WTO of their acceptance of the protocol for bringing their commitments into force. Fifty-three countries, including the United States, met the deadline, and these 53 are now empowered to decide whether to allow their commitments to enter into force, on an MFN basis, from March 1. We have been consulting with your staff, staff of other relevant committees, and the U.S. private sector to determine a strategy that is in the best commercial interest of the United States and that will demonstrate our view that all WTO Members must live up to their commitments.

2. Regional Trade Agenda

At the same time, we are pursuing an active agenda in each region of the world. A brief review is as follows:

Canada -- With Canada, our largest trade partner, we have serious concerns on a range of agriculture matters. We took an important step on these last December by concluding a market access package opening opportunities for American grain farmers, cattle ranchers and other agricultural producers. We will continue our work in these areas this year. We will also address major market access impediments to our

magazine publishers (as I note in the section on enforcement) and other media and entertainment industries. We will also continue to enforce our bilateral sectoral agreements. At the same time, we intend to work with Canada on bilateral issues of mutual interest, and on negotiations toward the Free Trade Area of the Americas and at the WTO where we share many goals.

Mexico -- Trade with Mexico has expanded very rapidly since passage of the North American Free Trade Agreement. Last year, Mexico passed Japan as both our second largest goods exports market and our second largest overall trade partner. We will continue to monitor implementation of Mexico's NAFTA commitments, scheduled to be complete by 2008, and address bilateral issues including land transportation, corn syrup and sugar, and telecommunications barriers as well as piracy in intellectual property rights. We have also stepped up our efforts in the trilateral work program now underway in more than 25 Committees and Working Groups, with the intention of maximizing our gains under the NAFTA.

Western Hemisphere -- The Miami and Santiago Summits of the Americas have called on us to complete work on a Free Trade Area of the Americas no later than the year 2005. This year, in accordance with Summit directions, we intend to achieve concrete progress toward the FTAA in our nine Negotiating Groups and through business facilitation and other measures. At the same time, we will seek approval from Congress of an expanded and improved Caribbean Basin Initiative with benefits similar to those now accorded Mexico and Canada.

Europe -- We are working to remove barriers and strengthen trade relations with the EU through the Transatlantic Economic Partnership begun last year. This includes negotiations on seven separate agenda items: technical trade barriers, agriculture (including biotechnology and food safety), intellectual property, government procurement, services, electronic commerce and advancing shared values such as transparency and participation for civil society. We are also working to ensure the protection of American interests as the EU expands to include Central and Eastern European nations. At the same time, we are enforcing European compliance with dispute settlement decisions and will address problems in our trade relations both bilaterally and through the new negotiating Round President Clinton has proposed.

Asia -- Under the Asia-Pacific Economic Cooperation (APEC) forum we are looking long-term toward free and open trade in the region. This year, as I noted earlier, we will seek WTO consensus on the nine-sector liberalization package begun in APEC, and begin work on six additional sectors. We will also address bilateral issues with Korea, the ASEAN nations and other Asian trade partners. This will include seeking Normal Trade Relations with Kyrgyzstan, Mongolia and Laos, and negotiating a broad trade and commercial agreement with Vietnam.

Japan -- In trade relations with Japan, our largest overseas trade partner, we will continue our intense and sustained effort to open and deregulate the Japanese market. We have concluded 35 bilateral trade agreements with Japan since 1993; we will monitor their implementation closely and enforce them vigorously. We will also address sectoral issues

including rice, steel, insurance, glass, film and other topics. And as I noted earlier, we are pursuing an ambitious set of goals under the Enhanced Initiative on Deregulation and Competition Policy, both in individual sectors and in broader structural issues. We hope to see substantial progress on these issues as Prime Minister Obuchi's spring visit approaches.

China -- We will monitor and strictly enforce our agreements on intellectual property and market access with China, and address bilateral trade problems in agriculture, direct marketing and other areas. At the same time, we will continue to seek broad market-opening through our negotiations toward China's accession to the World Trade Organization, which I address more fully below.

Africa -- USTR is implementing the President's Partnership for Economic Growth and Opportunity in Africa, which owes a great deal to the work of the Trade Subcommittee, by supporting economic reform, promoting expanded trade and investment ties, and encouraging Africa's full integration into the world trading system by negotiating bilateral agreements, technical assistance and other measures.

A sound policy framework in African countries that opens economies to private sector trade and investment offers the greatest potential for growth and poverty alleviation as well as trade opportunities for the U.S.. Last month, for example, we signed a Bilateral Investment Treaty with Mozambique and over the next few months we expect to sign Trade and Investment Framework Agreements, or TIFAs, with South Africa, Ghana, and the West African Economic and Monetary Union. We also place a very high priority on Congressional approval of the African Growth and Opportunity Act. I want to state my personal appreciation for the work of Chairman Crane, Congressman Rangel and Congressman McDermott to secure its early passage in this Congress.

Broader efforts to encourage full integration of developing countries into the trading system will also bolster our Africa policy. In this regard, we will seek renewal of the Generalized System of Preferences.

Middle East -- Building upon our Free Trade Agreement with Israel, we have inaugurated a program that aims to bolster the peace process, while advancing American interests. Starting with a framework of bilateral trade and investment consultations in the region and a newly inaugurated industrial zones program, we will help the Middle Eastern countries work toward a shared goal of increased intra-regional trade.

OECD -- We strongly support passage of the OECD Convention on Shipbuilding Subsidies and will work with you to ensure its success.

II. ENFORCING THE RULE OF LAW

Second, US trade policy will support and advance the rule of law internationally by ensuring the enforcement of trade agreements and U.S. rights in the trading system.

Much of our enforcement work takes place at the World Trade

Organization. We have filed more complaints in the WTO -- 41 cases to date -- than any other WTO member, and our record of success is strong. We have prevailed on 19 of the 21 American complaints acted upon so far, either by successful settlement or panel victory. In almost all cases, the losing parties have acted rapidly to address the problems. We will insist that this remain the case in all our disputes, including those with the European Union on beef hormones and bananas, and with Canada on magazines. At the same time, the U.S. has complied fully with all panel rulings it has lost, although these are few in number. And we will, of course, use our rights under the NAFTA to ensure open markets to our goods and services in Canada and Mexico.

We are also monitoring implementation of WTO commitments. All WTO developing country members are scheduled to fully implement their intellectual property commitments, and all members are required to implement customs valuation commitments by January 1, 2000. We will insist on strict compliance with these deadlines.

Likewise, we are vigilant to ensure enforcement of textile quotas and implementation of textile market access requirements overseas. A number of our trading partners clearly have further work to do in market access, including some of our largest and fastest growing textile suppliers. We have and will continue to aggressively pursue our rights, whether through the consultation process or ultimately through the WTO dispute settlement regime.

U.S. trade laws are also a vitally important means of ensuring respect for U.S. rights and interests in trade. We will continue to challenge aggressively market access barriers abroad using laws such as Section 301, "Special 301" and Section 1377, to open foreign markets and ensure fair treatment for our goods and services, ensure nondiscrimination in foreign government procurement and ensure compliance with telecommunications agreements.

To ensure that we have the maximum advantage of domestic trade laws, the Administration will reauthorize by Executive Order two laws for which authority has lapsed: "Super 301" and Title VII. We wish to work with the Subcommittee to include these laws in your legislative agenda.

The Administration is also, of course, committed to full and vigorous enforcement of our laws addressing dumping and subsidies, and on injurious import surges.

III. INTEGRATING TRANSITION ECONOMIES

Third, our trade policy will continue our progress toward integrating China, Russia and other economies in transition into the trading system. This will both advance specific American trade interests, and contribute to our larger goal of a more secure peace in the next century.

This task is the last great step in the process which began with the formation of the GATT and continued with the admission of Germany and Japan: the integration of China, Russia and sixteen other economies in

transition from communist planning into the trading system. These economies and a number of Middle Eastern nations are the two largest groups remaining outside the trading system. Their entry will make membership in the trading system nearly universal; and the accession of the transition economies will be a fundamentally important step in their domestic reforms as well. This would remove large distortions in world markets, dramatically enhance market access for American producers, and bolster international stability by giving these nations a greater stake in world prosperity beyond their borders

To support rather than undermine both domestic reform in these economies and the rules of the trading system, these countries must be brought into the WTO on commercially meaningful terms. The result must be enforceable commitments to open markets in goods, services and agricultural products; transparent, non-discriminatory regulatory systems; and effective national treatment at the border and in the domestic economy.

This is an ambitious task, but not an impossible task. Central European countries like Poland, Hungary and the Czech Republic have succeeded, and their experience shows that WTO membership has assisted their domestic economic reform policies. The most recent successful WTO applications, Latvia and Kyrgyzstan, have had the same experience.

In the months to come, we will negotiate intensely with all acceding economies, including China -- the largest prospective WTO member. We have made important progress with China in the past two years, and the visit of Premier Zhu Rongji in April offers China a chance to make a decisive advance. We will consult closely with the Subcommittee and with other members of Congress as negotiations proceed.

Likewise, at the most recent summit with Russia (September 1998), President Yeltsin agreed to work to intensify Russia's WTO accession efforts. Russia's current economic difficulties clearly present challenges and Russian Cabinet reshuffling has slowed the process, but we will continue to consult with the Russians toward a commercially viable accession package.

IV. THE 21ST-CENTURY ECONOMY

Fourth, trade policy will help lay the foundation for the 21st-century economy by ensuring that the trading system is compatible with rapid advances in civilian science and technology.

In medicine, environmental protection, agriculture, entertainment, transportation, materials science, information and more, science is advancing at extraordinary speed. This offers the world tremendous potential to increase wealth, raise productivity, improve health care, reduce hunger, protect the environment and promote education. These are also areas in which the United States has a significant comparative advantage.

Under President Clinton, our trade policy has made high technology a strategic priority. Consistent with national security, we have aimed to ease the development and commercialization of new technologies, and ensure

strong incentives for scientific and technological progress. We have negotiated far-reaching new agreements in sectors like computers, semiconductors, information technologies and many other areas. This work continues in multilateral, sectoral and regional negotiations.

In the multilateral system, the rapid advance of technology requires us to improve the trading system, institutions and negotiating methods. In a world where successive generations of new products arise in a matter of months, and both information and money move instantaneously, we can no longer take seven years to finish a negotiating Round, or let decades pass between identifying and acting on trade barriers. We will have to move faster and more efficiently, which is a significant reason for the President's call for an accelerated Round.

We must also ensure that trade policy, both in the WTO and in our regional and bilateral negotiations, helps ensure that we can take advantage of our comparative advantage in knowledge industries and other new technologies. Three broad issues cut across many sectors:

Intellectual Property Rights -- Our success in this field over the past decade owes a great deal to the work of Congress, both in the Trade Act of 1988 with its creation of Section 301, 8 and on the Uruguay Round. Today, the vast majority of our trading partners have passed modern intellectual property laws and are improving levels of enforcement. In this area, we will spend a great deal of time ensuring that all WTO members comply with their obligation to introduce full intellectual property protection by January 1, 2000. (For countries, like China, which are not WTO members, we will vigorously monitor compliance with bilateral agreements.)

We have also launched campaigns against worldwide piracy of new optical media technologies, and against end-user piracy of software. These issues are integral parts of our regional negotiating agenda in Asia, Latin America, Europe, Africa and the Middle East. Looking ahead, we must extend protection of intellectual property rights beyond basic laws and enforcement to protect new technologies like genetically engineered plant varieties.

Global Electronic Commerce -- In accordance with the President's Global Electronic Commerce initiative, USTR seeks to preserve electronic trade over the Internet as duty-free. At the last WTO Ministerial Conference, in May of 1998, we won agreement to a moratorium for tariffs on electronic transmissions. As I noted earlier, we will seek to extend that agreement this year. Likewise, in our negotiations toward the Free Trade Area of the Americas, at APEC and in the Transatlantic Economic Partnership, we have created special committees to advise us ways to ensure all participants can take maximum advantage of electronic commerce.

Biotechnology -- A third top priority for us in this area is biotechnology. Among the chief sources of innovation in this field are American agriculture and medicine. USTR will seek to ensure that pharmaceutical companies, farmers and ranchers can use safe, scientifically proven techniques like biotechnology to make agriculture both more productive and friendly to the environment, without fear of encountering trade discrimination. This is a priority for us in the

Transatlantic Economic Partnership negotiations and in developing our agenda for future WTO negotiations.

We also have an active sectoral high-tech agenda. This includes, for example, the ITA II agreement I discussed earlier. We are also working closely with our civil aircraft industry to ensure its future and combat foreign, particularly European, subsidies and other unfair practices. This work extends into many other fields.

V. RISING QUALITY OF LIFE

Fifth, US trade policy seeks to ensure that worldwide as in the United States, trade and growth go together with a rising quality of life, including setting high standards of environmental protection, the observance of core labor standards, and high levels of consumer protection.

As in our domestic economy, we regard environmental quality and protections for workers as essential parts of economic policy. Trade policy has an important role to play, in coordination with our efforts in other fora, to ensure growing respect for internationally recognized core labor standards and sustainable development worldwide.

1. Trade and the Environment

Our Administration believes that prosperity through open trade and the protection of health, safety and the environment need not conflict, and should be mutually supportive. This is the case in our domestic economy, where in the past three decades our GDP has risen in real terms from \$3.7 to \$8.5 trillion -- while our percentage of fishable and swimmable rivers and streams doubled, the number of citizens living in cities with unhealthy air fell by half, and many endangered or threatened species, including the bald eagle, are recovering. Where there are potential conflicts, we should strengthen our ability to resolve them in a manner that protects the environment, health and safety and does not undermine the trading system. This includes working to ensure that the proper expertise is brought to bear on complex technical and scientific issues, particularly those with environmental, health and safety dimensions.

In many cases elimination of trade barriers will also contribute to a cleaner environment and the conservation of natural resources. For example, this can help countries gain access to cost-effective equipment and technology. APEC's work toward an agreement to liberalize trade in environmental goods and services, part of which has now moved to the WTO, can help countries monitor, clean up and prevent pollution, and ensure clean air and water. Likewise, the APEC initiative on energy equipment and services can promote rapid dissemination of efficient power technologies, thus allowing production of power with reduced carbon emissions and contributing to international efforts to address climate change.

At the same time, as the trading system ensures that members avoid using environmental standards as disguised trade barriers, in eliminating barriers to trade we must not compromise on the achievement and

maintenance of high levels of environmental, health and safety protection. And the system must work together with multilateral environmental institutions.

At our suggestion, the WTO is convening a High-Level Meeting on trade and the environment this spring to more fully address these questions. This marks a new level of awareness and interest in the world trading community on trade and environmental issues.

We will also continue to support the effective implementation of the North American Agreement on Environmental Cooperation in conjunction with the NAFTA. Cooperative activities that have occurred as a result of this agreement have improved environmental protection in a number of different areas -- for example, an agreement on the conservation of North American birds; the creation of a North American Pollutant Release Inventory; an agreement on regional action plans for the phase-out or sound management of toxic substances, including DDT, chlordane, PCBs and mercury; and the creation of a trilateral working group that has improved the enforcement of environmental protection laws. Benefits have also resulted from the implementation of the Border Environment Cooperative Commission (BECC) which was also entered into in conjunction with the NAFTA. The BECC has fifteen environmental infrastructure projects under construction today, funded in part by the North American Development Bank, including the first wastewater treatment plants in Juarez.

2. Trade and Core Labor Standards

Likewise, the trade system must help to assure the dignity and safety of workers. Here again, we can draw lessons from our experience at home, where since 1970, as manufacturing production doubled, the number of workplace deaths fell 60%. Our efforts here include seeking closer cooperation between the WTO and the International Labor Organization, bolstering ILO capabilities to address exploitative child labor and other violations of internationally recognized labor rights as well as ensuring safe and healthy workplaces, and working with individual trade partners to advance our goals.

At the Singapore WTO Ministerial Conference in 1996, the WTO for the first time recognized the importance of labor standards and cooperative work with the International Labor Organization, while clearly separating advocacy of labor rights from protectionist trade policies. We wish to build on this to ensure that the trading system works more effectively with the International Labor Organization, with businesses and with citizen activists to ensure observance of internationally agreed core labor standards -- banning forced labor and exploitive child labor, guaranteeing the freedom to associate and bargain collectively and eliminating discrimination in the workplace. We also have raised labor standards in country policy reviews under the Trade Policy Review Mechanism. In these reviews each WTO member's trade regime is examined, and other members are provided an opportunity to raise questions. We have used this opportunity, for example in the recent Swaziland review, to seek clarifications about labor practices that we believe are inadequate.

To bolster these efforts, the President recently announced a \$25

million program to help the ILO work with developing countries to put in place basic labor protections, safe workplaces and guarantee worker rights and enforce their own laws so that workers everywhere can enjoy the benefits of a strong social safety net. (The US has already funded ILO child labor programs in Bangladesh, Thailand, the Philippines, Africa, and Brazil.) These are fundamental human rights and common concerns, and trade policy has a place in addressing them..

We are also taking steps in a number of other areas directly related to trade policy. The Administration has directed the Customs Service to step up its efforts to ensure that items made by forced or indentured child labor are not imported into the United States. USTR is enforcing provisions of existing law that impose penalties for clear violations of worker rights. For example, we partially removed GSP trade preferences from Pakistan over child labor concerns. At the same time, however, the Administration has worked through the Labor Department to develop long-term solutions to the problem, by addressing specific Pakistani industries. As a result, 7,000 children have been removed from jobs stitching soccer balls and 30,000 children from jobs knotting carpets.

Likewise, we are finding ways to address core labor standards as we advance our trade policy goals. The North American Agreement on Labor Cooperation under NAFTA is one example. Another is our most recent trade agreement -- the textile agreement with Cambodia -- which includes provisions requiring Cambodia to improve the enforcement of its labor laws in the garments sector.

VI. ADVANCING AMERICAN VALUES

Sixth, in 1999 we will seek to advance basic American values and concepts of good governance, by making the institutions of trade more transparent, accessible and responsive to citizens.

As the President has said, as trade grows, the rules of trade do more to ensure that markets are open to our goods and services, and the trading system coordinates more fully with environmental, labor and financial institutions, the need for transparency, accessibility and responsiveness grow. This is natural and a development which we both support and are working to realize.

One principal forum here is the WTO, where we are seeking agreements on more rapid release of documents, ensuring that citizens and citizen organizations can file amicus briefs in dispute settlement proceedings, and that dispute settlement proceedings be open to public observers. In the interim, President Clinton has made a standing offer to open any dispute panel involving the United States to the public, if our dispute partner agrees.

A second forum is the FTAA negotiations, in which -- for the first time in any trade negotiation -- we have created a Civil Society Committee to give business associations, labor unions, environmental groups, student associations, consumer representatives and others a formal means of conveying concerns and ideas to all of the governments involved in the talks.

A third is our creation of new Transatlantic Dialogues with the European Union for consumers, labor and environment as part of the Transatlantic Economic Partnership. We are working with these Dialogues to promote our shared values with Europe in the activities and negotiations we are undertaking as part of the TEP and multilaterally.

CONCLUSION

This is an ambitious and far-reaching agenda. We plan to work closely with the Subcommittee and Congress as a whole to realize it, and look forward to the benefit of your thoughts and advice at this hearing and in the months ahead. This includes the renewed negotiating authority that will help us bring our negotiations to a successful conclusion.

In conclusion, Mr. Chairman, much has changed in the international economy in the fifty-one years since the United States led 23 countries in creation of the GATT. Our national interest in economic events beyond our borders has grown, our people have found new opportunities and new challenges in trade, and many new nations have become active in trade.

These developments in many ways are the result of America's commitment to a vision of open and fair trade under the rule of law, and to the bipartisan policies we have pursued for many years to realize it. As a result of this success, we now face some new and complex challenges. The President's State of the Union Address outlined these challenges and the need for a new consensus to meet them.

But as deeply changed as today's world may be, the vision President Roosevelt laid out in one of the darkest moment of human history -- an open world, prosperous and governed by the rule of law -- remains valid in a world more prosperous, healthy and hopeful than ever before. And the necessity for a bipartisan consensus on our goals, and a strong partnership between the Executive and Legislative branches of government, remain essential to achieve this vision. With your advice and your help, as we open a new Round of negotiations and embark on a highly ambitious agenda for the next century, we hope to bring it closer to realization than ever.

Thank you very much, Mr. Chairman and Members of the Subcommittee.

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Wednesday, February 10, 1999

LEGISLATIVE REFERRAL MEMORANDUM

TO: Legislative Liaison Officer - See Distribution below

FROM: John D. Burnim (for) Assistant Director for Legislative Reference
OMB CONTACT: Annette E. Rooney
PHONE: (202)395-7300 FAX: (202)395-5691
SUBJECT: US Trade Representative Testimony on HR434 African Growth
and Opportunity Act

DEADLINE: 4:30 P.M. Wednesday, February 10, 1999

In accordance with OMB Circular A-19, OMB requests the views of your agency on the above subject before advising on its relationship to the program of the President. Please advise us if this item will affect direct spending or receipts for purposes of the "Pay-As-You-Go" provisions of Title XIII of the Omnibus Budget Reconciliation Act of 1990.

COMMENTS: If you do not respond by the deadline, we will presume that your agency has no comment.

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The following is the response of our agency to your request for views on the above-captioned subject:

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TRADE AND AMERICAN PROSPERITY IN 1999

Testimony of Ambassador Charlene Barshefsky
United States Trade Representative

Before the Subcommittee on Trade
Of the House Committee on Ways and Means
Washington, D.C.

February 11, 1999

Thank you, Mr. Chairman, for inviting my testimony on the role of trade in our economy, and the state of American trade policy today. I am grateful to you and to the Subcommittee as a whole for offering us this opportunity to discuss our trade policy record and agenda for the future, and I look forward to continuing the close working relationship we have had with the Subcommittee. And let me say that you have called this hearing at an opportune time, because we are opening a year in which every part of our trade agenda will be ambitious and will hold great promise for our country.

Three weeks ago, President Clinton called for the initiation of a new multilateral negotiating Round able to meet the demands of the 21st century. This will begin at the World Trade Organization's Third Ministerial Conference, chaired by the United States -- and the largest trade event ever held in the United States -- and it will shape world trade in the next century. Our multilateral agenda will be accompanied by the regional, bilateral and sectoral negotiations we have underway in each part of the world; and by enforcement of our rights under WTO dispute settlement, the North American Free Trade Agreement and through our domestic trade laws.

We hope and expect to carry out this agenda in the tradition of bipartisanship and close consultation between the Executive and Legislative branches which have characterized many years of American trade policy. My testimony will touch on each of these points, including trade negotiating authority, which we believe will help us achieve our goals. But let me begin by discussing the context in which we develop and execute

our policy agenda.

TRADE POLICY PRINCIPLES

Trade policy forms part of both our national economic policy and our approach to the world beyond our borders.

At home, engagement in world trade, based on fair rules and the rule of law, offers American firms, agricultural producers and workers larger markets. Almost 80% of world economic consumption takes place outside the U.S., and if America is to continue to grow and remain competitive in the future, trade policy must ensure that Americans have fair access to these markets. Trade also offers American consumers a greater choice of products at competitive prices and higher quality.

Overseas, trade helps increase world prosperity, advances the rule of law, and helps to strengthen international peace. As President Franklin Roosevelt said in 1944:

&A basic essential to peace, permanent peace, is a decent standard of living for all individual men and women and children in all nations. Freedom from fear is eternally linked with freedom from want. [And] it has been shown time and time again that if the standard of living in any country goes up, so does its purchasing power -- and that such a rise encourages a better standard of living in neighboring countries with whom it trades.⁸

These principles have formed the basis of American trade policy since the end of World War II. We have advanced them on a bipartisan basis through a strong working partnership between the Executive Branch and Congress through ten Administrations, ever since the creation of the General Agreement on Tariffs and Trade in 1948. The Clinton Administration's trade policy, we believe, is firmly in this tradition: such advances as the passage of the North American Free Trade Agreement, the Uruguay Round, our 35 bilateral trade agreements with Japan -- a total of 270 trade agreements -- would not have happened without the advice, support and contribution of the Trade Subcommittee and Congress as a whole.

TRADE AND THE US ECONOMY

The results of these policies have contributed immeasurably to the peace and prosperity America now enjoys. We have the most dynamic, creative and competitive economy in the world, and are ideally placed to succeed in the next century.

Since 1992, we have had uninterrupted growth -- our economy has expanded from \$7.1 trillion to \$8.5 trillion in real terms (1998 dollars) and last month, the present economic expansion became America's longest in history.

We have created jobs. Employment in America has risen from 109.5 to 127.2 million jobs, a net gain of nearly 18 million, as unemployment rates fell from 7.4% to 4.3%.

And we have raised wages. Since 1992, average wages have reversed a twenty-year decline and have grown by 6.0% in real terms, to \$449 a week on average. This family prosperity is reflected, for example, in record rates of home ownership.

Altogether, we have achieved an historic combination of high growth, low unemployment, low inflation, low interest rates and rising wages unmatched in decades. The reasons for this are many. They include improved support for education and job training and an uninterrupted reduction in the federal deficit beginning in 1993 and culminating with the budget surpluses of the past two years. But trade and participation in the world economy have played an irreplaceable role.

And overseas, as trade has grown and international trade rules have strengthened, the hopes of the wartime generation have been in many ways realized.

Peace among the world's great nations has grown more secure.

Prosperity has blossomed -- as world exports have grown from \$60 billion to \$6.5 trillion in constant dollars since 1960, world economic production has quadrupled and real per capita income has more than doubled, from under \$3100 to over \$6300 last year.

As a consequence, people have better lives. In 1955, the world average life expectancy at birth was 48 years; now it is 65. Where the worldwide infant mortality rate was 148 per thousand, today it is 59.

And faith in markets under the rule of law has been vindicated: those nations which shut off the free flow of goods, services and information have tended to stagnate while those which remained open to the world have tended to prosper. One need only examine the ghastly experiment which has taken place on the Korean peninsula -- as South Korea has risen to become one of the world's leading industrial powers, while North Korea is afflicted by chronic hunger -- to show how stark is the contrast. And there is no stronger vindication of our work than the fact that Russia, China and 16 other economies have abandoned central planning and seek WTO membership.

Our Administration has had the good fortune to build upon this foundation. Since 1992, we have negotiated 270 separate trade agreements which have helped open markets and create opportunity for Americans. These include five which have fundamentally transformed world trade: the North American Free Trade Agreement, which cemented our strategic trade relationship with our immediate neighbors; the Uruguay Round, which created the World Trade Organization with a binding dispute settlement mechanism and extended international trade rules to new areas through agreements on agriculture, services, intellectual property; and three multilateral agreements on information technology, financial services and basic telecommunications.

US TRADE TODAY

As a result, America's trade has flourished. Last year we exported \$932 billion in goods and services -- a 51% increase from the

1992 level of \$617 billion, despite a slowing in export growth due to the financial crisis. Our goods exports were very evenly divided among four major markets, meaning that we have critical trade interests in each part of the world:

Canada	Asia-Pacific	Latin
America	European Union	
\$156 billion	\$166 billion	\$143
billion	\$150 billion	

Measured by country, our largest five goods export markets were Canada at \$156 billion, followed by Mexico at \$71 billion, Japan at \$57 billion, the United Kingdom at \$40 billion and Germany at \$25 billion.

Service export figures are only partially available for 1998. Our full-year 1997 service exports, divided regionally, were more heavily weighted to Asia and Europe but still indicate critical interests in each region:

Canada	Asia-Pacific	Latin
America	European Union	
\$20.5 billion	\$73.6 billion	\$34.2
billion	\$74.8 billion	

In 1997, our six largest service export markets were Japan with \$34 billion, the United Kingdom with \$23.7 billion, Canada at \$20.5 billion, Germany at \$13.5 billion, France at \$9.4 billion and Mexico at \$9.3 billion.

Altogether, the United States was the world's largest exporter in 1998. We were also the largest exporter of the goods and services supporting the highest-wage jobs: agricultural products, advanced technology products and capital goods. Our goods exports now support 11.6 million American jobs.

The United States was also the world's largest importer, at \$1.1 trillion in goods and services imports in 1998. Imports play an important role in our economy, by raising living standards for consumers (especially lower-income Americans), dampening inflation, ensuring the widest possible choice of products at the best prices, and providing essential inputs for U.S. industries, many of which then export their goods at equally competitive prices. However, open markets depend on fair trade rules, and we are and will be vigilant in enforcing our laws against import surges, subsidies, dumping, or other measures intended to artificially boost exports or protect foreign markets.

TRADE AGENDA IN 1999

This brings me to our agenda for the years to come. As in the past, we hope to base our work on the foundation of a bipartisan consensus and a strong working relationship between the Administration and Congress. Generally speaking, our trade policy seeks the following goals.

- Address the trade effects of the financial crisis which now

directly affects nearly 40% of the world.

- Continue our progress toward open and fair world markets through a new negotiating Round, as well as our role as host and Chair of the WTO's Third Ministerial Conference, regional negotiations and bilateral talks.

- Advance the rule of law and defend US rights by ensuring full compliance with trade agreements and strongly enforcing our trade laws.

- Encourage the full participation of all economies, including economies in transition and developing nations, in the world trading system on a commercially meaningful basis;

- Ensure that the trading system helps lay the foundation for the 21st-century economy by offering maximum incentives for scientific and technological progress.

- Ensure that trade policy complements our efforts to protect the world environment and promote core labor standards overseas; and

- Advance basic American values including transparency and accessibility to citizens and involvement of civil society in the institutions of international trade.

TRADE NEGOTIATING AUTHORITY

As we pursue this agenda, the Administration will consult with the Subcommittee and Congress on the renewal of traditional trade negotiating authority. The President, in his State of the Union address, called for a new consensus on trade. He said we must find the common ground on which business, workers, farmers, environmentalists and government can stand together. This commitment to common ground has been a hallmark of the Subcommittee's approach to trade policy over the years. I want to personally thank you, Mr. Chairman, along with each member of the Subcommittee, for your commitment and hard work toward this goal in the last Congress.

Consistent with that approach, we believe negotiating authority should bolster the traditional bipartisan support for trade policy and allow us to pursue an agenda that reflects consensus goals. It is a tool which can help us negotiate with greater credibility and effectiveness on behalf of American economic interests, and thus contribute to our goal of opening markets, increasing growth and raising living standards.

TRADE EFFECTS OF FINANCIAL CRISIS

Let me now address our agenda in detail. I will begin with the trade effects of the financial crisis affecting Asia, Russia and parts of Latin America.

This crisis has now lasted a year and a half, and its effects on our trade interests have been severe. Countries which have implemented IMF reform programs have seen a number of good results, including currency stability and returning investor confidence. However, real economies

continue to suffer. Six major economies -- Hong Kong, Indonesia, Malaysia, South Korea, Russia and Thailand -- are likely to have contracted by 6% or more last year.

As a result of this crisis, the American trade imbalance has widened. This reflects largely a sharp drop of about \$30 billion in American exports to the Pacific Rim, and a consequent break with the pattern of rapid U.S. export growth of the past few years. Our overall import growth last year (with the principal exception of the steel sector, in which imports rose very rapidly in the second half of 1998, affecting thousands of jobs) remained consistent with growth rates in previous years. Thus the larger deficit largely reflects predictable macroeconomic factors.

Our trade policy response begins by ensuring that our trading partners continue to live by commitments at the WTO and in our regional and bilateral agreements. The strength of the trading system is an enormous advantage here -- despite the worst financial crisis in fifty years, the world has resisted the temptation to relapse into protectionism. This has greatly reduced the potential damage to our economy, and particularly to American manufacturing exporters and agricultural producers. In addition, other markets -- particularly our NAFTA partners Canada and Mexico, to whom U.S. goods exports grew by \$13 billion last year -- have in part compensated, thanks to the more open North American market NAFTA has created, for some but not all of these lost exports. An ambitious trade agenda will further strengthen our effort to ensure that the crisis does not cause the world to move backward.

We continue with a policy response covering several areas:

IMF Recovery Packages -- We have supported reform packages with the IMF at the center in affected countries. Several of these contain trade conditionalities which we vigorously monitor.

Restored Growth in Japan -- A return to growth in Japan, Asia's largest economy, is essential for the economic health of the region. The Administration's view is that this will require fiscal stimulus that continues until solid growth is restored, financial reform, and deregulation and market-opening. USTR's responsibilities lie in this last area. In addition to an aggressive bilateral agenda, the agreement we reached in Japan last May sets out concrete deregulatory measures in telecommunications, housing, medical devices, pharmaceuticals and financial services sectors, and measures to strengthen competition policy enforcement and transparency. When fully implemented, these will create opportunities for exporters and workers in America, other Pacific economies and Japan. We are now discussing new measures in these sectors and energy as well.

Steel -- The President's January 7 Steel Report to the Congress lays out a seven point action plan on the steel import surge. Among other points, the plan projects a roll-back of imports from Japan -- the key cause of the import surge -- to pre-crisis levels, and states that the Administration is prepared, if necessary, to self-initiate trade cases to ensure that this roll-back takes place. The plan also outlines actions

taken by the Commerce Department to expedite ongoing dumping investigations and apply any dumping margins retroactively. In addition, the Administration expresses strong support for an effective safeguards mechanism; and commits us to continue to assess the effectiveness of steps taken to date, and working closely with the industry, labor, and members of Congress, to assess additional steps. To assist in this ongoing review, we also announced that preliminary steel import data will be released, thus enabling the industry's business planners to react to imports on a more timely basis.

I. GROWTH AND HIGHER LIVING STANDARDS

Let me now turn to our negotiating agenda. In this agenda, we seek enduring goals -- growth, higher living standards, the rule of law, a rising quality of life, better protection of health, safety and the environment, and the advance of basic values. As President Clinton said in the State of the Union address, we need to find new methods of negotiating and address a broader array of issues to secure these goals in the next century.

1. New Round and WTO Ministerial Conference

This is the basis of President Clinton's call for a new, accelerated negotiating Round for the 21st century. The Round would begin at the WTO's Third Ministerial Conference, which I will chair and which will be held in Seattle from November 30th to December 3rd. This will be the largest trade event ever held in America, bringing government leaders, Trade Ministers, business leaders, non-governmental organizations and others interested in trade policy from around the world. It is an extraordinary opportunity for us to shape at least the next decade of multilateral trade negotiations and to highlight our economic dynamism to the world.

The Round President Clinton has called for would be somewhat different from previous Rounds, in that we should be able to pursue three dimensions simultaneously: first, a negotiating agenda to be completed on an accelerated timetable; second, institutional reforms and capacity-building at the WTO; and third, ongoing results in priority areas.

To begin with, we would hope to advance a number of important initiatives in the months leading up to the Ministerial Conference and at the event itself. They include:

- An E-commerce and Information Technology Agreement II adding new products to the sectors already covered by the first ITA.
- Extension of last May's multilateral declaration not to assess customs duties on electronic commerce, to make sure that the Internet remains an electronic duty-free zone.
- An agreement on transparency in procurement to create more predictable and competitive bidding, reducing the opportunity for bribery and corruption and helping ensure more effective allocation of resources.
- Build consensus on the sectoral liberalization initiative begun in the Asia-Pacific Economic Cooperation forum. This would eliminate

tariffs and in some cases liberalize services in chemicals; energy equipment and services; environmental goods and services; fish and fishery products; gems and jewelry; medical and scientific instruments; toys; and forest products. Meaningful participation by Japan in the fishery and forest products sectors would be essential to success.

The second dimension of institutional reform would promote transparency, allow the WTO to facilitate trade and participation for less developed nations, help it coordinate more effectively with international bodies in other fields, and continue to strengthen public confidence in the WTO as an institution. Here we would hope to take up such issues as:

- Trade facilitation. Most of the world's regional trading arrangements -- ASEAN, APEC, the European Union, Mercosur, NAFTA, the proposed FTAA -- contain a critical element of trade facilitation, often beginning with customs reform to reduce transaction costs and make trade more efficient. The WTO can help accomplish this on a much broader scale.

- Capacity-building. We need to narrow the growing disparity between the rich countries and the poor countries. We have to ensure that the WTO can work effectively with member economies and other international institutions, particularly with respect to the least developed nations, to ensure that they have both access to markets and technical assistance to meet the kinds of obligations that will help them grow. This and other issues will be addressed at a High-Level Meeting on Trade and Development this March.

- Addressing the intersection between trade and environmental policies. As trade promotes growth overseas, we must at the same time ensure clean air, clean water and protection of our natural heritage, as well as effective approaches to broader questions like biodiversity and climate change. We have already scheduled a High-Level Meeting of trade and environment experts in March, which we anticipate will provide fresh and valuable input to our work in this area and help frame a vision for future work.

- Addressing the intersection between trade and labor. Again, as in our domestic economy, growth can and should be accompanied by safer workplaces, elimination of exploitive child labor and respect for core labor standards. The WTO in particular can work in more coordination with the International Labor Organization on some of these issues. As the President has announced, the US will provide funds for a new multilateral program in the ILO to provide technical assistance for international labor rights initiatives, and through our own Department of Labor will help our trading partners strengthen labor law enforcement. These and other such efforts should be a focus of renewed cooperation with the ILO.

- Coordination with the international financial institutions, in a world where the separation of trade from financial policy has become entirely artificial. The WTO must work more effectively with the IMF and World Bank to achieve their common goals of a more stable, predictable and prosperous world.

- Transparency. We will also seek reform, openness and

accountability in the WTO itself. Dispute settlement must be transparent and open to the public. Citizens must have access to panel reports and documents. Civil society must be able to contribute to the work of the WTO, to ensure both that the WTO can hear from many points of view including labor, environmental, consumer and other groups, and that its work will rest on the broadest possible consensus.

With respect to the expedited negotiating agenda of this Round, we are now consulting with Congress, industry, and other interested parties on a detailed negotiating agenda for talks which would begin after the Ministerial. While the final scope of the agenda is yet to be determined, we believe that at a minimum they should include such issues as:

- Agriculture, where we envision broad reductions in tariffs, the elimination of export subsidies, and further reductions in trade-distorting domestic supports linked to production. We must seek transparency and improved disciplines on state trading enterprises, seek reform of the EU's Common Agricultural Policy, and ensure that the world's agricultural producers can use safe, scientifically proven biotechnology techniques without fear of trade discrimination.
- Services, in which we hope to see specific commitments for broad liberalization and market access in a range of sectors, including but not limited to audiovisual services, construction, express delivery, financial services, professional services, telecommunications, travel and tourism, and others.
- Government procurement, in which purchases are over \$3.1 trillion per year, much of it in sectors where America sets the world standard: high technology, telecommunications, construction, engineering, aerospace and so forth. At present, only 26 of the 133 WTO Members belong to the plurilateral WTO Government Procurement Agreement. We thus look to bring more countries under existing disciplines.
- Intellectual property, where our efforts to ensure full compliance with the existing provisions of the Uruguay Round will be combined with campaigns against piracy in newly developed optical media technologies such as CDs, CD-ROMs, digital video discs and others; and end-user piracy of software.
- Industrial tariff and non-tariff barriers, where we will seek to continue our progress in reducing bound and applied tariff levels, and continue to address non-tariff measures in industrials sectors.
- A forward work-program on newer issues for the multilateral system to consider, including considering how competition and investment policies meet the test of assuring fair and open trade and how the WTO can help to create an international pro-competitive regulatory climate, particularly in services, and further advance our efforts against bribery and corruption.

Outside the context of the Round, we are pursuing the accession of 31 economies to the World Trade Organization: Latvia, whose accession is complete and awaiting ratification; and Albania, Algeria, Andorra,

Armenia, Azerbaijan, Belarus, Cambodia, China, Croatia, Estonia, FYR of Macedonia, Georgia, Jordan, Kazakhstan, Laos, Lithuania, Moldova, Nepal, Oman, Russia, Samoa, Saudi Arabia, Seychelles, Sudan, Taiwan, Tonga, Ukraine, Uzbekistan, Vanuatu and Vietnam. In all cases we seek a commercially meaningful accession with the greatest possible commitments to all WTO agreements, including the most recent ones.

We are also exploring ways to more fully integrate the least developed countries, particularly in Africa, into the system. This includes both seeking deeper commitments, and technical assistance in fulfilling those commitments, and legislation to improve trade relations with Africa.

Finally, we will shortly be deciding on entry into force of the 1997 WTO financial services negotiations. As you may recall, these extended negotiations concluded on an interim basis in 1995 because we were dissatisfied with offers from important trading partners, especially in developing and emerging markets. In contrast, in the negotiations that concluded in December 1997, we obtained broader and deeper commitments, in banking, insurance, and securities, from a wide range of developed and developing countries, including the key emerging markets of primary interest to U.S. industry. These countries had until January 29, 1999, to complete any necessary domestic procedures and formally notify the WTO of their acceptance of the protocol for bringing their commitments into force. Fifty-three countries, including the United States, met the deadline, and these 53 are now empowered to decide whether to allow their commitments to enter into force, on an MFN basis, from March 1. We have been consulting with your staff, staff of other relevant committees, and the U.S. private sector to determine a strategy that is in the best commercial interest of the United States and that will demonstrate our view that all WTO Members must live up to their commitments.

2. Regional Trade Agenda

At the same time, we are pursuing an active agenda in each region of the world. A brief review is as follows:

Canada -- With Canada, our largest trade partner, we have serious concerns on a range of agriculture matters. We took an important step on these last December by concluding a market access package opening opportunities for American grain farmers, cattle ranchers and other agricultural producers. We will continue our work in these areas this year. We will also address major market access impediments to our magazine publishers (as I note in the section on enforcement) and other media and entertainment industries. We will also continue to enforce our bilateral sectoral agreements. At the same time, we intend to work with Canada on bilateral issues of mutual interest, and on negotiations toward the Free Trade Area of the Americas and at the WTO where we share many goals.

Mexico -- Trade with Mexico has expanded very rapidly since passage of the North American Free Trade Agreement. Last year, Mexico passed Japan as both our second largest goods exports market and our second largest overall trade partner. We will continue to monitor

implementation of Mexico's NAFTA commitments, scheduled to be complete by 2008, and address bilateral issues including land transportation, corn syrup and sugar, and telecommunications barriers as well as piracy in intellectual property rights. We have also stepped up our efforts in the trilateral work program now underway in more than 25 Committees and Working Groups, with the intention of maximizing our gains under the NAFTA.

Western Hemisphere -- The Miami and Santiago Summits of the Americas have called on us to complete work on a Free Trade Area of the Americas no later than the year 2005. This year, in accordance with Summit directions, we intend to achieve concrete progress toward the FTAA in our nine Negotiating Groups and through business facilitation and other measures. At the same time, we will seek approval from Congress of an expanded and improved Caribbean Basin Initiative with benefits similar to those now accorded Mexico and Canada.

Europe -- We are working to remove barriers and strengthen trade relations with the EU through the Transatlantic Economic Partnership begun last year. This includes negotiations on seven separate agenda items: technical trade barriers, agriculture (including biotechnology and food safety), intellectual property, government procurement, services, electronic commerce and advancing shared values such as transparency and participation for civil society. We are also working to ensure the protection of American interests as the EU expands to include Central and Eastern European nations. At the same time, we are enforcing European compliance with dispute settlement decisions and will address problems in our trade relations both bilaterally and through the new negotiating Round President Clinton has proposed.

Asia -- Under the Asia-Pacific Economic Cooperation (APEC) forum we are looking long-term toward free and open trade in the region. This year, as I noted earlier, we will seek WTO consensus on the nine-sector liberalization package begun in APEC, and begin work on six additional sectors. We will also address bilateral issues with Korea, the ASEAN nations and other Asian trade partners. This will include seeking Normal Trade Relations with Kyrgyzstan, Mongolia and Laos, and negotiating a broad trade and commercial agreement with Vietnam.

Japan -- In trade relations with Japan, our largest overseas trade partner, we will continue our intense and sustained effort to open and deregulate the Japanese market. We have concluded 35 bilateral trade agreements with Japan since 1993; we will monitor their implementation closely and enforce them vigorously. We will also address sectoral issues including rice, steel, insurance, glass, film and other topics. And as I noted earlier, we are pursuing an ambitious set of goals under the Enhanced Initiative on Deregulation and Competition Policy, both in individual sectors and in broader structural issues. We hope to see substantial progress on these issues as Prime Minister Obuchi's spring visit approaches.

China -- We will monitor and strictly enforce our agreements on intellectual property and market access with China, and address bilateral trade problems in agriculture, direct marketing and other areas. At the same time, we will continue to seek broad market-opening through our

negotiations toward China's accession to the World Trade Organization, which I address more fully below.

Africa -- USTR is implementing the President's Partnership for Economic Growth and Opportunity in Africa, which owes a great deal to the work of the Trade Subcommittee, by supporting economic reform, promoting expanded trade and investment ties, and encouraging Africa's full integration into the world trading system by negotiating bilateral agreements, technical assistance and other measures.

A sound policy framework in African countries that opens economies to private sector trade and investment offers the greatest potential for growth and poverty alleviation as well as trade opportunities for the U.S.. Last month, for example, we signed a Bilateral investment Treaty with Mozambique and over the next few months we expect to sign Trade and Investment Framework Agreements, or TIFAs, with South Africa, Ghana, and the West African Economic and Monetary Union. We also place a very high priority on Congressional approval of the African Growth and Opportunity Act. I want to state my personal appreciation for the work of Chairman Crane, Congressman Rangel and Congressman McDermott to secure its early passage in this Congress.

Broader efforts to encourage full integration of developing countries into the trading system will also bolster our Africa policy. In this regard, we will seek renewal of the Generalized System of Preferences.

Middle East -- Building upon our Free Trade Agreement with Israel, we have inaugurated a program that aims to bolster the peace process, while advancing American interests. Starting with a framework of bilateral trade and investment consultations in the region and a newly inaugurated industrial zones program, we will help the Middle Eastern countries work toward a shared goal of increased intra-regional trade.

OECD -- We strongly support passage of the OECD Convention on Shipbuilding Subsidies and will work with you to ensure its success.

II. ENFORCING THE RULE OF LAW

Second, US trade policy will support and advance the rule of law internationally by ensuring the enforcement of trade agreements and U.S. rights in the trading system.

Much of our enforcement work takes place at the World Trade Organization. We have filed more complaints in the WTO -- 41 cases to date -- than any other WTO member, and our record of success is strong. We have prevailed on 19 of the 21 American complaints acted upon so far, either by successful settlement or panel victory. In almost all cases, the losing parties have acted rapidly to address the problems. We will insist that this remain the case in all our disputes, including those with the European Union on beef hormones and bananas, and with Canada on magazines. At the same time, the U.S. has complied fully with all panel rulings it has lost, although these are few in number. And we will, of course, use our rights under the NAFTA to ensure open markets to our goods and services in Canada and Mexico.

We are also monitoring implementation of WTO commitments. All WTO developing country members are scheduled to fully implement their intellectual property commitments, and all members are required to implement customs valuation commitments by January 1, 2000. We will insist on strict compliance with these deadlines.

Likewise, we are vigilant to ensure enforcement of textile quotas and implementation of textile market access requirements overseas. A number of our trading partners clearly have further work to do in market access, including some of our largest and fastest growing textile suppliers. We have and will continue to aggressively pursue our rights, whether through the consultation process or ultimately through the WTO dispute settlement regime.

U.S. trade laws are also a vitally important means of ensuring respect for U.S. rights and interests in trade. We will continue to challenge aggressively market access barriers abroad using laws such as Section 301, "Special 301" and Section 1377, to open foreign markets and ensure fair treatment for our goods and services, ensure nondiscrimination in foreign government procurement and ensure compliance with telecommunications agreements.

To ensure that we have the maximum advantage of domestic trade laws, the Administration will reauthorize by Executive Order two laws for which authority has lapsed: "Super 301" and Title VII. We wish to work with the Subcommittee to include these laws in your legislative agenda.

The Administration is also, of course, committed to full and vigorous enforcement of our laws addressing dumping and subsidies, and on injurious import surges.

III. INTEGRATING TRANSITION ECONOMIES

Third, our trade policy will continue our progress toward integrating China, Russia and other economies in transition into the trading system. This will both advance specific American trade interests, and contribute to our larger goal of a more secure peace in the next century.

This task is the last great step in the process which began with the formation of the GATT and continued with the admission of Germany and Japan: the integration of China, Russia and sixteen other economies in transition from communist planning into the trading system. These economies and a number of Middle Eastern nations are the two largest groups remaining outside the trading system. Their entry will make membership in the trading system nearly universal; and the accession of the transition economies will be a fundamentally important step in their domestic reforms as well. This would remove large distortions in world markets, dramatically enhance market access for American producers, and bolster international stability by giving these nations a greater stake in world prosperity beyond their borders

To support rather than undermine both domestic reform in these

economies and the rules of the trading system, these countries must be brought into the WTO on commercially meaningful terms. The result must be enforceable commitments to open markets in goods, services and agricultural products; transparent, non-discriminatory regulatory systems; and effective national treatment at the border and in the domestic economy.

This is an ambitious task, but not an impossible task. Central European countries like Poland, Hungary and the Czech Republic have succeeded, and their experience shows that WTO membership has assisted their domestic economic reform policies. The most recent successful WTO applications, Latvia and Kyrgyzstan, have had the same experience.

In the months to come, we will negotiate intensely with all acceding economies, including China -- the largest prospective WTO member. We have made important progress with China in the past two years, and the visit of Premier Zhu Rongji in April offers China a chance to make a decisive advance. We will consult closely with the Subcommittee and with other members of Congress as negotiations proceed.

Likewise, at the most recent summit with Russia (September 1998), President Yeltsin agreed to work to intensify Russia's WTO accession efforts. Russia's current economic difficulties clearly present challenges and Russian Cabinet reshuffling has slowed the process, but we will continue to consult with the Russians toward a commercially viable accession package.

IV. THE 21ST-CENTURY ECONOMY

Fourth, trade policy will help lay the foundation for the 21st-century economy by ensuring that the trading system is compatible with rapid advances in civilian science and technology.

In medicine, environmental protection, agriculture, entertainment, transportation, materials science, information and more, science is advancing at extraordinary speed. This offers the world tremendous potential to increase wealth, raise productivity, improve health care, reduce hunger, protect the environment and promote education. These are also areas in which the United States has a significant comparative advantage.

Under President Clinton, our trade policy has made high technology a strategic priority. Consistent with national security, we have aimed to ease the development and commercialization of new technologies, and ensure strong incentives for scientific and technological progress. We have negotiated far-reaching new agreements in sectors like computers, semiconductors, information technologies and many other areas. This work continues in multilateral, sectoral and regional negotiations.

In the multilateral system, the rapid advance of technology requires us to improve the trading system's institutions and negotiating methods. In a world where successive generations of new products arise in a matter of months, and both information and money move instantaneously, we can no longer take seven years to finish a negotiating Round, or let decades pass between identifying and acting on trade barriers. We will have to move faster and more efficiently, which is a significant reason

for the President's call for an accelerated Round.

We must also ensure that trade policy, both in the WTO and in our regional and bilateral negotiations, helps ensure that we can take advantage of our comparative advantage in knowledge industries and other new technologies. Three broad issues cut across many sectors:

Intellectual Property Rights -- Our success in this field over the past decade owes a great deal to the work of Congress, both in the Trade Act of 1988 with its creation of Section 301, 8 and on the Uruguay Round. Today, the vast majority of our trading partners have passed modern intellectual property laws and are improving levels of enforcement. In this area, we will spend a great deal of time ensuring that all WTO members comply with their obligation to introduce full intellectual property protection by January 1, 2000. (For countries, like China, which are not WTO members, we will vigorously monitor compliance with bilateral agreements.)

We have also launched campaigns against worldwide piracy of new optical media technologies, and against end-user piracy of software. These issues are integral parts of our regional negotiating agenda in Asia, Latin America, Europe, Africa and the Middle East. Looking ahead, we must extend protection of intellectual property rights beyond basic laws and enforcement to protect new technologies like genetically engineered plant varieties.

Global Electronic Commerce -- In accordance with the President's Global Electronic Commerce initiative, USTR seeks to preserve electronic trade over the Internet as duty-free. At the last WTO Ministerial Conference, in May of 1998, we won agreement to a standstill for tariffs on electronic transmissions. As I noted earlier, we will seek to extend that agreement this year. Likewise, in our negotiations toward the Free Trade Area of the Americas, at APEC and in the Transatlantic Economic Partnership, we have created special committees to advise us ways to ensure all participants can take maximum advantage of electronic commerce.

Biotechnology -- A third top priority for us in this area is biotechnology. Among the chief sources of innovation in this field are American agriculture and medicine. USTR will seek to ensure that pharmaceutical companies, farmers and ranchers can use safe, scientifically proven techniques like biotechnology to make agriculture both more productive and friendly to the environment, without fear of encountering trade discrimination. This is a priority for us in the Transatlantic Economic Partnership negotiations and in developing our agenda for future WTO negotiations.

We also have an active sectoral high-tech agenda. This includes, for example, the ITA II agreement I discussed earlier. We are also working closely with our civil aircraft industry to ensure its future and combat foreign, particularly European, subsidies and other unfair practices. This work extends into many other fields.

V. RISING QUALITY OF LIFE

Fifth, US trade policy seeks to ensure that worldwide as in the United States, trade and growth go together with a rising quality of life, including setting high standards of environmental protection, the observance of core labor standards, and high levels of consumer protection.

As in our domestic economy, we regard environmental quality and protections for workers as essential parts of economic policy. Trade policy has an important role to play, in coordination with our efforts in other fora, to ensure growing respect for internationally recognized core labor standards and sustainable development worldwide.

1. Trade and the Environment

Our Administration believes that prosperity through open trade and the protection of health, safety and the environment need not conflict, and should be mutually supportive. This is the case in our domestic economy, where in the past three decades our GDP has risen in real terms from \$3.7 to \$8.5 trillion -- while our percentage of fishable and swimmable rivers and streams doubled, the number of citizens living in cities with unhealthy air fell by half, and many endangered or threatened species, including the bald eagle, are recovering. Where there are potential conflicts, we should strengthen our ability to resolve them in a manner that protects the environment, health and safety and does not undermine the trading system. This includes working to ensure that the proper expertise is brought to bear on complex technical and scientific issues, particularly those with environmental, health and safety dimensions.

In many cases elimination of trade barriers will also contribute to a cleaner environment and the conservation of natural resources. For example, this can help countries gain access to cost-effective equipment and technology. APEC's work toward an agreement to liberalize trade in environmental goods and services, part of which has now moved to the WTO, can help countries monitor, clean up and prevent pollution, and ensure clean air and water. Likewise, the APEC initiative on energy equipment and services can promote rapid dissemination of efficient power technologies, thus allowing production of power with reduced carbon emissions and contributing to international efforts to address climate change.

At the same time, as the trading system ensures that members avoid using environmental standards as disguised trade barriers, in eliminating barriers to trade we must not compromise on the achievement and maintenance of high levels of environmental, health and safety protection. And the system must work together with multilateral environmental institutions.

At our suggestion, the WTO is convening a High-Level Meeting on trade and the environment this spring to more fully address these questions. This marks a new level of awareness and interest in the world trading community on trade and environmental issues.

We will also continue to support the effective implementation of the North American Agreement on Environmental Cooperation in conjunction

with the NAFTA. Cooperative activities that have occurred as a result of this agreement have improved environmental protection in a number of different areas -- for example, an agreement on the conservation of North American birds; the creation of a North American Pollutant Release Inventory; an agreement on regional action plans for the phase-out or sound management of toxic substances, including DDT, chlordane, PCBs and mercury; and the creation of a trilateral working group that has improved the enforcement of environmental protection laws. Benefits have also resulted from the implementation of the Border Environment Cooperative Commission (BECC) which was also entered into in conjunction with the NAFTA. The BECC has fifteen environmental infrastructure projects under construction today, funded in part by the North American Development Bank, including the first wastewater treatment plants in Juarez.

2. Trade and Core Labor Standards

Likewise, the trade system must help to assure the dignity and safety of workers. Here again, we can draw lessons from our experience at home, where since 1970, as manufacturing production doubled, the number of workplace deaths fell 60%. Our efforts here include seeking closer cooperation between the WTO and the International Labor Organization, bolstering ILO capabilities to address exploitative child labor and other violations of internationally recognized labor rights as well as ensuring safe and healthy workplaces, and working with individual trade partners to advance our goals.

At the Singapore WTO Ministerial Conference in 1996, the WTO for the first time recognized the importance of labor standards and cooperative work with the International Labor Organization, while clearly separating advocacy of labor rights from protectionist trade policies. We wish to build on this to ensure that the trading system works more effectively with the International Labor Organization, with businesses and with citizen activists to ensure observance of internationally agreed core labor standards -- banning forced labor and exploitive child labor, guaranteeing the freedom to associate and bargain collectively and eliminating discrimination in the workplace. We also have raised labor standards in country policy reviews under the Trade Policy Review Mechanism. In these reviews each WTO member's trade regime is examined, and other members are provided an opportunity to raise questions. We have used this opportunity, for example in the recent Swaziland review, to seek clarifications about labor practices that we believe are inadequate.

To bolster these efforts, the President recently announced a \$25 million program to help the ILO work with developing countries to put in place basic labor protections, safe workplaces and guarantee worker rights and enforce their own laws so that workers everywhere can enjoy the benefits of a strong social safety net. (The US has already funded ILO child labor programs in Bangladesh, Thailand, the Philippines, Africa, and Brazil.) These are fundamental human rights and common concerns, and trade policy has a place in addressing them..

We are also taking steps in a number of other areas directly related to trade policy. The Administration has directed the Customs Service to step up its efforts to ensure that items made by forced or

indentured child labor are not imported into the United States. USTR is enforcing provisions of existing law that impose penalties for clear violations of worker rights. For example, we partially removed GSP trade preferences from Pakistan over child labor concerns. At the same time, however, the Administration has worked through the Labor Department to develop long-term solutions to the problem, by addressing specific Pakistani industries. As a result, 7,000 children have been removed from jobs stitching soccer balls and 30,000 children from jobs knotting carpets.

Likewise, we are finding ways to address core labor standards as we advance our trade policy goals. The North American Agreement on Labor Cooperation under NAFTA is one example. Another is our most recent trade agreement -- the textile agreement with Cambodia -- which includes provisions requiring Cambodia to improve the enforcement of its labor laws in the garments sector.

VI. ADVANCING AMERICAN VALUES

Sixth, in 1999 we will seek to advance basic American values and concepts of good governance, by making the institutions of trade more transparent, accessible and responsive to citizens.

As the President has said, as trade grows, the rules of trade do more to ensure that markets are open to our goods and services, and the trading system coordinates more fully with environmental, labor and financial institutions, the need for transparency, accessibility and responsiveness grow. This is natural and a development which we both support and are working to realize.

One principal forum here is the WTO, where we are seeking agreements on more rapid release of documents, ensuring that citizens and citizen organizations can file amicus briefs in dispute settlement proceedings, and that dispute settlement proceedings be open to public observers. In the interim, President Clinton has made a standing offer to open any dispute panel involving the United States to the public, if our dispute partner agrees.

A second forum is the FTAA negotiations, in which -- for the first time in any trade negotiation -- we have created a Civil Society Committee to give business associations, labor unions, environmental groups, student associations, consumer representatives and others a formal means of conveying concerns and ideas to all of the governments involved in the talks.

A third is our creation of new Transatlantic Dialogues with the European Union for consumers, labor and environment as part of the Transatlantic Economic Partnership. We are working with these Dialogues to promote our shared values with Europe in the activities and negotiations we are undertaking as part of the TEP and multilaterally.

CONCLUSION

This is an ambitious and far-reaching agenda. We plan to work closely with the Subcommittee and Congress as a whole to realize it, and look forward to the benefit of your thoughts and advice at this hearing

and in the months ahead. This includes the renewed negotiating authority that will help us bring our negotiations to a successful conclusion.

In conclusion, Mr. Chairman, much has changed in the international economy in the fifty-one years since the United States led 23 countries in creation of the GATT. Our national interest in economic events beyond our borders has grown, our people have found new opportunities and new challenges in trade, and many new nations have become active in trade.

These developments in many ways are the result of America's commitment to a vision of open and fair trade under the rule of law, and to the bipartisan policies we have pursued for many years to realize it. As a result of this success, we now face some new and complex challenges. The President's State of the Union Address outlined these challenges and the need for a new consensus to meet them.

But as deeply changed as today's world may be, the vision President Roosevelt laid out in one of the darkest moment of human history -- an open world, prosperous and governed by the rule of law -- remains valid in a world more prosperous, healthy and hopeful than ever before. And the necessity for a bipartisan consensus on our goals, and a strong partnership between the Executive and Legislative branches of government, remain essential to achieve this vision. With your advice and your help, as we open a new Round of negotiations and embark on a highly ambitious agenda for the next century, we hope to bring it closer to realization than ever.

Thank you very much, Mr. Chairman and Members of the Subcommittee.

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TO: Dorothy Robyn (CN=Dorothy Robyn/OU=OPD/O=EOP@EOP [OPD])
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TEXT:

Attached is USTR testimony before H. Ways and Means - TRADE POLICY.
Testimony is nearly identical to the one given before S. Finance on
1/26/99. If you have any comments, please let me know by 4:00 PM TODAY.
(It has also been circulated interagency and to other EXOP staff.)

TRADE AND AMERICAN PROSPERITY IN 1999

Testimony of Ambassador Charlene Barshefsky
United States Trade Representative

Before the Subcommittee on Trade
Of the House Committee on Ways and Means
Washington, D.C.

February 11, 1999

Thank you, Mr. Chairman, for inviting my testimony on the role of trade in our economy, and the state of American trade policy today. I am grateful to you and to the Subcommittee as a whole for offering us this opportunity to discuss our trade policy record and agenda for the future, and I look forward to continuing the close working relationship we have had with the Subcommittee. And let me say that you have called this hearing at an opportune time, because we are opening a year in which every part of our trade agenda will be ambitious and will hold great promise for our country.

Three weeks ago, President Clinton called for the initiation of a new multilateral negotiating Round able to meet the demands of the 21st century. This will begin at the World Trade Organization's Third Ministerial Conference, chaired by the United States -- and the largest trade event ever held in the United States -- and it will shape world trade in the next century. Our multilateral agenda will be accompanied by the regional, bilateral and sectoral negotiations we have underway in each part of the world; and by enforcement of our rights under WTO dispute settlement, the North American Free Trade Agreement and through our domestic trade laws.

We hope and expect to carry out this agenda in the tradition of bipartisanship and close consultation between the Executive and Legislative branches which have characterized many years of American trade policy. My testimony will touch on each of these points, including trade negotiating authority, which we believe will help us achieve our goals. But let me begin by discussing the context in which we develop and execute our policy agenda.

TRADE POLICY PRINCIPLES

Trade policy forms part of both our national economic policy and our approach to the world beyond our borders.

At home, engagement in world trade, based on fair rules and the rule of law, offers American firms, agricultural producers and workers larger markets. Almost 80% of world economic consumption takes place outside the U.S., and if America is to continue to grow and remain competitive in the future, trade policy must ensure that Americans have fair access to these markets. Trade also offers American consumers a greater choice of products at competitive prices and higher quality.

Overseas, trade helps increase world prosperity, advances the rule of law, and helps to strengthen international peace. As President Franklin Roosevelt said in 1944:

&A basic essential to peace, permanent peace, is a decent standard of living for all individual men and women and children in all nations. Freedom from fear is eternally linked with freedom from want. [And] it has been shown time and time again that if the standard of living in any country goes up, so does its purchasing power -- and that such a rise encourages a better standard of living in neighboring countries with whom it trades.⁸

These principles have formed the basis of American trade policy since the end of World War II. We have advanced them on a bipartisan basis through a strong working partnership between the Executive Branch and Congress through ten Administrations, ever since the creation of the General Agreement on Tariffs and Trade in 1948. The Clinton Administration's trade policy, we believe, is firmly in this tradition: such advances as the passage of the North American Free Trade Agreement, the Uruguay Round, our 35 bilateral trade agreements with Japan -- a total of 270 trade agreements -- would not have happened without the advice, support and contribution of the Trade Subcommittee and Congress as a whole.

TRADE AND THE US ECONOMY

The results of these policies have contributed immeasurably to the peace and prosperity America now enjoys. We have the most dynamic, creative and competitive economy in the world, and are ideally placed to succeed in the next century.

Since 1992, we have had uninterrupted growth -- our economy has expanded from \$7.1 trillion to \$8.5 trillion in real terms (1998 dollars)

and last month, the present economic expansion became America's longest in history.

We have created jobs. Employment in America has risen from 109.5 to 127.2 million jobs, a net gain of nearly 18 million, as unemployment rates fell from 7.4% to 4.3%.

And we have raised wages. Since 1992, average wages have reversed a twenty-year decline and have grown by 6.0% in real terms, to \$449 a week on average. This family prosperity is reflected, for example, in record rates of home ownership.

Altogether, we have achieved an historic combination of high growth, low unemployment, low inflation, low interest rates and rising wages unmatched in decades. The reasons for this are many. They include improved support for education and job training and an uninterrupted reduction in the federal deficit beginning in 1993 and culminating with the budget surpluses of the past two years. But trade and participation in the world economy have played an irreplaceable role.

And overseas, as trade has grown and international trade rules have strengthened, the hopes of the wartime generation have been in many ways realized.

Peace among the world's great nations has grown more secure.

Prosperity has blossomed -- as world exports have grown from \$60 billion to \$6.5 trillion in constant dollars since 1960, world economic production has quadrupled and real per capita income has more than doubled, from under \$3100 to over \$6300 last year.

As a consequence, people have better lives. In 1955, the world average life expectancy at birth was 48 years; now it is 65. Where the worldwide infant mortality rate was 148 per thousand, today it is 59.

And faith in markets under the rule of law has been vindicated: those nations which shut off the free flow of goods, services and information have tended to stagnate while those which remained open to the world have tended to prosper. One need only examine the ghastly experiment which has taken place on the Korean peninsula -- as South Korea has risen to become one of the world's leading industrial powers, while North Korea is afflicted by chronic hunger -- to show how stark is the contrast. And there is no stronger vindication of our work than the fact that Russia, China and 16 other economies have abandoned central planning and seek WTO membership.

Our Administration has had the good fortune to build upon this foundation. Since 1992, we have negotiated 270 separate trade agreements which have helped open markets and create opportunity for Americans. These include five which have fundamentally transformed world trade: the North American Free Trade Agreement, which cemented our strategic trade relationship with our immediate neighbors; the Uruguay Round, which created the World Trade Organization with a binding dispute settlement mechanism and extended international trade rules to new areas through agreements on agriculture, services, intellectual property; and three

multilateral agreements on information technology, financial services and basic telecommunications.

US TRADE TODAY

As a result, America's trade has flourished. Last year we exported \$932 billion in goods and services -- a 51% increase from the 1992 level of \$617 billion, despite a slowing in export growth due to the financial crisis. Our goods exports were very evenly divided among four major markets, meaning that we have critical trade interests in each part of the world:

Canada	Asia-Pacific	Latin
America	European Union	
\$156 billion	\$166 billion	\$143 billion

Measured by country, our largest five goods export markets were Canada at \$156 billion, followed by Mexico at \$71 billion, Japan at \$57 billion, the United Kingdom at \$40 billion and Germany at \$25 billion.

Service export figures are only partially available for 1998. Our full-year 1997 service exports, divided regionally, were more heavily weighted to Asia and Europe but still indicate critical interests in each region:

Canada	Asia-Pacific	Latin
America	European Union	
\$20.5 billion	\$73.6 billion	\$34.2 billion

In 1997, our six largest service export markets were Japan with \$34 billion, the United Kingdom with \$23.7 billion, Canada at \$20.5 billion, Germany at \$13.5 billion, France at \$9.4 billion and Mexico at \$9.3 billion.

Altogether, the United States was the world's largest exporter in 1998. We were also the largest exporter of the goods and services supporting the highest-wage jobs: agricultural products, advanced technology products and capital goods. Our goods exports now support 11.6 million American jobs.

The United States was also the world's largest importer, at \$1.1 trillion in goods and services imports in 1998. Imports play an important role in our economy, by raising living standards for consumers (especially lower-income Americans), dampening inflation, ensuring the widest possible choice of products at the best prices, and providing essential inputs for U.S. industries, many of which then export their goods at equally competitive prices. However, open markets depend on fair trade rules, and we are and will be vigilant in enforcing our laws against import surges, subsidies, dumping, or other measures intended to artificially boost exports or protect foreign markets.

TRADE AGENDA IN 1999

This brings me to our agenda for the years to come. As in the past, we hope to base our work on the foundation of a bipartisan consensus and a strong working relationship between the Administration and Congress. Generally speaking, our trade policy seeks the following goals.

- Address the trade effects of the financial crisis which now directly affects nearly 40% of the world.
- Continue our progress toward open and fair world markets through a new negotiating Round, as well as our role as host and Chair of the WTO's Third Ministerial Conference, regional negotiations and bilateral talks.
- Advance the rule of law and defend US rights by ensuring full compliance with trade agreements and strongly enforcing our trade laws.
- Encourage the full participation of all economies, including economies in transition and developing nations, in the world trading system on a commercially meaningful basis;
- Ensure that the trading system helps lay the foundation for the 21st-century economy by offering maximum incentives for scientific and technological progress.
- Ensure that trade policy complements our efforts to protect the world environment and promote core labor standards overseas; and
- Advance basic American values including transparency and accessibility to citizens and involvement of civil society in the institutions of international trade.

TRADE NEGOTIATING AUTHORITY

As we pursue this agenda, the Administration will consult with the Subcommittee and Congress on the renewal of traditional trade negotiating authority. The President, in his State of the Union address, called for a new consensus on trade. He said we must find the common ground on which business, workers, farmers, environmentalists and government can stand together. This commitment to common ground has been a hallmark of the Subcommittee's approach to trade policy over the years. I want to personally thank you, Mr. Chairman, along with each member of the Subcommittee, for your commitment and hard work toward this goal in the last Congress.

Consistent with that approach, we believe negotiating authority should bolster the traditional bipartisan support for trade policy and allow us to pursue an agenda that reflects consensus goals. It is a tool which can help us negotiate with greater credibility and effectiveness on behalf of American economic interests, and thus contribute to our goal of opening markets, increasing growth and raising living standards.

TRADE EFFECTS OF FINANCIAL CRISIS

Let me now address our agenda in detail. I will begin with the

trade effects of the financial crisis affecting Asia, Russia and parts of Latin America.

This crisis has now lasted a year and a half, and its effects on our trade interests have been severe. Countries which have implemented IMF reform programs have seen a number of good results, including currency stability and returning investor confidence. However, real economies continue to suffer. Six major economies -- Hong Kong, Indonesia, Malaysia, South Korea, Russia and Thailand -- are likely to have contracted by 6% or more last year.

As a result of this crisis, the American trade imbalance has widened. This reflects largely a sharp drop of about \$30 billion in American exports to the Pacific Rim, and a consequent break with the pattern of rapid U.S. export growth of the past few years. Our overall import growth last year (with the principal exception of the steel sector, in which imports rose very rapidly in the second half of 1998, affecting thousands of jobs) remained consistent with growth rates in previous years. Thus the larger deficit largely reflects predictable macroeconomic factors.

Our trade policy response begins by ensuring that our trading partners continue to live by commitments at the WTO and in our regional and bilateral agreements. The strength of the trading system is an enormous advantage here -- despite the worst financial crisis in fifty years, the world has resisted the temptation to relapse into protectionism. This has greatly reduced the potential damage to our economy, and particularly to American manufacturing exporters and agricultural producers. In addition, other markets -- particularly our NAFTA partners Canada and Mexico, to whom U.S. goods exports grew by \$13 billion last year -- have in part compensated, thanks to the more open North American market NAFTA has created, for some but not all of these lost exports. An ambitious trade agenda will further strengthen our effort to ensure that the crisis does not cause the world to move backward.

We continue with a policy response covering several areas:

IMF Recovery Packages -- We have supported reform packages with the IMF at the center in affected countries. Several of these contain trade conditionalities which we vigorously monitor.

Restored Growth in Japan -- A return to growth in Japan, Asia's largest economy, is essential for the economic health of the region. The Administration's view is that this will require fiscal stimulus that continues until solid growth is restored, financial reform, and deregulation and market-opening. USTR's responsibilities lie in this last area. In addition to an aggressive bilateral agenda, the agreement we reached in Japan last May sets out concrete deregulatory measures in telecommunications, housing, medical devices, pharmaceuticals and financial services sectors, and measures to strengthen competition policy enforcement and transparency. When fully implemented, these will create opportunities for exporters and workers in America, other Pacific economies and Japan. We are now discussing new measures in these sectors and energy as well.

Steel -- The President's January 7 Steel Report to the Congress lays out a seven point action plan on the steel import surge. Among other points, the plan projects a roll-back of imports from Japan to the key cause of the import surge to pre-crisis levels, and states that the Administration is prepared, if necessary, to self-initiate trade cases to ensure that this roll-back takes place. The plan also outlines actions taken by the Commerce Department to expedite ongoing dumping investigations and apply any dumping margins retroactively. In addition, the Administration expresses strong support for an effective safeguards mechanism; and commits us to continue to assess the effectiveness of steps taken to date, and working closely with the industry, labor, and members of Congress, to assess additional steps. To assist in this ongoing review, we also announced that preliminary steel import data will be released, thus enabling the industry's business planners to react to imports on a more timely basis.

I. GROWTH AND HIGHER LIVING STANDARDS

Let me now turn to our negotiating agenda. In this agenda, we seek enduring goals -- growth, higher living standards, the rule of law, a rising quality of life, better protection of health, safety and the environment, and the advance of basic values. As President Clinton said in the State of the Union address, we need to find new methods of negotiating and address a broader array of issues to secure these goals in the next century.

1. New Round and WTO Ministerial Conference

This is the basis of President Clinton's call for a new, accelerated negotiating Round for the 21st century. The Round would begin at the WTO's Third Ministerial Conference, which I will chair and which will be held in Seattle from November 30th to December 3rd. This will be the largest trade event ever held in America, bringing government leaders, Trade Ministers, business leaders, non-governmental organizations and others interested in trade policy from around the world. It is an extraordinary opportunity for us to shape at least the next decade of multilateral trade negotiations and to highlight our economic dynamism to the world.

The Round President Clinton has called for would be somewhat different from previous Rounds, in that we should be able to pursue three dimensions simultaneously: first, a negotiating agenda to be completed on an accelerated timetable; second, institutional reforms and capacity-building at the WTO; and third, ongoing results in priority areas.

To begin with, we would hope to advance a number of important initiatives in the months leading up to the Ministerial Conference and at the event itself. They include:

- An E-commerce and Information Technology Agreement II adding new products to the sectors already covered by the first ITA.

- Extension of last May's multilateral declaration not to assess customs duties on electronic commerce, to make sure that the Internet remains an electronic duty-free zone.

-- An agreement on transparency in procurement to create more predictable and competitive bidding, reducing the opportunity for bribery and corruption and helping ensure more effective allocation of resources.

-- Build consensus on the sectoral liberalization initiative begun in the Asia-Pacific Economic Cooperation forum. This would eliminate tariffs and in some cases liberalize services in chemicals; energy equipment and services; environmental goods and services; fish and fishery products; gems and jewelry; medical and scientific instruments; toys; and forest products. Meaningful participation by Japan in the fishery and forest products sectors would be essential to success.

The second dimension of institutional reform would promote transparency, allow the WTO to facilitate trade and participation for less developed nations, help it coordinate more effectively with international bodies in other fields, and continue to strengthen public confidence in the WTO as an institution. Here we would hope to take up such issues as:

-- Trade facilitation. Most of the world's regional trading arrangements -- ASEAN, APEC, the European Union, Mercosur, NAFTA, the proposed FTAA -- contain a critical element of trade facilitation, often beginning with customs reform to reduce transaction costs and make trade more efficient. The WTO can help accomplish this on a much broader scale.

-- Capacity-building. We need to narrow the growing disparity between the rich countries and the poor countries. We have to ensure that the WTO can work effectively with member economies and other international institutions, particularly with respect to the least developed nations, to ensure that they have both access to markets and technical assistance to meet the kinds of obligations that will help them grow. This and other issues will be addressed at a High-Level Meeting on Trade and Development this March.

-- Addressing the intersection between trade and environmental policies. As trade promotes growth overseas, we must at the same time ensure clean air, clean water and protection of our natural heritage, as well as effective approaches to broader questions like biodiversity and climate change. We have already scheduled a High-Level Meeting of trade and environment experts in March, which we anticipate will provide fresh and valuable input to our work in this area and help frame a vision for future work.

-- Addressing the intersection between trade and labor. Again, as in our domestic economy, growth can and should be accompanied by safer workplaces, elimination of exploitive child labor and respect for core labor standards. The WTO in particular can work in more coordination with the International Labor Organization on some of these issues. As the President has announced, the US will provide funds for a new multilateral program in the ILO to provide technical assistance for international labor rights initiatives, and through our own Department of Labor will help our trading partners strengthen labor law enforcement. These and other such efforts should be a focus of renewed cooperation with the ILO.

-- Coordination with the international financial institutions, in a world where the separation of trade from financial policy has become entirely artificial. The WTO must work more effectively with the IMF and World Bank to achieve their common goals of a more stable, predictable and prosperous world.

-- Transparency. We will also seek reform, openness and accountability in the WTO itself. Dispute settlement must be transparent and open to the public. Citizens must have access to panel reports and documents. Civil society must be able to contribute to the work of the WTO, to ensure both that the WTO can hear from many points of view including labor, environmental, consumer and other groups, and that its work will rest on the broadest possible consensus.

With respect to the expedited negotiating agenda of this Round, we are now consulting with Congress, industry, and other interested parties on a detailed negotiating agenda for talks which would begin after the Ministerial. While the final scope of the agenda is yet to be determined, we believe that at a minimum they should include such issues as:

-- Agriculture, where we envision broad reductions in tariffs, the elimination of export subsidies, and further reductions in trade-distorting domestic supports linked to production. We must seek transparency and improved disciplines on state trading enterprises, seek reform of the EU's Common Agricultural Policy, and ensure that the world's agricultural producers can use safe, scientifically proven biotechnology techniques without fear of trade discrimination.

-- Services, in which we hope to see specific commitments for broad liberalization and market access in a range of sectors, including but not limited to audiovisual services, construction, express delivery, financial services, professional services, telecommunications, travel and tourism, and others.

-- Government procurement, in which purchases are over \$3.1 trillion per year, much of it in sectors where America sets the world standard: high technology, telecommunications, construction, engineering, aerospace and so forth. At present, only 26 of the 133 WTO Members belong to the plurilateral WTO Government Procurement Agreement. We thus look to bring more countries under existing disciplines.

-- Intellectual property, where our efforts to ensure full compliance with the existing provisions of the Uruguay Round will be combined with campaigns against piracy in newly developed optical media technologies such as CDs, CD-ROMs, digital video discs and others; and end-user piracy of software.

-- Industrial tariff and non-tariff barriers, where we will seek to continue our progress in reducing bound and applied tariff levels, and continue to address non-tariff measures in industrial sectors.

-- A forward work-program on newer issues for the multilateral system to consider, including considering how competition and investment policies meet the test of assuring fair and open trade and how the WTO can

help to create an international pro-competitive regulatory climate, particularly in services, and further advance our efforts against bribery and corruption.

Outside the context of the Round, we are pursuing the accession of 31 economies to the World Trade Organization: Latvia, whose accession is complete and awaiting ratification; and Albania, Algeria, Andorra, Armenia, Azerbaijan, Belarus, Cambodia, China, Croatia, Estonia, FYR of Macedonia, Georgia, Jordan, Kazakhstan, Laos, Lithuania, Moldova, Nepal, Oman, Russia, Samoa, Saudi Arabia, Seychelles, Sudan, Taiwan, Tonga, Ukraine, Uzbekistan, Vanuatu and Vietnam. In all cases we seek a commercially meaningful accession with the greatest possible commitments to all WTO agreements, including the most recent ones.

We are also exploring ways to more fully integrate the least developed countries, particularly in Africa, into the system. This includes both seeking deeper commitments, and technical assistance in fulfilling those commitments, and legislation to improve trade relations with Africa.

Finally, we will shortly be deciding on entry into force of the 1997 WTO financial services negotiations. As you may recall, these extended negotiations concluded on an interim basis in 1995 because we were dissatisfied with offers from important trading partners, especially in developing and emerging markets. In contrast, in the negotiations that concluded in December 1997, we obtained broader and deeper commitments, in banking, insurance, and securities, from a wide range of developed and developing countries, including the key emerging markets of primary interest to U.S. industry. These countries had until January 29, 1999, to complete any necessary domestic procedures and formally notify the WTO of their acceptance of the protocol for bringing their commitments into force. Fifty-three countries, including the United States, met the deadline, and these 53 are now empowered to decide whether to allow their commitments to enter into force, on an MFN basis, from March 1. We have been consulting with your staff, staff of other relevant committees, and the U.S. private sector to determine a strategy that is in the best commercial interest of the United States and that will demonstrate our view that all WTO Members must live up to their commitments.

2. Regional Trade Agenda

At the same time, we are pursuing an active agenda in each region of the world. A brief review is as follows:

Canada -- With Canada, our largest trade partner, we have serious concerns on a range of agriculture matters. We took an important step on these last December by concluding a market access package opening opportunities for American grain farmers, cattle ranchers and other agricultural producers. We will continue our work in these areas this year. We will also address major market access impediments to our magazine publishers (as I note in the section on enforcement) and other media and entertainment industries. We will also continue to enforce our bilateral sectoral agreements. At the same time, we intend to work with Canada on bilateral issues of mutual interest, and on negotiations toward

the Free Trade Area of the Americas and at the WTO where we share many goals.

Mexico -- Trade with Mexico has expanded very rapidly since passage of the North American Free Trade Agreement. Last year, Mexico passed Japan as both our second largest goods exports market and our second largest overall trade partner. We will continue to monitor implementation of Mexico's NAFTA commitments, scheduled to be complete by 2008, and address bilateral issues including land transportation, corn syrup and sugar, and telecommunications barriers as well as piracy in intellectual property rights. We have also stepped up our efforts in the trilateral work program now underway in more than 25 Committees and Working Groups, with the intention of maximizing our gains under the NAFTA.

Western Hemisphere -- The Miami and Santiago Summits of the Americas have called on us to complete work on a Free Trade Area of the Americas no later than the year 2005. This year, in accordance with Summit directions, we intend to achieve concrete progress toward the FTAA in our nine Negotiating Groups and through business facilitation and other measures. At the same time, we will seek approval from Congress of an expanded and improved Caribbean Basin Initiative with benefits similar to those now accorded Mexico and Canada.

Europe -- We are working to remove barriers and strengthen trade relations with the EU through the Transatlantic Economic Partnership begun last year. This includes negotiations on seven separate agenda items: technical trade barriers, agriculture (including biotechnology and food safety), intellectual property, government procurement, services, electronic commerce and advancing shared values such as transparency and participation for civil society. We are also working to ensure the protection of American interests as the EU expands to include Central and Eastern European nations. At the same time, we are enforcing European compliance with dispute settlement decisions and will address problems in our trade relations both bilaterally and through the new negotiating Round President Clinton has proposed.

Asia -- Under the Asia-Pacific Economic Cooperation (APEC) forum we are looking long-term toward free and open trade in the region. This year, as I noted earlier, we will seek WTO consensus on the nine-sector liberalization package begun in APEC, and begin work on six additional sectors. We will also address bilateral issues with Korea, the ASEAN nations and other Asian trade partners. This will include seeking Normal Trade Relations with Kyrgyzstan, Mongolia and Laos, and negotiating a broad trade and commercial agreement with Vietnam.

Japan -- In trade relations with Japan, our largest overseas trade partner, we will continue our intense and sustained effort to open and deregulate the Japanese market. We have concluded 35 bilateral trade agreements with Japan since 1993; we will monitor their implementation closely and enforce them vigorously. We will also address sectoral issues including rice, steel, insurance, glass, film and other topics. And as I noted earlier, we are pursuing an ambitious set of goals under the Enhanced Initiative on Deregulation and Competition Policy, both in individual sectors and in broader structural issues. We hope to see

substantial progress on these issues as Prime Minister Obuchi's spring visit approaches.

China -- We will monitor and strictly enforce our agreements on intellectual property and market access with China, and address bilateral trade problems in agriculture, direct marketing and other areas. At the same time, we will continue to seek broad market-opening through our negotiations toward China's accession to the World Trade Organization, which I address more fully below.

Africa -- USTR is implementing the President's Partnership for Economic Growth and Opportunity in Africa, which owes a great deal to the work of the Trade Subcommittee, by supporting economic reform, promoting expanded trade and investment ties, and encouraging Africa's full integration into the world trading system by negotiating bilateral agreements, technical assistance and other measures.

A sound policy framework in African countries that opens economies to private sector trade and investment offers the greatest potential for growth and poverty alleviation as well as trade opportunities for the U.S.. Last month, for example, we signed a Bilateral Investment Treaty with Mozambique and over the next few months we expect to sign Trade and Investment Framework Agreements, or TIFAs, with South Africa, Ghana, and the West African Economic and Monetary Union. We also place a very high priority on Congressional approval of the African Growth and Opportunity Act. I want to state my personal appreciation for the work of Chairman Crane, Congressman Rangel and Congressman McDermott to secure its early passage in this Congress.

Broader efforts to encourage full integration of developing countries into the trading system will also bolster our Africa policy. In this regard, we will seek renewal of the Generalized System of Preferences.

Middle East -- Building upon our Free Trade Agreement with Israel, we have inaugurated a program that aims to bolster the peace process, while advancing American interests. Starting with a framework of bilateral trade and investment consultations in the region and a newly inaugurated industrial zones program, we will help the Middle Eastern countries work toward a shared goal of increased intra-regional trade.

OECD -- We strongly support passage of the OECD Convention on Shipbuilding Subsidies and will work with you to ensure its success.

II. ENFORCING THE RULE OF LAW

Second, US trade policy will support and advance the rule of law internationally by ensuring the enforcement of trade agreements and U.S. rights in the trading system.

Much of our enforcement work takes place at the World Trade Organization. We have filed more complaints in the WTO -- 41 cases to date -- than any other WTO member, and our record of success is strong. We have prevailed on 19 of the 21 American complaints acted upon so far, either by successful settlement or panel victory. In almost all cases,

the losing parties have acted rapidly to address the problems. We will insist that this remain the case in all our disputes, including those with the European Union on beef hormones and bananas, and with Canada on magazines. At the same time, the U.S. has complied fully with all panel rulings it has lost, although these are few in number. And we will, of course, use our rights under the NAFTA to ensure open markets to our goods and services in Canada and Mexico.

We are also monitoring implementation of WTO commitments. All WTO developing country members are scheduled to fully implement their intellectual property commitments, and all members are required to implement customs valuation commitments by January 1, 2000. We will insist on strict compliance with these deadlines.

Likewise, we are vigilant to ensure enforcement of textile quotas and implementation of textile market access requirements overseas. A number of our trading partners clearly have further work to do in market access, including some of our largest and fastest growing textile suppliers. We have and will continue to aggressively pursue our rights, whether through the consultation process or ultimately through the WTO dispute settlement regime.

U.S. trade laws are also a vitally important means of ensuring respect for U.S. rights and interests in trade. We will continue to challenge aggressively market access barriers abroad using laws such as Section 301, "Special 301" and Section 1377, to open foreign markets and ensure fair treatment for our goods and services, ensure nondiscrimination in foreign government procurement and ensure compliance with telecommunications agreements.

To ensure that we have the maximum advantage of domestic trade laws, the Administration will reauthorize by Executive Order two laws for which authority has lapsed: "Super 301" and Title VII. We wish to work with the Subcommittee to include these laws in your legislative agenda.

The Administration is also, of course, committed to full and vigorous enforcement of our laws addressing dumping and subsidies, and on injurious import surges.

III. INTEGRATING TRANSITION ECONOMIES

Third, our trade policy will continue our progress toward integrating China, Russia and other economies in transition into the trading system. This will both advance specific American trade interests, and contribute to our larger goal of a more secure peace in the next century.

This task is the last great step in the process which began with the formation of the GATT and continued with the admission of Germany and Japan: the integration of China, Russia and sixteen other economies in transition from communist planning into the trading system. These economies and a number of Middle Eastern nations are the two largest groups remaining outside the trading system. Their entry will make membership in the trading system nearly universal; and the accession of

the transition economies will be a fundamentally important step in their domestic reforms as well. This would remove large distortions in world markets, dramatically enhance market access for American producers, and bolster international stability by giving these nations a greater stake in world prosperity beyond their borders

To support rather than undermine both domestic reform in these economies and the rules of the trading system, these countries must be brought into the WTO on commercially meaningful terms. The result must be enforceable commitments to open markets in goods, services and agricultural products; transparent, non-discriminatory regulatory systems; and effective national treatment at the border and in the domestic economy.

This is an ambitious task, but not an impossible task. Central European countries like Poland, Hungary and the Czech Republic have succeeded, and their experience shows that WTO membership has assisted their domestic economic reform policies. The most recent successful WTO applications, Latvia and Kyrgyzstan, have had the same experience.

In the months to come, we will negotiate intensely with all acceding economies, including China -- the largest prospective WTO member. We have made important progress with China in the past two years, and the visit of Premier Zhu Rongji in April offers China a chance to make a decisive advance. We will consult closely with the Subcommittee and with other members of Congress as negotiations proceed.

Likewise, at the most recent summit with Russia (September 1998), President Yeltsin agreed to work to intensify Russia's WTO accession efforts. Russia's current economic difficulties clearly present challenges and Russian Cabinet reshuffling has slowed the process, but we will continue to consult with the Russians toward a commercially viable accession package.

IV. THE 21ST-CENTURY ECONOMY

Fourth, trade policy will help lay the foundation for the 21st-century economy by ensuring that the trading system is compatible with rapid advances in civilian science and technology.

In medicine, environmental protection, agriculture, entertainment, transportation, materials science, information and more, science is advancing at extraordinary speed. This offers the world tremendous potential to increase wealth, raise productivity, improve health care, reduce hunger, protect the environment and promote education. These are also areas in which the United States has a significant comparative advantage.

Under President Clinton, our trade policy has made high technology a strategic priority. Consistent with national security, we have aimed to ease the development and commercialization of new technologies, and ensure strong incentives for scientific and technological progress. We have negotiated far-reaching new agreements in sectors like computers, semiconductors, information technologies and many other areas. This work continues in multilateral, sectoral and regional negotiations.

In the multilateral system, the rapid advance of technology requires us to improve the trading system's institutions and negotiating methods. In a world where successive generations of new products arise in a matter of months, and both information and money move instantaneously, we can no longer take seven years to finish a negotiating Round, or let decades pass between identifying and acting on trade barriers. We will have to move faster and more efficiently, which is a significant reason for the President's call for an accelerated Round.

We must also ensure that trade policy, both in the WTO and in our regional and bilateral negotiations, helps ensure that we can take advantage of our comparative advantage in knowledge industries and other new technologies. Three broad issues cut across many sectors:

Intellectual Property Rights -- Our success in this field over the past decade owes a great deal to the work of Congress, both in the Trade Act of 1988 with its creation of Section 301, 8 and on the Uruguay Round. Today, the vast majority of our trading partners have passed modern intellectual property laws and are improving levels of enforcement. In this area, we will spend a great deal of time ensuring that all WTO members comply with their obligation to introduce full intellectual property protection by January 1, 2000. (For countries, like China, which are not WTO members, we will vigorously monitor compliance with bilateral agreements.)

We have also launched campaigns against worldwide piracy of new optical media technologies, and against end-user piracy of software. These issues are integral parts of our regional negotiating agenda in Asia, Latin America, Europe, Africa and the Middle East. Looking ahead, we must extend protection of intellectual property rights beyond basic laws and enforcement to protect new technologies like genetically engineered plant varieties.

Global Electronic Commerce -- In accordance with the President's Global Electronic Commerce initiative, USTR seeks to preserve electronic trade over the Internet as duty-free. At the last WTO Ministerial Conference, in May of 1998, we won agreement to a moratorium for tariffs on electronic transmissions. As I noted earlier, we will seek to extend that agreement this year. Likewise, in our negotiations toward the Free Trade Area of the Americas, at APEC and in the Transatlantic Economic Partnership, we have created special committees to advise us ways to ensure all participants can take maximum advantage of electronic commerce.

Biotechnology -- A third top priority for us in this area is biotechnology. Among the chief sources of innovation in this field are American agriculture and medicine. USTR will seek to ensure that pharmaceutical companies, farmers and ranchers can use safe, scientifically proven techniques like biotechnology to make agriculture both more productive and friendly to the environment, without fear of encountering trade discrimination. This is a priority for us in the Transatlantic Economic Partnership negotiations and in developing our agenda for future WTO negotiations.

We also have an active sectoral high-tech agenda. This includes,

for example, the ITA II agreement I discussed earlier. We are also working closely with our civil aircraft industry to ensure its future and combat foreign, particularly European, subsidies and other unfair practices. This work extends into many other fields.

V. RISING QUALITY OF LIFE

Fifth, US trade policy seeks to ensure that worldwide as in the United States, trade and growth go together with a rising quality of life, including setting high standards of environmental protection, the observance of core labor standards, and high levels of consumer protection.

As in our domestic economy, we regard environmental quality and protections for workers as essential parts of economic policy. Trade policy has an important role to play, in coordination with our efforts in other fora, to ensure growing respect for internationally recognized core labor standards and sustainable development worldwide.

1. Trade and the Environment

Our Administration believes that prosperity through open trade and the protection of health, safety and the environment need not conflict, and should be mutually supportive. This is the case in our domestic economy, where in the past three decades our GDP has risen in real terms from \$3.7 to \$8.5 trillion -- while our percentage of fishable and swimmable rivers and streams doubled, the number of citizens living in cities with unhealthy air fell by half, and many endangered or threatened species, including the bald eagle, are recovering. Where there are potential conflicts, we should strengthen our ability to resolve them in a manner that protects the environment, health and safety and does not undermine the trading system. This includes working to ensure that the proper expertise is brought to bear on complex technical and scientific issues, particularly those with environmental, health and safety dimensions.

In many cases elimination of trade barriers will also contribute to a cleaner environment and the conservation of natural resources. For example, this can help countries gain access to cost-effective equipment and technology. APEC's work toward an agreement to liberalize trade in environmental goods and services, part of which has now moved to the WTO, can help countries monitor, clean up and prevent pollution, and ensure clean air and water. Likewise, the APEC initiative on energy equipment and services can promote rapid dissemination of efficient power technologies, thus allowing production of power with reduced carbon emissions and contributing to international efforts to address climate change.

At the same time, as the trading system ensures that members avoid using environmental standards as disguised trade barriers, in eliminating barriers to trade we must not compromise on the achievement and maintenance of high levels of environmental, health and safety protection. And the system must work together with multilateral environmental institutions.

At our suggestion, the WTO is convening a High-Level Meeting on trade and the environment this spring to more fully address these questions. This marks a new level of awareness and interest in the world trading community on trade and environmental issues.

We will also continue to support the effective implementation of the North American Agreement on Environmental Cooperation in conjunction with the NAFTA. Cooperative activities that have occurred as a result of this agreement have improved environmental protection in a number of different areas -- for example, an agreement on the conservation of North American birds; the creation of a North American Pollutant Release Inventory; an agreement on regional action plans for the phase-out or sound management of toxic substances, including DDT, chlordane, PCBs and mercury; and the creation of a trilateral working group that has improved the enforcement of environmental protection laws. Benefits have also resulted from the implementation of the Border Environment Cooperative Commission (BECC) which was also entered into in conjunction with the NAFTA. The BECC has fifteen environmental infrastructure projects under construction today, funded in part by the North American Development Bank, including the first wastewater treatment plants in Juarez.

2. Trade and Core Labor Standards

Likewise, the trade system must help to assure the dignity and safety of workers. Here again, we can draw lessons from our experience at home, where since 1970, as manufacturing production doubled, the number of workplace deaths fell 60%. Our efforts here include seeking closer cooperation between the WTO and the International Labor Organization, bolstering ILO capabilities to address exploitative child labor and other violations of internationally recognized labor rights as well as ensuring safe and healthy workplaces, and working with individual trade partners to advance our goals.

At the Singapore WTO Ministerial Conference in 1996, the WTO for the first time recognized the importance of labor standards and cooperative work with the International Labor Organization, while clearly separating advocacy of labor rights from protectionist trade policies. We wish to build on this to ensure that the trading system works more effectively with the International Labor Organization, with businesses and with citizen activists to ensure observance of internationally agreed core labor standards -- banning forced labor and exploitive child labor, guaranteeing the freedom to associate and bargain collectively and eliminating discrimination in the workplace. We also have raised labor standards in country policy reviews under the Trade Policy Review Mechanism. In these reviews each WTO member's trade regime is examined, and other members are provided an opportunity to raise questions. We have used this opportunity, for example in the recent Swaziland review, to seek clarifications about labor practices that we believe are inadequate.

To bolster these efforts, the President recently announced a \$25 million program to help the ILO work with developing countries to put in place basic labor protections, safe workplaces and guarantee worker rights and enforce their own laws so that workers everywhere can enjoy the benefits of a strong social safety net. (The US has already funded ILO

child labor programs in Bangladesh, Thailand, the Philippines, Africa, and Brazil.) These are fundamental human rights and common concerns, and trade policy has a place in addressing them..

We are also taking steps in a number of other areas directly related to trade policy. The Administration has directed the Customs Service to step up its efforts to ensure that items made by forced or indentured child labor are not imported into the United States. USTR is enforcing provisions of existing law that impose penalties for clear violations of worker rights. For example, we partially removed GSP trade preferences from Pakistan over child labor concerns. At the same time, however, the Administration has worked through the Labor Department to develop long-term solutions to the problem, by addressing specific Pakistani industries. As a result, 7,000 children have been removed from jobs stitching soccer balls and 30,000 children from jobs knotting carpets.

Likewise, we are finding ways to address core labor standards as we advance our trade policy goals. The North American Agreement on Labor Cooperation under NAFTA is one example. Another is our most recent trade agreement -- the textile agreement with Cambodia -- which includes provisions requiring Cambodia to improve the enforcement of its labor laws in the garments sector.

VI. ADVANCING AMERICAN VALUES

Sixth, in 1999 we will seek to advance basic American values and concepts of good governance, by making the institutions of trade more transparent, accessible and responsive to citizens.

As the President has said, as trade grows, the rules of trade do more to ensure that markets are open to our goods and services, and the trading system coordinates more fully with environmental, labor and financial institutions, the need for transparency, accessibility and responsiveness grow. This is natural and a development which we both support and are working to realize.

One principal forum here is the WTO, where we are seeking agreements on more rapid release of documents, ensuring that citizens and citizen organizations can file amicus briefs in dispute settlement proceedings, and that dispute settlement proceedings be open to public observers. In the interim, President Clinton has made a standing offer to open any dispute panel involving the United States to the public, if our dispute partner agrees.

A second forum is the FTAA negotiations, in which -- for the first time in any trade negotiation -- we have created a Civil Society Committee to give business associations, labor unions, environmental groups, student associations, consumer representatives and others a formal means of conveying concerns and ideas to all of the governments involved in the talks.

A third is our creation of new Transatlantic Dialogues with the European Union for consumers, labor and environment as part of the Transatlantic Economic Partnership. We are working with these Dialogues

to promote our shared values with Europe in the activities and negotiations we are undertaking as part of the TEP and multilaterally.

CONCLUSION

This is an ambitious and far-reaching agenda. We plan to work closely with the Subcommittee and Congress as a whole to realize it, and look forward to the benefit of your thoughts and advice at this hearing and in the months ahead. This includes the renewed negotiating authority that will help us bring our negotiations to a successful conclusion.

In conclusion, Mr. Chairman, much has changed in the international economy in the fifty-one years since the United States led 23 countries in creation of the GATT. Our national interest in economic events beyond our borders has grown, our people have found new opportunities and new challenges in trade, and many new nations have become active in trade.

These developments in many ways are the result of America's commitment to a vision of open and fair trade under the rule of law, and to the bipartisan policies we have pursued for many years to realize it. As a result of this success, we now face some new and complex challenges. The President's State of the Union Address outlined these challenges and the need for a new consensus to meet them.

But as deeply changed as today's world may be, the vision President Roosevelt laid out in one of the darkest moment of human history -- an open world, prosperous and governed by the rule of law -- remains valid in a world more prosperous, healthy and hopeful than ever before. And the necessity for a bipartisan consensus on our goals, and a strong partnership between the Executive and Legislative branches of government, remain essential to achieve this vision. With your advice and your help, as we open a new Round of negotiations and embark on a highly ambitious agenda for the next century, we hope to bring it closer to realization than ever.

Thank you very much, Mr. Chairman and Members of the Subcommittee.

Message Sent

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SUBJECT: FW:John Makin's Economic Outlook

TO: Sharon H. Yuan (CN=Sharon H. Yuan/OU=OPD/O=EOP [OPD])
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TEXT:

> Economic Outlook
> February 19, 1999

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>

> The Dangerous Preference For Fixed Exchange Rates

>

> The most remarkable thing about the current G-7 (excluding American)

> preoccupation with pegging exchange rates among major currencies is the
> fact that it follows directly on the heels of nearly two years of
> disastrous efforts to foist exchange rate rigidity onto developing
> countries. Fortunately, the refusal by America alone to join the drive
> toward re-pegging currencies is sufficient to stop it. One would think
> that the Japanese who, intermittently, have made heavy use of exchange
> rate depreciation to cushion the rising deflationary momentum on their
> unfortunate island would be in favor of continued permissible flexibility
> of exchange rates. But, disoriented and seriously weakened by continued
> adherence to the old symbols of stability, hard money and a stable
> currency, the Japanese can be counted on to side with the Europeans in
> pushing for exchange rate pegs, as was clearly demonstrated at the recent
> G-7 meeting in Bonn.

>

> Today, twenty years after the great battle against global inflation

> was being fought, most central banks and the IMF have replaced the
> productive goal of avoiding inflation during an era of excess demand, with
> the counterproductive goal of preventing currency devaluations during an
> era of excess supply. The prevalence of excess capacity (supply) has
> meant that the battle against currency devaluations has been lost in the
> developing countries of the world, with the list of losers extended from
> Thailand, Indonesia, and South Korea in 1997 to Russia in 1998 and Brazil
> in 1999.

- >
- > With their devaluations, the developing countries have exported very
- > harmful deflation to Japan where it is already present, moderately harmful
- > deflation to Europe where it is about to appear, and helpful deflation to
- > the United States where it has served as a powerful tonic to extend
- > dramatically an investment-led expansion. What happens over the next year
- > in this excess supply environment, which is so baffling to most
- > policymakers, is crucial to avoiding a global financial meltdown. While
- > central banks know how to end inflationary episodes by raising interest
- > rates and slowing money growth, many central banks seem puzzled about how
- > to end deflationary episodes. Witness the current struggle over deflation
- > at the Bank of Japan, the rising tension with fiscal policy at the
- > European Central Bank, and the queasiness attending a souring U.S. stock
- > market and economy at the Federal Reserve.
- >
- > As the twentieth century draws to a close, it seems that lying about
- > exchange rate pledges has replaced lying about price stability as the
- > fashion among central banks outside of America. The failure during the
- > 1970s by G-7 central banks, especially the American Federal Reserve, to
- > keep their promises about price stability created an excess demand hot
- > potato scenario. Rising prices in industrial countries caused booms in
- > emerging markets, especially Latin America, which pulled investment
- > capital into those areas. The booms ended when the overheating got
- > intolerable in the industrial countries (especially the United States)
- and
- > the Federal Reserve called an end to the easy money scenario. Fed
- > tightening, begun in 1979/80, eventually collapsed the emerging market
- > boom in 1982 when Mexico declared itself unable to service its debts.
- > There followed a major Latin American debt crisis associated with the
- > battle to control inflation that, in turn, was necessitated by a failure
- > of the Federal Reserve and other major central banks to keep their
- > promises of stable prices.
- >
- > The reaction to the clear costs of the inflationary environment
- > during the late 1970s and early 1980s was a reaffirmed commitment to price
- > stability that has persisted in the United States, Europe, Japan, and
- > spread abroad to emerging markets. The late 1990s has seen an excess
- > supply hot potato replace the excess demand hot potato scenario of the
- > 1980s. Under the excess supply hot potato scenario, emerging markets
- > pegged their currencies to the dollar, which in turn was stabilized by the
- > Fed's long and persistent anti-inflation efforts. The pegging of emerging
- > market currencies to the dollar meant that investors in emerging markets
- > could use dollar interest rates, held unusually low by the Fed's
- > anti-inflation efforts, to finance a myriad of investment projects. The
- > unusually low cost of capital in emerging markets created a chronic excess
- > supply (capacity) situation, which meant that the hard currency pegs to

- > the dollar were no longer viable. Consequently, one by one the currencies
- > of emerging market countries like Thailand, Indonesia, South Korea,
- > Russia, and Brazil have been devalued in an effort to redress large excess
- > capacity problems.
- >
- > The following description of Shanghai, another classic case of
- > excess capacity problems, is typical:
- >
- > "Shanghai's property sector is the most obvious case of excess
- > capacity. Over two thousand high rises have been completed in the city
- > in
- > the 1990s. There are around five hundred under construction. Optimistic
- > estimates project that it will take ten years or more to fill the existing
- > buildings. If the property sector is cut back, Shanghai's economy will
- > clearly slow down. The whole country has a similar problem. The
- > manufacturing sector and the property sector account for about two thirds
- > of the total investment. If these two sectors have to invest less, can
- > investment drive the economy?
- >
- > If investment and consumption won't lead the economy, it leaves only
- > the external sector. East Asia is still crawling at the bottom. Europe
- > is slower than last year. The U.S. probably peaked in Q4 1998. China
- > will have to go for market share to achieve higher export growth, which
- > means trouble for other East Asian economies."
- >
- >
- > This description of Shanghai's and China's economic problems and the need
- > to export deflation was written by Andy Xie, a Morgan Stanley analyst
- > based in Hong Kong. It is typical of the Asian economy's problems.
- > Whereas in the 1970s, excess demand conditions in the developed G-7
- > economies ultimately benefited the commodity sensitive emerging markets,
- > the process has been reversed in the 1990s. The promise by emerging
- > market central banks to maintain a peg to the dollar put the cost of
- > capital too low and created an excess supply situation among emerging
- > markets that has, so far, greatly benefited the developed economies of the
- > G-7. The export of excess supply conditions in emerging markets has
- > created a triple benefit for financial markets and the economies of the
- > developed world, especially the United States. The collapse of emerging
- > market economies has lowered raw materials prices, while simultaneously
- > creating a reflux of capital back to the "safe haven" location in
- > developed economies. The acute phase of the emerging markets crisis, the
- > devaluation and default by Russia in August of 1998, and the near-failure
- > of Long-Term Capital Management created enough turbulence in the financial
- > sector of the advanced countries to cause the Federal Reserve to ease
- > sharply- cutting interest rates by 75 basis points in the space of six
- > weeks-and accelerate money growth through the end of 1998.
- >

> Everywhere in the world today, except in the United States, the need is
> for demand growth. This fact produces the odd result that monetary
policy
> in the United States, accommodative as it has been, is far more
> appropriate for areas like Europe and Japan where demand growth is
> inadequate, prices are falling, and unemployment is rising. The
exporters
> of deflation will now have to be Japan and Europe, with the U.S. as
> importer. But there may arise some problems in financial markets as this
> process goes forward.

>
> Two events have occurred that sound like good news but actually
will
> jeopardize the stability of financial markets in the United States,
> Europe, and Japan. First, the acute phase of the emerging market debt
> crisis is probably over. The end of that acute phase was marked by the
> Brazilian devaluation which, while disrupting markets in Latin America,
> was not the calamitous, systemic risk-threatening event that it was
> expected to be. The need to hold the line in Brazil was used rather to
> justify a \$40 billion gift package for the Brazilian government from the
> IMF. That package will be delivered no matter what the Brazilians do and
> having cut their currency loose, the Brazilians will begin to get on with
> the business of re-scheduling their debts and allowing private sector
> demand to rise in a way that deals with excess capacity in Brazil, while
> the government attends to the task of shrinking its bloated public
sector.
> With Brazil's devaluation in mind, it will be interesting to compare the
> performance of two different Latin American economies-Mexico and
> Argentina. The Mexicans have elected to absorb the strain of Brazil's
> devaluation attempt to capture demand by letting their own currency
> devalue, while Argentina has elected to maintain a rigid peg to the
> dollar. During the month after the Brazilian devaluation on January 13,
> the stock market of Argentina fell by 2.1 percent while Mexico's stock
> market rose by 25 percent. Clearly, the relief of excess supply problems
> is the appropriate policy in a world that continues to be characterized
by
> considerable excess capacity.

>
> The second major event was the February 15 decision by Japan to
> reverse its hard yen policy. After touting the benefits of a strong yen
> for months, Japan's chatty Vice Minister of Finance Eisuke Sakakibara
> released a statement through his pipeline to the hedge fund community,
> Medley Global Advisors. Said Sakakibara, "I am now willing to tolerate a
> weaker yen, because it will be driven by the Bank of Japan's correct
> decision to liquefy the Japanese money supply. As the yen declines in
> response to this new policy shift, you can be assured that I will not
> stand in the way. We will not oppose it."

>
> Sakakibara's statement came in the context of another failed
effort
> at reflation by Japan's central bank. The Friday before this statement,
> the Bank of Japan met and elected to cut the overnight rate from 25 basis
> points to 15 basis points or lower. The aim was to signal an easing of
> monetary policy, but after a brief yen sell off and JGB (Japanese

- > Government Bond) rally, the movements were reversed with the yen
- > strengthening again and JGBs selling off. More action was clearly
- > required to create the desperately needed reflation in Japan so

Sakakibara

- > leaked his weaker yen comment. Meanwhile, the Ministry of Finance
- > announced that it would buy an extra \$3.5 billion worth of Japanese
- > government bonds between now and March 31 (the end of Japan's fiscal
- year)
- > in an effort to avoid having a weaker currency push up interest rates in
- > Japan and to minimize balance sheet damage to Japan's financial
- > institutions from much lower prices of government bonds.
- >
- > Watching Japan carry out its efforts at reflation is somewhat

akin

- > to watching an inept driver attempt to shift the gears on a fine
- > automobile. The frequent gnashing and crunching of gears is painful to
- > watch and to hear. Japan knows it must reflate and late last year
- > announced the seventh in its long series of fiscal stimulus packages to
- > attempt to push up demand. However, financing the package led to such an
- > increase in the supply of Japanese government bonds that interest rates
- > rose sharply from well below 1 percent to over 2 percent in the space of
- a
- > month. Now Japan hopes to push down its currency, thereby joining the
- > reflation league without allowing its interest rates to rise. This will
- > be difficult to engineer since a falling currency pushes up interest
- rates
- > in two ways. First, it raises expected inflation and second it increases
- > expected growth by shifting demand onto Japanese producers and away from
- > producers elsewhere. Indeed, a rise in interest rates in Japan from
- > current levels to between 3.5 and 4 percent would be a desirable symptom
- > of a recovering Japanese economy. Of course, since Japanese banks hold
- > large stocks of JGBs on their balance sheets, the government will try to
- > have to have its cake and eat it too by depreciating the currency and
- > getting the economy to recover while trying to avoid higher interest
- > rates. This is impossible. If Japan gets the economic recovery it wants
- > and desperately needs by reflation, the yen will fall and interest rates
- > will rise-probably to 3.5 or 4 percent-especially in view of the huge
- \$300
- > to \$500 billion supply of new bonds the Japanese government will have to
- > sell each year to finance its government spending programs and bank
- > bailouts.
- >
- > If the acute phase of the emerging market debt crisis has

stabilized

- > with the Brazilian devaluation and the Japanese have rejoined the
- > reflation camp, the rally in the financial markets in the United States
- > and, by association, in Europe is in jeopardy. As is so often the case,
- > when policymakers actually obtain their most fervent wishes the byproduct
- > in financial markets is less than desirable. G-7 policymakers have been
- > hoping for a stabilization of the emerging market debt crisis and a
- > recovery in Japan since June of 1997 when the overt deflationary crisis
- > first hit. However, the byproduct of that crisis, falling commodity
- > prices, capital flowing to financial markets in developed countries, and
- > extra Fed easings have been remarkably constructive for the equity

markets

> in the United States and Europe. Now that the process is coming to an
> end, the clear sailing in U.S. equity markets, not to mention U.S. bond
> markets, may be over.

>

> For starters there is no reason to suppose that market conditions won't
> return to those prevailing just before the acute phase of the emerging
> market debt crisis occurred in August with the Russian devaluation and
> default. At that time, yields on U.S. ten-year bonds were about 5.5
> percent versus about 5 percent in mid-February 1999. True, the federal
> funds rate at 4.75 percent today is more supportive of lower U.S. yields
> than it was last summer at 5.5 percent, but Japanese bond yields at 2 to
> 2.5 percent instead of 0.9 percent levels of last summer are less
> supportive of lower U.S. yields. The S&P stock index stood just below
> 1,100 last August, about 15 percent below 1,250, the high reached in
> mid-February. The dollar was at 145 yen per dollar prior to a two-stage
> collapse that took it as low as 110 yen early this year.

>

> The lower commodity prices that improved American terms of trade,
> the search for a "safe haven" in rising U.S. financial markets, and the
> easier U.S. monetary policy in the fourth quarter of 1998, all part of

the

> acute phase of the global financial crisis, added mightily to U.S.
> economic performance. During the fourth quarter of 1998, stronger
> investment spending along with continued firm consumption growth and
> stronger government spending, resulted in a 5.6 percent growth rate with
> very low (0.8 percent) inflation. But now that Brazil's devaluation and
> the relatively calm aftermath have signaled an end to the "systemic" risk
> bogeyman haunting policymakers watching the emerging market debt crisis,
> and Japan has seemingly begun to come to its senses about the need to
> reflate, the easiest of times for the U.S. economy are behind it. In

1997

> and 1998 the U.S. economy, with the wind at its back, was akin to the
> fastest racecar on the track when all the slow cars break down and move
to

> the sidelines. The result is great lap times in the form of high GDP
> growth rates and higher valuations placed on earnings of U.S. companies.

>

> When the slower cars are repaired and start to get back onto the
> track, the U.S. economy, still the fastest in the world, has to navigate
> through some traffic such as a possible firming in raw materials prices,
> stable to rising interest rates, and a neutral Fed that might even
> consider tightening if any signs of wage pressure emerge. Lap times for
> the fast car, represented by price/earnings ratios in the stock market,
> begin to drop back to normal. A price/earnings ratio for the S&P stocks
> of 25 on \$40 per share would take the S&P down by about 25 percent to
> 1,000 from its current lofty level of 1,250 with a price/earnings ratio
of

> 30. These adjustments are not a disaster for the U.S. but rather a
return

> to normalcy with regard to costs of raw materials and costs of capital.
> The parallel development will be a return to normalcy in pricing of the
> earnings streams expected from U.S. firms as resumption of global demand
> growth reduces the excess supply problem and all of the positives it has

> brought to the U.S. economy.

>

> While the stock market may return to more normal levels relative to

> prospective earnings, bond yields may also revert to levels that prevailed

> before the Russian/LTCM crisis, about 50 basis points above current

> levels. Mitigating the rise in bond yields will be a likely strong

> appreciation by the U.S. dollar, especially against the yen as Japan

> reverts to currency depreciation in order to reflate external demand in

> its efficient traded goods sector. Japanese interest rates will also have

> to rise, a process inevitable in an economy that is starting to recover.

> Even at zero inflation, Japanese interest rates would average around 3.5

> percent without the huge prospective supply (the equivalent of over \$350

> billion a year in new Japanese government bonds) currently facing global

> financial markets. Japan must remember that if it gets its wish and the

> economy starts to recover, one of the byproducts will be higher interest

> rates that, in turn, will be signaling higher real returns available in

> the Japanese economy and a reversal of the deflationary forces that have

> taken hold over the past year.

>

> The U.S. Federal Reserve will probably welcome the strength of the

> dollar. The sharp easing last fall, accompanied by an acceleration of

> economic growth to close to 6 percent, or twice the Fed's sustainable

> rate, has created some restiveness about the degree of accommodation of

> U.S. monetary policy. A stronger dollar shifts demand away from U.S.

> producers and will help to relieve any incipient overheating pressure that

> might have built up in the U.S. economy. The underlying strength of the

> U.S. economy is still a useful lever that global policymakers can employ

> to pry the world out of its current deflationary excess supply slump, but

> currencies (including the yen and the Euro) must be permitted to weaken in

> order to shift demand growth away from the U.S. and onto Japan and Europe.

>

>

> The problems in emerging markets and Japan are by no means over.

> But events of the last month signal that they have probably passed their

> most acute phase. The next problem facing world financial markets and

> policymakers will be to make room for some of the slower economies to get

> back into the race. This will require the U.S. economy to throttle back

> and a stronger dollar is probably the ideal way to accomplish this move.

> The fact that a stronger dollar is the mirror image of weaker currencies

> elsewhere which, in turn, may be interpreted as abandonment of promises to

> maintain fixed exchange rates is not a bad thing.

>

> If the world has learned anything in the past two years, it ought to be

> that promising stable currencies in a deflationary world characterized by

> excess capacity amounts to no more than a cruel hoax. Fighting for

> exchange rate stability is not the moral or practical equivalent of

- > fighting inflation in a world of excess demand as the IMF, the European
- > Central Bank, and the Bank of Japan seem to have supposed. Efforts to
- > further the cause of exchange rate fixity in a world of excess capacity
- > are a mistaken carryover from the last global debt crisis in the 1980s
- > when promising price level stability and hard currencies was the way out
- > of the crisis.
- >
- > It would be heartening to hear from the G-7 some recognition
- of the
- > distinction between the desirability of seeking price level stability in
- a
- > world of excess demand and the dangers of pursuing exchange rate rigidity
- > in a world of excess supply. Failing that, we shall have to rely on
- > markets and the Federal Reserve to do the job for them.
- >
- >

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CREATOR: Marty J. Hoffmann (CN=Marty J. Hoffmann/OU=WHO/O=EOP [WHO])

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Testimony of Chairman Alan Greenspan
The Federal Reserve's semiannual report on monetary policy
Before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate
February 23, 1999

Mr. Chairman and members of the Committee, I appreciate the opportunity
to present the Federal
Reserve's semiannual report on monetary policy.

The U.S. economy over the past year again performed admirably. Despite
the challenges
presented by severe economic downturns in a number of foreign countries
and episodic financial
turmoil abroad and at home, our real GDP grew about 4 percent for a third
straight year. In 1998,
2-3/4 million jobs were created on net, bringing the total increase in
payrolls to more than 18
million during the current economic expansion, which late last year
became the longest in U.S.
peacetime history. Unemployment edged down further to a 4-1/4 percent
rate, the lowest since
1970.

And despite taut labor markets, inflation also fell to its lowest rate in
many decades by some
broad measures, although a portion of this decline owed to decreases in
oil, commodity, and other
import prices that are unlikely to be repeated. Hourly labor compensation
adjusted for inflation
posted further impressive gains. Real compensation gains have been
supported by robust
advances in labor productivity, which in turn have partly reflected heavy

investment in plant and equipment, often embodying innovative technologies.

Can this favorable performance be sustained? In many respects the fundamental underpinnings of the recent U.S. economic performance are strong. Flexible markets and the shift to surplus on the books of the federal government are facilitating the build-up in cutting-edge capital stock. That build-up in turn is spawning rapid advances in productivity that are helping to keep inflation well behaved. The new technologies and the optimism of consumers and investors are supporting asset prices and sustaining spending.

But, after eight years of economic expansion, the economy appears stretched in a number of dimensions, implying considerable upside and downside risks to the economic outlook. The robust increase of production has been using up our nation's spare labor resources, suggesting that recent strong growth in spending cannot continue without a pickup in inflation unless labor productivity growth increases significantly further. Equity prices are high enough to raise questions about whether shares are overvalued. The debt of the household and business sectors has mounted, as has the external debt of the country as a whole, reflecting the deepening current account deficit. We remain vulnerable to rapidly changing conditions overseas, which, as we saw last summer, can be transmitted to U.S. markets quickly and traumatically. I will be commenting on many of these issues as I review the developments of the past year and the prospects going forward. In light of all these risks, monetary policy must be ready to move quickly in either direction should we perceive imbalances and distortions developing that could undermine the economic expansion.

Recent Developments

A hallmark of our economic performance over the past year was the continuing sharp expansion of business investment spending. Competitive global markets and persisting technological advances both spurred the business drive to become more efficient and induced the price declines for many types of new equipment that made capital spending more attractive.

Business success in enhancing productivity and the expectation of still further, perhaps accelerated, advances buoyed public optimism about profit prospects, which contributed to another sizable

boost in equity prices. Rising household wealth along with strong growth in real income, related to better pay, slower inflation, and expanding job opportunities, boosted consumption at the fastest clip in a decade and a half. The gains in income and wealth last year, along with a further decrease in mortgage rates, also prompted considerable activity in the housing sector.

The impressive performance of the private sector was reflected in a continued improvement in the federal budget. Burgeoning receipts, along with continuing restraint on federal spending, produced the first unified budget surplus in thirty years, allowing the Treasury to begin to pay down the federal debt held by the public. This shift in the federal government's fiscal position has fostered an increase in overall national saving as a share of GDP to 17-1/4 percent from the 14-1/2 percent low reached in 1993. This rise in national saving has helped to hold down real interest rates and to facilitate the financing of the boom in private investment spending.

Foreign savers have provided an additional source of funds for vigorous domestic investment. The counterpart of our high and rising current account deficit has been ever faster increases in the net indebtedness of U.S. residents to foreigners. The rapid widening of the current account deficit has some disquieting aspects, especially when viewed in a longer-term context. Foreigners presumably will not want to raise indefinitely the share of their portfolios in claims on the United States. Should the sustainability of the buildup of our foreign indebtedness come into question, the exchange value of the dollar may well decline, imparting pressures on prices in the United States.

In the recent economic environment, however, the widening of the trade and current account deficits had some beneficial aspects. It provided a safety valve for strong U.S. domestic demand, thereby helping to restrain pressures on U.S. resources. It also cushioned, to some extent, economic weakness in our trading partners.

Moreover, decreasing import prices, which partly came from the appreciation of the dollar through mid-summer, contributed to low overall U.S. inflation, as did ample manufacturing capacity in the United States and lower prices for oil and other commodities stemming from the weak activity abroad. The marked drop in energy prices significantly contributed to the subdued, less than 1

percent, increase in the price index for total personal consumption expenditures during 1998. In addition, supported by rapid accumulation of more efficient capital, the growth of labor productivity picked up last year, allowing nominal labor compensation to post another sizable gain without putting added upward pressure on costs and prices. I shall return to an analysis of the extraordinary performance of inflation later in my remarks.

The Federal Open Market Committee conducted monetary policy last year with the aim of sustaining the remarkable combination of economic expansion and low inflation. At its meetings from March to July, the inflation risks accompanying the continued strength of domestic demand and the tightening of labor markets necessitated that the FOMC place itself on heightened inflation alert. Although the FOMC kept the nominal federal funds rate unchanged, it allowed the real funds rate to rise with continuing declines in inflation and, presumably, inflation expectations. In August, the FOMC returned to an unbiased policy predilection in response to the adverse implications for the U.S. outlook of worsening conditions in foreign economies and in global financial markets, including our own.

Shortly thereafter, a further deterioration in financial market conditions began to pose a more serious threat to economic stability. In the wake of the Russian crisis and subsequent difficulties in other emerging-market economies, investors perceived that the uncertainties in financial markets had broadened appreciably and as a consequence they became decidedly more risk averse.

Safe-haven demands for U.S. Treasury securities intensified at the expense of private debt securities. As a result, quality spreads escalated dramatically, especially for lower-rated issuers. Many financial markets turned illiquid, with wider bid-asked spreads and heightened price volatility, and issuance was disrupted in some private securities markets. Even the liquidity in the market for seasoned issues of U.S. Treasury securities dried up, as investors shifted toward the more actively traded, recently issued securities and dealers pared inventories, fearing that heightened price volatility posed an unacceptable risk to their capital.

Responding to losses in foreign financial markets and to pressures from counterparties, highly leveraged investors began to unwind their positions, which further weighed on market conditions.

As credit became less available to business borrowers in capital markets, their demands were redirected to commercial banks, which reacted to the enlarged borrowing, and more uncertain business prospects, by tightening their standards and terms on such lending.

To cushion the domestic economy from the impact of the increasing weakness in foreign economies and the less accommodative conditions in U.S. financial markets, the FOMC, beginning in late September, undertook three policy easings. By mid-November, the FOMC had reduced the federal funds rate from 5-1/2 percent to 4-3/4 percent. These actions were taken to rebalance the risks to the outlook, and, in the event, the markets have recovered appreciably. Our economy has weathered the disturbances with remarkable resilience, though some yield and bid-asked spreads still reflect a hesitancy on the part of market participants to take on risk. The Federal Reserve must continue to evaluate, among other issues, whether the full extent of the policy easings undertaken last fall to address the seizing-up of financial markets remains appropriate as those disturbances abate.

To date, domestic demand and hence employment and output have remained vigorous. Real GDP is estimated to have risen at a annual rate exceeding 5-1/2 percent in the fourth quarter of last year. Although some slowing from this torrid pace is most likely in the first quarter, labor markets remain exceptionally tight and the economy evidently retains a great deal of underlying momentum despite the global economic problems and the still-visible remnants of the earlier financial turmoil in the United States. At the same time, no evidence of any upturn in inflation has, as yet, surfaced.

Abroad, the situation is mixed. In some East Asian countries that, in recent years, experienced a loss of investor confidence, a severe currency depreciation, and a deep recession, early signs of stabilization and economic recovery have appeared. This is particularly the case for Korea and Thailand. Authorities in those countries, in the context of IMF stabilization programs, early on established appropriate macroeconomic policies and undertook significant structural reforms to buttress the banking system and repair the finances of the corporate sector. As investor confidence has returned, exchange rates have risen and interest rates have fallen. With persistence

and follow-through on reforms, the future of those economies has promise.

The situations in some other emerging market economies are not as encouraging. The Russian government's decision in mid-August to suspend payments on its domestic debt and devalue the ruble took markets by surprise. Investor flight exacerbated the collapse of prices in Russian financial markets and led to a sharp depreciation of the ruble. The earlier decline in output gathered momentum, and by late in the year inflation had moved up to a triple-digit annual rate. Russia's stabilization program with the IMF has been on hold since the financial crisis hit, and the economic outlook there remains troubling.

The Russian financial crisis immediately spilled over to some other countries, hitting Latin America especially hard. Countering downward pressure on the exchange values of the affected currencies, interest rates moved sharply higher, especially in Brazil. As a consequence of the high interest rates and growing economic uncertainty, Brazil's economic activity took a turn for the worse. Higher interest rates also had negative consequences for the fiscal outlook, as much of Brazil's substantial domestic debt effectively carries floating interest rates. With budget reform legislation encountering various setbacks, market confidence waned further and capital outflows from Brazil continued, drawing down foreign currency reserves. Ultimately, the decision was taken to allow the real to float, and it subsequently depreciated sharply.

Brazilian authorities must walk a very narrow, difficult path of restoring confidence and keeping inflation contained with monetary policy while dealing with serious fiscal imbalances. Although the situation in Brazil remains uncertain, there has been limited contagion to other countries thus far. Apparently, the slow onset of the crisis has enabled many parties with Brazilian exposures to hedge those positions or allow them to run off. With the net exposure smaller, and increasingly held by those who both recognized the heightened risk and were willing to bear it, some of the elements that might have contributed to further contagion may have been significantly reduced.

The Economic Outlook

These recent domestic and international developments provide the backdrop for U.S. economic prospects. Our economy's performance should remain solid this year, though likely with a slower

pace of economic expansion and a slightly higher rate of overall inflation than last year. The stocks of business equipment, housing, and household durable goods have been growing rapidly to quite high levels relative to business sales or household incomes during the past few years, and some slowing in the growth of spending on these items seems a reasonable prospect. Moreover, part of the rapid increase in spending, especially in the household sector, has resulted from the surge in wealth associated with a runup in equity prices that is unlikely to be repeated. And the purchasing power of income and wealth has been enhanced by declines in oil and other import prices, which also are unlikely to recur this year. Assuming that aggregate demand decelerates, underlying inflation pressures, as captured by core price measures, in all likelihood will not intensify significantly in the year ahead, though the Federal Reserve will need to monitor developments carefully. We perceive stable prices as optimum for economic growth. Both inflation and deflation raise volatility and risks that thwart maximum economic growth.

Most Governors and Reserve Bank Presidents foresee that economic growth this year will slow to a 2-1/2 to 3 percent rate. Such growth would keep the unemployment rate about unchanged. The central tendency of the Governors' and Presidents' predictions of CPI inflation is 2 to 2-1/2 percent. This level represents a pickup from last year, when energy prices were falling, but it is in the vicinity of core CPI inflation over the last couple of years.

This outlook involves several risks. The continuing downside risk posed by possible economic and financial instability around the world was highlighted earlier this year by the events in Brazil.

Although financial contagion elsewhere has been limited to date, more significant knock-on effects in financial markets and in the economies of Brazil's important trading partners, including the United States, are still possible. Moreover, the economies of several of our key industrial trading partners have shown evidence of weakness, which if it deepens could further depress demands for our exports.

Another downside risk is that growth in capital spending, especially among manufacturers, could weaken appreciably if pressures on domestic profit margins mount and capacity utilization drops further. And it remains to be seen whether corporate earnings will disappoint investors, even if the

slowing of economic growth is only moderate. Investors appear to have incorporated into current equity price levels both robust profit expectations and low compensation for risk. As the economy slows to a more sustainable pace as expected, profit forecasts could be pared back, which together with a greater sense of vulnerability in business prospects could damp appetites for equities. A downward correction to stock prices, and an associated increase in the cost of equity capital, could compound a slowdown in the growth of capital spending. In addition, a stock market decline would tend to restrain consumption spending through its effect on household net worth.

But on the upside, our economy has proven surprisingly robust in recent years. More rapid increases in capital spending, productivity, real wages, and asset prices have combined to boost economic growth far more and far longer than many of us would have anticipated.

This "virtuous cycle" has been able to persist because the behavior of inflation also has been surprisingly favorable, remaining well contained at levels of utilization of labor that in the past would have produced accelerating prices. That it has not done so in recent years has been the result of a combination of special one-time factors holding down prices and more lasting changes in the processes determining inflation.

Among the temporary factors, the sizable declines in the prices of oil, other internationally traded commodities, and other imports contributed directly to holding down inflation last year, and also indirectly by reducing inflation expectations. But these prices are not likely to fall further, and they could begin to rise as some Asian economies revive and the effects of the net depreciation of the dollar since mid-summer are felt more strongly.

At the same time, however, recent experience does seem to suggest that the economy has become less inflation prone than in the past, so that the chances of an inflationary breakout arguably are, at least for now, less than they would have been under similar conditions in earlier cycles.

Several years ago I suggested that worker insecurity might be an important reason for unusually damped inflation. From the early 1990s through 1996, survey results indicated that workers were

becoming much more concerned about being laid off. Workers' underlying fear of technology-driven job obsolescence, and hence willingness to stress job security over wage increases, appeared to have suppressed labor cost pressures despite a reduced unemployment rate. More recently, that effect seems to have diminished in part. So while job loss fears probably contributed to wage and price suppression through 1996, it does not appear that a further heightening of worker insecurity about employment prospects can explain the more recent improved behavior of inflation.

Instead, a variety of evidence, anecdotal and otherwise, suggests that the source of recent restrained inflation may be emanating more from employers than from employees. In the current economic setting, businesses sense that they have lost pricing power and generally have been unwilling to raise wages any faster than they can support at current price levels. Firms have evidently concluded that if they try to increase their prices, their competitors will not follow, and they will lose market share and profits.

Given the loss of pricing power, it is not surprising that individual employers resist pay increases. But why has pricing power of late been so delimited. Monetary policy certainly has played a role in constraining the rise in the general level of prices and damping inflation expectations over the 1980s and 1990s. But our current discretionary monetary policy has difficulty anchoring the price level over time in the same way that the gold standard did in the last century.

Enhanced opportunities for productive capital investment to hold down costs also may have helped to damp inflation. Through the 1970s and 1980s, firms apparently found it easier and more profitable to seek relief from rising nominal labor costs through price increases than through cost-reducing capital investments. Price relief evidently has not been available in recent years. But relief from cost pressures has. The newer technologies have made capital investment distinctly more profitable, enabling firms to substitute capital for labor far more productively than they would have a decade or two ago.

Starting in 1993, capital investment, especially in high-tech equipment, rose sharply beyond normal cyclical experience, apparently the result of expected increases in rates

of return on the new investment. Had the profit expectations not been realized, one would have anticipated outlays to fall back. Instead, their growth accelerated through the remainder of the decade.

More direct evidence confirms improved underlying profitability. According to rough estimates, labor and capital productivity has risen significantly during the past five years. It seems likely that the synergies of advances in laser, fiber optic, satellite, and computer technologies with older technologies have enlarged the pool of opportunities to achieve a rate of return above the cost of capital. Moreover, the newer technologies have facilitated a dramatic foreshortening of the lead times on the delivery of capital equipment over the past decade, presumably allowing businesses to react more expeditiously to an actual or expected rise in nominal compensation costs than, say, they could have in the 1980s. In addition, the surge in investment not only has restrained costs, it has also increased industrial capacity faster than factory output has risen. The resulting slack in product markets has put greater competitive pressure on businesses to hold down prices, despite taut labor markets.

The role of technology in damping inflation is manifest not only in its effects on U.S. productivity and costs, but also through international trade, where technological developments have progressively broken down barriers to cross-border trade. The enhanced competition in tradeable goods has enabled excess capacity previously bottled up in one country to augment worldwide supply and exert restraint on prices in all countries' markets. The resulting price discipline also has constrained nominal wage gains in internationally tradeable goods industries. As workers have attempted to shift to other sectors, gains in nominal wages and increases in prices in nontradeable goods industries have been held down as well.

The process of price containment has potentially become, to some extent, self-reinforcing. Lower inflation in recent years has altered expectations. Workers no longer believe that escalating gains in nominal wages are needed to reap respectable increases in real wages, and their remaining sense of job insecurity is reinforcing this. Since neither firms nor their competitors can count any longer on a general inflationary tendency to validate decisions to raise their own prices, each company

feels compelled to concentrate on efforts to hold down costs. The availability of new technology to each company and its rivals affords both the opportunity and the competitive necessity of taking steps to boost productivity.

It is difficult to judge whether these significant shifts in the market environment in which firms function is sufficient to account for our benign overall price behavior during the past half decade.

Undoubtedly, other factors have been at work as well, including those temporary factors I mentioned earlier and some more lasting I have not discussed, such as worldwide deregulation and privatization, and the freeing up of resources previously employed to produce military products that was brought about by the end of the cold war. There also may be other contributory forces lurking unseen in the wings that will only become clear in time. Over the longer run, of course, the actions of the central bank determine the degree of overall liquidity and hence rate of inflation. It is up to us to validate the favorable inflation developments of recent years.

Although the pace of productivity increase has picked up in recent years, the extraordinary strength of demand has meant that the substitution of capital for labor has not prevented us from rapidly depleting the pool of available workers. This worker depletion constitutes a critical upside risk to the inflation outlook because it presumably cannot continue for very much longer without putting increasing pressure on labor markets and on costs.

The number of people willing to work can be usefully defined as the unemployed component of the labor force plus those not actively seeking work, and thus not counted in the labor force, but who nonetheless say they would like a job if they could get one. This pool of potential workers aged 16 to 64 currently numbers about 10 million, or just 5-3/4 percent of that group's population--the lowest such percentage on record, which begins in 1970, and 2-1/2 percentage points below its average over that period. The rapid increase in aggregate demand has generated growth of employment in excess of growth in population, causing the number of potential workers to fall since the mid-1990s at a rate of a bit under 1 million annually. We cannot judge with precision how much further this level can decline without sparking ever greater upward pressures on wages and prices. But, should labor market conditions continue to

tighten, there has to be
some point at which the rise in nominal wages will start increasingly
outpacing the gains in labor
productivity, and prices inevitably will begin to accelerate.

Ranges for Money and Credit

At its February meeting, the Committee elected to ratify the provisional
ranges for all three
aggregates that it had established last July. Specifically, the Committee
again has set growth rate
ranges over the four quarters of 1999 of 1 to 5 percent for M2, 2 to 6
percent for M3, and 3 to 7
percent for domestic nonfinancial debt. As in previous years, the
Committee interpreted the ranges
for the broader monetary aggregates as benchmarks for what money growth
would be under
conditions of price stability and sustainable economic growth, assuming
historically typical velocity
behavior.

Last year, these monetary aggregates far overshot the upper bounds of
their annual ranges. While
nominal GDP growth did exceed the rate likely consistent with sustained
price stability, the rapid
growth of M2 and M3 also reflected outsized declines in their velocities,
that is, the ratio of
nominal GDP to money. M2 velocity dropped by about 3 percent, while M3
velocity plunged by
5-1/4 percent.

Part of these velocity declines reflected some reduction in the
opportunity cost of holding money;
interest rates on Treasury securities, which represent an alternative
return on non-monetary assets,
dropped more than did the average of interest rates on deposits and money
market mutual funds in
M2, drawing funds into the aggregate. Even so, much of last year's
aberrant behavior of broad
money velocity cannot readily be explained by conventional determinants.
Although growth of the
broad aggregates was strong earlier in the year, it accelerated in the
fourth quarter after credit
markets became turbulent. Perhaps robust money growth late in the year
partly reflected a
reaction to this turmoil by the public, who began scrambling for safer
and more liquid financial
assets. Monetary expansion has moderated so far this year, evidently in
lagged response to the
calming of financial markets in the autumn. Layered on top of these
influences, though, the public
also may have been reapportioning their savings flows into money balances
because the huge
runup in stock prices in recent years has resulted in an uncomfortable
portion of their net worth in

equity.

For the coming year, the broad monetary aggregates could again run high relative to these ranges.

To be sure, the decline in the velocities of the broader aggregates this year should abate to some extent, as money demand behavior returns more to normal, and growth in nominal GDP should slow as well, as suggested by the Governors' and Presidents' central tendency. Both factors would restrain broad money expansion relative to last year. Still, the growth of M2 and M3 could well remain outside their price-stability ranges this year. Obviously, considerable uncertainty continues to surround the prospective behavior of monetary velocities and growth rates.

Domestic nonfinancial debt seems more likely than the monetary aggregates to grow within its range for this year. Indeed, domestic nonfinancial debt also could grow more slowly this year than last year's 6-1/4 percent pace, which was in the upper part of its 3 to 7 percent annual range.

With the federal budget surplus poised to widen further this year, federal debt should contract even more quickly than last year. And debt in each of the major nonfederal sectors in all likelihood will decelerate as well from last year's relatively elevated rates, along with the projected slowing of nominal GDP growth.

The FOMC's Disclosure Policy

The FOMC at recent meetings has discussed not only the stance of policy, but also when and how it communicates its views of the evolving economic situation to the public. The FOMC's objective is to release as much information about monetary policy decision making, and as promptly, as is consistent with maintaining an effective deliberative process and avoiding roiling markets unnecessarily. Since early 1994, each change in the target nominal federal funds rate has been announced immediately with a brief rationale for the action. The FOMC resolved at its December meeting to take advantage of an available, but unused policy, originally stated in early 1994, of releasing, on an infrequent basis, a statement immediately after some FOMC meetings at which the stance of monetary policy has not been changed. The Federal Reserve will release such a statement when it wishes to communicate to the public a major shift in its views about the balance of risks or the likely direction of future policy. Such an announcement need not be made after

every change in the tilt of the directive. Instead, this option would be reserved for situations in which the consensus of the Committee clearly had shifted significantly, though not by enough to change current policy, and in which the absence of an explanation risked misleading markets about the prospects for monetary policy.

Year 2000 Issues

Before closing, I'd like to address an issue that has been receiving increasing attention--the century date change. While no one can say that the rollover to the year 2000 will be trouble free, I am impressed by the efforts to date to address the problem in the banking and financial system. For our part, the Federal Reserve System has now completed remediation and testing of 101 of its 103 mission-critical applications, with the remaining two to be replaced by the end of March. We opened a test facility in June at which more than 6000 depository institutions to date have conducted tests of their Y2K compliant systems, and we are well along in our risk mitigation and contingency planning activities. As a precautionary measure, the Federal Reserve has acted to increase the currency in inventory by about one-third to approximately \$200 billion in late 1999 and has other contingency arrangements available if needed. While we do not expect currency demand to increase dramatically, the Federal Reserve believes it is important for the public to have confidence in the availability of cash in advance of the rollover. As a result of these kinds of activities, I can say with assurance that the Federal Reserve will be ready in both its operations and planning activities for the millennium rollover.

The banking industry is also working hard, and with evident success, to prepare for the event. By the end of the first quarter, every institution in the industry will have been subject to two rounds of on-site Y2K examinations. The Federal Reserve, like the other regulators, has found that only a small minority of institutions has fallen behind in their preparations, and those institutions have been targeted for additional follow-up and, as necessary, formal enforcement actions. The overwhelming majority of the industry has made impressive progress in their remediation, testing, and contingency planning efforts.

Concluding Comment

Americans can justifiably feel proud of their recent economic achievements. Competitive markets,

with open trade both domestically and internationally, have kept our production efficient and on the expanding frontier of technological innovation. The determination of Americans to improve their skills and knowledge has allowed workers to be even more productive, elevating their real earnings. Macroeconomic policies have provided a favorable setting for the public to take greatest advantage of opportunities to improve its economic well being. The restrained fiscal policy of the Administration and the Congress has engendered the welcome advent of a unified budget surplus, freeing up funds for capital investment. A continuation of responsible fiscal and, we trust, monetary policies should afford Americans the opportunity to make considerable further economic progress over time.

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Testimony of Chairman Alan Greenspan

The Federal Reserve's semiannual report on monetary policy

Before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate

February 23, 1999

Mr. Chairman and members of the Committee, I appreciate the opportunity to present the Federal Reserve's semiannual report on monetary policy.

The U.S. economy over the past year again performed admirably. Despite the challenges

presented by severe economic downturns in a number of foreign countries and episodic financial

turmoil abroad and at home, our real GDP grew about 4 percent for a third straight year. In 1998,

2-3/4 million jobs were created on net, bringing the total increase in payrolls to more than 18

million during the current economic expansion, which late last year became the longest in U.S.

peacetime history. Unemployment edged down further to a 4-1/4 percent rate, the lowest since 1970.

And despite taut labor markets, inflation also fell to its lowest rate in

many decades by some broad measures, although a portion of this decline owed to decreases in oil, commodity, and other import prices that are unlikely to be repeated. Hourly labor compensation adjusted for inflation posted further impressive gains. Real compensation gains have been supported by robust advances in labor productivity, which in turn have partly reflected heavy investment in plant and equipment, often embodying innovative technologies.

Can this favorable performance be sustained? In many respects the fundamental underpinnings of the recent U.S. economic performance are strong. Flexible markets and the shift to surplus on the books of the federal government are facilitating the build-up in cutting-edge capital stock. That build-up in turn is spawning rapid advances in productivity that are helping to keep inflation well behaved. The new technologies and the optimism of consumers and investors are supporting asset prices and sustaining spending.

But, after eight years of economic expansion, the economy appears stretched in a number of dimensions, implying considerable upside and downside risks to the economic outlook. The robust increase of production has been using up our nation's spare labor resources, suggesting that recent strong growth in spending cannot continue without a pickup in inflation unless labor productivity growth increases significantly further. Equity prices are high enough to raise questions about whether shares are overvalued. The debt of the household and business sectors has mounted, as has the external debt of the country as a whole, reflecting the deepening current account deficit. We remain vulnerable to rapidly changing conditions overseas, which, as we saw last summer, can be transmitted to U.S. markets quickly and traumatically. I will be commenting on many of these issues as I review the developments of the past year and the prospects going forward. In light of all these risks, monetary policy must be ready to move quickly in either direction should we perceive imbalances and distortions developing that could undermine the economic expansion.

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The impressive performance of the private sector was reflected in a
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Moreover, decreasing import prices, which partly came from the appreciation of the dollar through mid-summer, contributed to low overall U.S. inflation, as did ample manufacturing capacity in the United States and lower prices for oil and other commodities stemming from the weak activity abroad. The marked drop in energy prices significantly contributed to the subdued, less than 1 percent, increase in the price index for total personal consumption expenditures during 1998. In addition, supported by rapid accumulation of more efficient capital, the growth of labor productivity picked up last year, allowing nominal labor compensation to post another sizable gain without putting added upward pressure on costs and prices. I shall return to an analysis of the extraordinary performance of inflation later in my remarks.

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Many financial markets turned illiquid, with wider bid-asked spreads and heightened price volatility, and issuance was disrupted in some private securities markets. Even the liquidity in the market for seasoned issues of U.S. Treasury securities dried up, as investors shifted toward the

more actively traded, recently issued securities and dealers pared inventories, fearing that heightened price volatility posed an unacceptable risk to their capital.

Responding to losses in foreign financial markets and to pressures from counterparties, highly leveraged investors began to unwind their positions, which further weighed on market conditions.

As credit became less available to business borrowers in capital markets, their demands were redirected to commercial banks, which reacted to the enlarged borrowing, and more uncertain business prospects, by tightening their standards and terms on such lending.

To cushion the domestic economy from the impact of the increasing weakness in foreign economies and the less accommodative conditions in U.S. financial markets, the FOMC, beginning in late September, undertook three policy easings. By mid-November, the FOMC had reduced the federal funds rate from 5-1/2 percent to 4-3/4 percent. These actions were taken to rebalance the risks to the outlook, and, in the event, the markets have recovered appreciably. Our economy has weathered the disturbances with remarkable resilience, though some yield and bid-asked spreads still reflect a hesitancy on the part of market participants to take on risk. The Federal Reserve must continue to evaluate, among other issues, whether the full extent of the policy easings undertaken last fall to address the seizing-up of financial markets remains appropriate as those disturbances abate.

To date, domestic demand and hence employment and output have remained vigorous. Real GDP is estimated to have risen at a annual rate exceeding 5-1/2 percent in the fourth quarter of last year. Although some slowing from this torrid pace is most likely in the first quarter, labor markets remain exceptionally tight and the economy evidently retains a great deal of underlying momentum despite the global economic problems and the still-visible remnants of the earlier financial turmoil in the United States. At the same time, no evidence of any upturn in inflation has, as yet, surfaced.

Abroad, the situation is mixed. In some East Asian countries that, in recent years, experienced a loss of investor confidence, a severe currency depreciation, and a deep recession, early signs of stabilization and economic recovery have appeared. This is particularly the case for Korea and

Thailand. Authorities in those countries, in the context of IMF stabilization programs, early on established appropriate macroeconomic policies and undertook significant structural reforms to buttress the banking system and repair the finances of the corporate sector. As investor confidence has returned, exchange rates have risen and interest rates have fallen. With persistence and follow-through on reforms, the future of those economies has promise.

The situations in some other emerging market economies are not as encouraging. The Russian government's decision in mid-August to suspend payments on its domestic debt and devalue the ruble took markets by surprise. Investor flight exacerbated the collapse of prices in Russian financial markets and led to a sharp depreciation of the ruble. The earlier decline in output gathered momentum, and by late in the year inflation had moved up to a triple-digit annual rate. Russia's stabilization program with the IMF has been on hold since the financial crisis hit, and the economic outlook there remains troubling.

The Russian financial crisis immediately spilled over to some other countries, hitting Latin America especially hard. Countering downward pressure on the exchange values of the affected currencies, interest rates moved sharply higher, especially in Brazil. As a consequence of the high interest rates and growing economic uncertainty, Brazil's economic activity took a turn for the worse. Higher interest rates also had negative consequences for the fiscal outlook, as much of Brazil's substantial domestic debt effectively carries floating interest rates. With budget reform legislation encountering various setbacks, market confidence waned further and capital outflows from Brazil continued, drawing down foreign currency reserves. Ultimately, the decision was taken to allow the real to float, and it subsequently depreciated sharply.

Brazilian authorities must walk a very narrow, difficult path of restoring confidence and keeping inflation contained with monetary policy while dealing with serious fiscal imbalances. Although the situation in Brazil remains uncertain, there has been limited contagion to other countries thus far. Apparently, the slow onset of the crisis has enabled many parties with Brazilian exposures to hedge those positions or allow them to run off. With the net exposure smaller, and increasingly held by those who both recognized the heightened risk and were willing to bear it, some of the

elements that might have contributed to further contagion may have been significantly reduced.

The Economic Outlook

These recent domestic and international developments provide the backdrop for U.S. economic prospects. Our economy's performance should remain solid this year, though likely with a slower pace of economic expansion and a slightly higher rate of overall inflation than last year. The stocks of business equipment, housing, and household durable goods have been growing rapidly to quite high levels relative to business sales or household incomes during the past few years, and some slowing in the growth of spending on these items seems a reasonable prospect. Moreover, part of the rapid increase in spending, especially in the household sector, has resulted from the surge in wealth associated with a runup in equity prices that is unlikely to be repeated. And the purchasing power of income and wealth has been enhanced by declines in oil and other import prices, which also are unlikely to recur this year. Assuming that aggregate demand decelerates, underlying inflation pressures, as captured by core price measures, in all likelihood will not intensify significantly in the year ahead, though the Federal Reserve will need to monitor developments carefully. We perceive stable prices as optimum for economic growth. Both inflation and deflation raise volatility and risks that thwart maximum economic growth.

Most Governors and Reserve Bank Presidents foresee that economic growth this year will slow to a 2-1/2 to 3 percent rate. Such growth would keep the unemployment rate about unchanged. The central tendency of the Governors' and Presidents' predictions of CPI inflation is 2 to 2-1/2 percent. This level represents a pickup from last year, when energy prices were falling, but it is in the vicinity of core CPI inflation over the last couple of years.

This outlook involves several risks. The continuing downside risk posed by possible economic and financial instability around the world was highlighted earlier this year by the events in Brazil. Although financial contagion elsewhere has been limited to date, more significant knock-on effects in financial markets and in the economies of Brazil's important trading partners, including the United States, are still possible. Moreover, the economies of several of our key industrial trading partners have shown evidence of weakness, which if it deepens could further depress demands for

our exports.

Another downside risk is that growth in capital spending, especially among manufacturers, could weaken appreciably if pressures on domestic profit margins mount and capacity utilization drops further. And it remains to be seen whether corporate earnings will disappoint investors, even if the slowing of economic growth is only moderate. Investors appear to have incorporated into current equity price levels both robust profit expectations and low compensation for risk. As the economy slows to a more sustainable pace as expected, profit forecasts could be pared back, which together with a greater sense of vulnerability in business prospects could damp appetites for equities. A downward correction to stock prices, and an associated increase in the cost of equity capital, could compound a slowdown in the growth of capital spending. In addition, a stock market decline would tend to restrain consumption spending through its effect on household net worth.

But on the upside, our economy has proven surprisingly robust in recent years. More rapid increases in capital spending, productivity, real wages, and asset prices have combined to boost economic growth far more and far longer than many of us would have anticipated.

This "virtuous cycle" has been able to persist because the behavior of inflation also has been surprisingly favorable, remaining well contained at levels of utilization of labor that in the past would have produced accelerating prices. That it has not done so in recent years has been the result of a combination of special one-time factors holding down prices and more lasting changes in the processes determining inflation.

Among the temporary factors, the sizable declines in the prices of oil, other internationally traded commodities, and other imports contributed directly to holding down inflation last year, and also indirectly by reducing inflation expectations. But these prices are not likely to fall further, and they could begin to rise as some Asian economies revive and the effects of the net depreciation of the dollar since mid-summer are felt more strongly.

At the same time, however, recent experience does seem to suggest that the economy has become less inflation prone than in the past, so that the chances of an

inflationary breakout arguably are, at least for now, less than they would have been under similar conditions in earlier cycles.

Several years ago I suggested that worker insecurity might be an important reason for unusually damped inflation. From the early 1990s through 1996, survey results indicated that workers were becoming much more concerned about being laid off. Workers' underlying fear of technology-driven job obsolescence, and hence willingness to stress job security over wage increases, appeared to have suppressed labor cost pressures despite a reduced unemployment rate. More recently, that effect seems to have diminished in part. So while job loss fears probably contributed to wage and price suppression through 1996, it does not appear that a further heightening of worker insecurity about employment prospects can explain the more recent improved behavior of inflation.

Instead, a variety of evidence, anecdotal and otherwise, suggests that the source of recent restrained inflation may be emanating more from employers than from employees. In the current economic setting, businesses sense that they have lost pricing power and generally have been unwilling to raise wages any faster than they can support at current price levels. Firms have evidently concluded that if they try to increase their prices, their competitors will not follow, and they will lose market share and profits.

Given the loss of pricing power, it is not surprising that individual employers resist pay increases. But why has pricing power of late been so delimited. Monetary policy certainly has played a role in constraining the rise in the general level of prices and damping inflation expectations over the 1980s and 1990s. But our current discretionary monetary policy has difficulty anchoring the price level over time in the same way that the gold standard did in the last century.

Enhanced opportunities for productive capital investment to hold down costs also may have helped to damp inflation. Through the 1970s and 1980s, firms apparently found it easier and more profitable to seek relief from rising nominal labor costs through price increases than through cost-reducing capital investments. Price relief evidently has not been available in recent years. But relief from cost pressures has. The newer technologies have made capital

investment distinctly
more profitable, enabling firms to substitute capital for labor far more
productively than they would
have a decade or two ago.

Starting in 1993, capital investment, especially in high-tech equipment,
rose sharply beyond normal
cyclical experience, apparently the result of expected increases in rates
of return on the new
investment. Had the profit expectations not been realized, one would have
anticipated outlays to
fall back. Instead, their growth accelerated through the remainder of the
decade.

More direct evidence confirms improved underlying profitability.
According to rough estimates,
labor and capital productivity has risen significantly during the past
five years. It seems likely that
the synergies of advances in laser, fiber optic, satellite, and computer
technologies with older
technologies have enlarged the pool of opportunities to achieve a rate of
return above the cost of
capital. Moreover, the newer technologies have facilitated a dramatic
foreshortening of the lead
times on the delivery of capital equipment over the past decade,
presumably allowing businesses
to react more expeditiously to an actual or expected rise in nominal
compensation costs than, say,
they could have in the 1980s. In addition, the surge in investment not on
ly has restrained costs, it
has also increased industrial capacity faster than factory output has
risen. The resulting slack in
product markets has put greater competitive pressure on businesses to
hold down prices, despite
taut labor markets.

The role of technology in damping inflation is manifest not only in its
effects on U.S. productivity
and costs, but also through international trade, where technological
developments have
progressively broken down barriers to cross-border trade. The enhanced
competition in tradeable
goods has enabled excess capacity previously bottled up in one country to
augment worldwide
supply and exert restraint on prices in all countries' markets. The
resulting price discipline also has
constrained nominal wage gains in internationally tradeable goods
industries. As workers have
attempted to shift to other sectors, gains in nominal wages and increases
in prices in nontradeable
goods industries have been held down as well.

The process of price containment has potentially become, to some extent,
self-reinforcing. Lower

inflation in recent years has altered expectations. Workers no longer believe that escalating gains in nominal wages are needed to reap respectable increases in real wages, and their remaining sense of job insecurity is reinforcing this. Since neither firms nor their competitors can count any longer on a general inflationary tendency to validate decisions to raise their own prices, each company feels compelled to concentrate on efforts to hold down costs. The availability of new technology to each company and its rivals affords both the opportunity and the competitive necessity of taking steps to boost productivity.

It is difficult to judge whether these significant shifts in the market environment in which firms function is sufficient to account for our benign overall price behavior during the past half decade. Undoubtedly, other factors have been at work as well, including those temporary factors I mentioned earlier and some more lasting I have not discussed, such as worldwide deregulation and privatization, and the freeing up of resources previously employed to produce military products that was brought about by the end of the cold war. There also may be other contributory forces lurking unseen in the wings that will only become clear in time. Over the longer run, of course, the actions of the central bank determine the degree of overall liquidity and hence rate of inflation. It is up to us to validate the favorable inflation developments of recent years.

Although the pace of productivity increase has picked up in recent years, the extraordinary strength of demand has meant that the substitution of capital for labor has not prevented us from rapidly depleting the pool of available workers. This worker depletion constitutes a critical upside risk to the inflation outlook because it presumably cannot continue for very much longer without putting increasing pressure on labor markets and on costs.

The number of people willing to work can be usefully defined as the unemployed component of the labor force plus those not actively seeking work, and thus not counted in the labor force, but who nonetheless say they would like a job if they could get one. This pool of potential workers aged 16 to 64 currently numbers about 10 million, or just 5-3/4 percent of that group's population--the lowest such percentage on record, which begins in 1970, and 2-1/2 percentage points below its average over that period. The rapid increase in

aggregate demand has generated growth of employment in excess of growth in population, causing the number of potential workers to fall since the mid-1990s at a rate of a bit under 1 million annually. We cannot judge with precision how much further this level can decline without sparking ever greater upward pressures on wages and prices. But, should labor market conditions continue to tighten, there has to be some point at which the rise in nominal wages will start increasingly outpacing the gains in labor productivity, and prices inevitably will begin to accelerate.

Ranges for Money and Credit

At its February meeting, the Committee elected to ratify the provisional ranges for all three aggregates that it had established last July. Specifically, the Committee again has set growth rate ranges over the four quarters of 1999 of 1 to 5 percent for M2, 2 to 6 percent for M3, and 3 to 7 percent for domestic nonfinancial debt. As in previous years, the Committee interpreted the ranges for the broader monetary aggregates as benchmarks for what money growth would be under conditions of price stability and sustainable economic growth, assuming historically typical velocity behavior.

Last year, these monetary aggregates far overshot the upper bounds of their annual ranges. While nominal GDP growth did exceed the rate likely consistent with sustained price stability, the rapid growth of M2 and M3 also reflected outsized declines in their velocities, that is, the ratio of nominal GDP to money. M2 velocity dropped by about 3 percent, while M3 velocity plunged by 5-1/4 percent.

Part of these velocity declines reflected some reduction in the opportunity cost of holding money; interest rates on Treasury securities, which represent an alternative return on non-monetary assets, dropped more than did the average of interest rates on deposits and money market mutual funds in M2, drawing funds into the aggregate. Even so, much of last year's aberrant behavior of broad money velocity cannot readily be explained by conventional determinants. Although growth of the broad aggregates was strong earlier in the year, it accelerated in the fourth quarter after credit markets became turbulent. Perhaps robust money growth late in the year partly reflected a reaction to this turmoil by the public, who began scrambling for safer and more liquid financial

assets. Monetary expansion has moderated so far this year, evidently in lagged response to the calming of financial markets in the autumn. Layered on top of these influences, though, the public also may have been reapportioning their savings flows into money balances because the huge runup in stock prices in recent years has resulted in an uncomfortable portion of their net worth in equity.

For the coming year, the broad monetary aggregates could again run high relative to these ranges.

To be sure, the decline in the velocities of the broader aggregates this year should abate to some extent, as money demand behavior returns more to normal, and growth in nominal GDP should slow as well, as suggested by the Governors' and Presidents' central tendency. Both factors would restrain broad money expansion relative to last year. Still, the growth of M2 and M3 could well remain outside their price-stability ranges this year. Obviously, considerable uncertainty continues to surround the prospective behavior of monetary velocities and growth rates.

Domestic nonfinancial debt seems more likely than the monetary aggregates to grow within its range for this year. Indeed, domestic nonfinancial debt also could grow more slowly this year than last year's 6-1/4 percent pace, which was in the upper part of its 3 to 7 percent annual range.

With the federal budget surplus poised to widen further this year, federal debt should contract even more quickly than last year. And debt in each of the major nonfederal sectors in all likelihood will decelerate as well from last year's relatively elevated rates, along with the projected slowing of nominal GDP growth.

The FOMC's Disclosure Policy

The FOMC at recent meetings has discussed not only the stance of policy, but also when and how it communicates its views of the evolving economic situation to the public. The FOMC's objective is to release as much information about monetary policy decision making, and as promptly, as is consistent with maintaining an effective deliberative process and avoiding roiling markets unnecessarily. Since early 1994, each change in the target nominal federal funds rate has been announced immediately with a brief rationale for the action. The FOMC resolved at its December meeting to take advantage of an available, but unused policy, originally stated in early 1994, of

releasing, on an infrequent basis, a statement immediately after some FOMC meetings at which the stance of monetary policy has not been changed. The Federal Reserve will release such a statement when it wishes to communicate to the public a major shift in its views about the balance of risks or the likely direction of future policy. Such an announcement need not be made after every change in the tilt of the directive. Instead, this option would be reserved for situations in which the consensus of the Committee clearly had shifted significantly, though not by enough to change current policy, and in which the absence of an explanation risked misleading markets about the prospects for monetary policy.

Year 2000 Issues

Before closing, I'd like to address an issue that has been receiving increasing attention--the century date change. While no one can say that the rollover to the year 2000 will be trouble free, I am impressed by the efforts to date to address the problem in the banking and financial system. For our part, the Federal Reserve System has now completed remediation and testing of 101 of its 103 mission-critical applications, with the remaining two to be replaced by the end of March. We opened a test facility in June at which more than 6000 depository institutions to date have conducted tests of their Y2K compliant systems, and we are well along in our risk mitigation and contingency planning activities. As a precautionary measure, the Federal Reserve has acted to increase the currency in inventory by about one-third to approximately \$200 billion in late 1999 and has other contingency arrangements available if needed. While we do not expect currency demand to increase dramatically, the Federal Reserve believes it is important for the public to have confidence in the availability of cash in advance of the rollover. As a result of these kinds of activities, I can say with assurance that the Federal Reserve will be ready in both its operations and planning activities for the millennium rollover.

The banking industry is also working hard, and with evident success, to prepare for the event. By the end of the first quarter, every institution in the industry will have been subject to two rounds of on-site Y2K examinations. The Federal Reserve, like the other regulators, has found that only a small minority of institutions has fallen behind in their preparations, and those institutions have been targeted for additional follow-up and, as necessary, formal enforcement

actions. The overwhelming majority of the industry has made impressive progress in their remediation, testing, and contingency planning efforts.

Concluding Comment

Americans can justifiably feel proud of their recent economic achievements. Competitive markets, with open trade both domestically and internationally, have kept our production efficient and on the expanding frontier of technological innovation. The determination of Americans to improve their skills and knowledge has allowed workers to be even more productive, elevating their real earnings. Macroeconomic policies have provided a favorable setting for the public to take greatest advantage of opportunities to improve its economic well being. The restrained fiscal policy of the Administration and the Congress has engendered the welcome advent of a unified budget surplus, freeing up funds for capital investment. A continuation of responsible fiscal and, we trust, monetary policies should afford Americans the opportunity to make considerable further economic progress over time.

ARMS Email SystemRECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Sharon H. Yuan (CN=Sharon H. Yuan/OU=OPD/O=EOP [OPD])

CREATION DATE/TIME:10-MAR-1999 17:55:12.00

SUBJECT: Emerging Markets Special Report: Currency Board Planned for Ecu

TO: David V. Noyce (CN=David V. Noyce/OU=OPD/O=EOP @ EOP [OPD])

READ:UNKNOWN

CC: Melissa G. Green (CN=Melissa G. Green/OU=OPD/O=EOP @ EOP [OPD])

READ:UNKNOWN

CC: Bruce McNamer (CN=Bruce McNamer/OU=OPD/O=EOP @ EOP [OPD])

READ:UNKNOWN

TEXT:

This should probably go in Gene's ABC book.

-SY

----- Forwarded by Sharon H. Yuan/OPD/EOP on 03/10/99

05:56 PM -----

Sharon H. Yuan

03/10/99 05:53:44 PM

Record Type: Record

To: Bruce McNamer/OPD/EOP

cc:

Subject: Emerging Markets Special Report: Currency Board Planned
for Ecu

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05:56 PM -----

Medley_Global_Advisors @ medleyadvisors.com

03/10/99 05:02:00 PM

Record Type: Record

To: Lael Brainard

cc:

Subject: Emerging Markets Special Report: Currency Board Planned for Ecu

MEDLEY GLOBAL ADVISORS
EMERGING MARKETS SPECIAL REPORT

Currency Board Planned for Ecuador

March 10, 1999

The folks in Washington sorely need to win a game in the world series of financial crises, and they may finally have done so. Latin America is about to welcome a new currency board arrangement as Ecuador is set to give birth to a sister to the Argentine Convertibility Plan. Midwife to the plan will be the IMF, which helped lift President Mahuad over the fiscal hurdle that stood between a banking and currency crisis that was spiraling out of control and the foreign financing needed to back the sucre. We have learned that announcements are planned for tomorrow night covering the launch of a currency board, new tax measures to be implemented by presidential decree, and the imposition of foreign exchange controls (but no freeze on deposits). The re-opening of banks may be delayed until Monday so the new measures can be digested. In lieu of gifts, please buy bonds in the baby's name.

A MAN, A PLAN, A BOARD, ECUADOR

As Ecuador closed its banks this week to forestall runs and the nation girded itself for yet another general strike, the economic team huddled with the US Treasury and the IMF to seek a way out. At the depressed level of the sucre, it was clear that a currency board is a relatively cheap alternative for Ecuador -- the Central Bank only lacks about \$400 million of what is needed to back the plan. The US Treasury and the Andean Development Corporation (CAF) stood ready to help, but the IMF would only come on board if the fiscal gap could be closed. Repeated attempts to pass new tax legislation have failed in Congress, and the Fund was not going to risk another Russia or Brazil. Mahuad has been trying to bring the opposition on board for tax reforms. Now an ultimatum has been sent: sign on to the program that will be announced tomorrow night, or Congress will be dissolved. Shortly thereafter Mahuad called Jose Gallardo, head of the Air Force, and nominal head of all the armed forces, asking for his support in a call for emergency powers. This support was apparently quickly and unconditionally given, and a state of national emergency was declared last night.

The plan is taking shape as follows:

Announce an accord on the key elements of an IMF Letter of Intent and the launch of a currency board backed by existing reserves, US Treasury, CAF, and IMF support (totaling up to \$800 million from the three).
Announce new tax measures to be implemented by presidential decree. The constitution stands mute on the issue of whether this is permissible under a state of national emergency. The President is trying to stay inside the constitution at this point, but he is prepared to do what is necessary to push through the economic program.
Foreign exchange controls will be imposed for an indeterminate period. The authorities are considering up to six months to be a reasonable time to allow relaxation. There will be no freeze on deposits, but some

limited restrictions may be applied.

Reopening of the banks may be delayed until Monday. No attempt will be made to save Banco Progreso, which sparked last week's run on deposits. If need be, Congress will be dissolved so that tax measures can be implemented. Also, if necessary the state of emergency can be extended beyond the initial 60 days.

A quick and relatively cheaply bought success in Ecuador is something IMF chief Camdessus would dearly love to achieve after the protracted crisis in Brazil. This development will allow Camdessus to go to the IADB meetings claiming to have saved not just one, but two countries.

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ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:

RFC-822-headers:

Received: from conversion.pmdf.eop.gov by PMDF.EOP.GOV (PMDF V5.1-9 #29131)
id <01J8O83YWO4G001UD7@PMDF.EOP.GOV> for brainard_l@a1.eop.gov; Wed,
10 Mar 1999 17:03:59 EST

Received: from storm.eop.gov by PMDF.EOP.GOV (PMDF V5.1-9 #29131)
with ESMTP id <01J8O83VW5VK004GQ6@PMDF.EOP.GOV> for brainard_l@a1.eop.gov;
Wed, 10 Mar 1999 17:03:55 -0500 (EST)

Received: from mig1.medleyadvisors.com ([206.41.15.104])
by EOP.GOV (PMDF V5.2-29 #34437) with SMTP id <01J8O83MJBMC0003FO@EOP.GOV> for

brainard_l@a1.eop.gov; Wed, 10 Mar 1999 17:03:41 -0500 (EST)

Received: by mig1.medleyadvisors.com(Lotus SMTP MTA SMTP v4.6 (462.2 9-3-1997))

id 85256730.00791853 ; Wed, 10 Mar 1999 17:02:40 -0500

X-Lotus-FromDomain: MEDLEY

===== END ATTACHMENT 1 =====

ARMS Email SystemRECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Bruce McNamer (CN=Bruce McNamer/OU=OPD/O=EOP [OPD])

CREATION DATE/TIME:15-MAR-1999 18:43:50.00

SUBJECT: Brazil today

TO: Lael Brainard (CN=Lael Brainard/OU=OPD/O=EOP @ EOP [OPD])

READ:UNKNOWN

TO: Melissa G. Green (CN=Melissa G. Green/OU=OPD/O=EOP @ EOP [OPD])

READ:UNKNOWN

CC: Sharon H. Yuan (CN=Sharon H. Yuan/OU=OPD/O=EOP @ EOP [OPD])

READ:UNKNOWN

TEXT:

All good news:

Market up 9%

Currency strengthened to 1.86

European and Japanese banks signed on to plan to keep credit lines open

Story below:

Bonanza day for Bovespa

Optimism over economy catapults
Brazilian stocks higher by 8.8 percent

March 15, 1999: 5:06 p.m. ET

NEW YORK (CNNfn) - The biggest news from the financial markets in Latin America Monday came from the region's biggest economy, Brazil, where stocks soared nearly 9 percent to their highest level in seven months.

The equities and currency markets were cheered by international investors' positive response to a tour by senior economic officials of international financial centers aimed at shoring up investor confidence in Brazil.

Shares on the Bovespa index leapt 839 points, or 8.77 percent, to close at 10,414.

Expectations that credit could be eased to Brazil, combined with optimism that the country will meet new fiscal targets set with the International Monetary Fund, helped push the Bovespa above the 10,000-point psychological barrier. The index has not closed above 10,000 since last August.

"It seems Brazil's road show was well-received. We could see some financing and maybe debt issues," a

seem

trader at a local brokerage said. "In general, things

to be looking better for the economy."

European, U.S. and Japanese banks agreed to maintain credit exposure to Brazil until the end of August after the Latin American giant hammered out new targets with the IMF to ensure a steady flow of rescue loans.

The surge was led by a 150.3 percent jump in the common shares of Light Participacoes (Lightpar), which rose amid expectations that the power company will administer the transmission lines of the state-controlled energy company Eletrobras.

"People are counting up and projecting what the company's cash flow could be," said Roberto Dumas, an analyst at Banco BBA/Paribas in Sao Paulo.

Also cheering the markets were a string of positive economic reports.

Earlier Monday, the Finance Ministry said it will cut the Financial Transactions Tax (IOF) to 0.5 percent from 2 percent on international capital entering the country for investment in fixed-income funds and on foreign exchange deals by local banks.

The new lower rate is effective March 17 and remains in place until June 30, said the official, a spokeswoman for the Federal Tax Secretariat, part of the Finance Ministry.

"The measure will make it easier for foreign cash to enter the country," she added.

The news also boosted the country's currency, the real, which closed firmer by 2.7 percent to 1.86 against the dollar.

Also on Monday, the central bank released the country's nominal public sector deficit for 1998. The closely watched indicator widened to 8.02 percent of gross domestic product (GDP) in 1998, but the figure was within a ceiling of 72.879 billion reais agreed with the International Monetary Fund last year.

The nominal deficit "is large, but not unexpectedly large," said Constantin Jancso, economist at MCM consultants in Sao Paulo.

Brazil's surge proved a supporting factor but not necessarily a dominant one in trading on other bolsas.

Mexican stocks made solid gains bolstered by a strong local currency and advances on the Dow and in Brazil, dealers said.

The leading IPC share index closed up 48.65 points, or 1.04 percent, at 4,746.38.

"Simply put, the economic fundamentals (of Mexico) continue strong. A lot of foreign investment money has been coming in," one dealer said.

The Mexican peso closed at its strongest level against the dollar in almost seven months as investors continued to flood Mexico, driving up demand for the

local currency, dealers said.

The benchmark 48-hour peso gained 2.8 centavos to close at 9.678 per dollar. The 24-hour peso firmed 2.7 centavos to finish at 9.673 per dollar.

A strong peso helps stocks because it boosts Mexico's economic image abroad and attracts international investors.

In Venezuela, however, stocks were yielding some of the ground gained last week over optimism about further OPEC oil production cuts.

The IBC index closed down 61.30 points, or 1.52 percent, at 3,961.74.

Elsewhere in the region, shares in Argentina jumped 2.31 percent to 417.400; Chilean stocks inched up 0.10 percent to 3,980.54; and Colombian shares moved higher by 0.24 percent to close at 919.14.

Peruvian stocks bucked the upward trend, however, slipping 0.53 percent to close at 1,454.95. Bonanza day

for Bovespa

ARMS Email SystemRECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Sharon H. Yuan (CN=Sharon H. Yuan/OU=OPD/O=EOP [OPD])

CREATION DATE/TIME:15-MAR-1999 10:11:45.00

SUBJECT: LRM AER74 - - TREASURY Testimony on FY 2000 Budget Request for Treasury's International Programs

TO: Bruce McNamer (CN=Bruce McNamer/OU=OPD/O=EOP @ EOP [OPD])

READ:UNKNOWN

TEXT:

----- Forwarded by Sharon H. Yuan/OPD/EOP on 03/15/99

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Annette E. Rooney
03/15/99 10:08:58 AM

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LRM ID: AER74

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
Washington, D.C. 20503-0001

Monday, March 15, 1999

LEGISLATIVE REFERRAL MEMORANDUM

TO: Legislative Liaison Officer - See Distribution below

FROM: John D. Burnim (for) Assistant Director for Legislative Reference

OMB CONTACT: Annette E. Rooney

PHONE: (202)395-7300 FAX: (202)395-5691

SUBJECT: TREASURY Testimony on FY 2000 Budget Request for Treasury's International Programs

DEADLINE: 3:30 PM Monday, March 15, 1999

In accordance with OMB Circular A-19, OMB requests the views of your agency on the above subject before advising on its relationship to the program of the President. Please advise us if this item will affect direct spending or receipts for purposes of the "Pay-As-You-Go" provisions of Title XIII of the Omnibus Budget Reconciliation Act of 1990.

COMMENTS: If you do not respond by the deadline, we will presume that your agency/office has no comment.

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Patricia A. Battenfield
Joseph F. Bouchard
Alphonse J. Maldon

LRM ID: AER74 SUBJECT: TREASURY Testimony on FY 2000 Budget Request for Treasury's International Programs

RESPONSE TO
LEGISLATIVE REFERRAL
MEMORANDUM

If your response to this request for views is short (e.g., concur/no comment), we prefer that you respond by e-mail or by faxing us this response sheet. If the response is short and you prefer to call, please call the branch-wide line shown below (NOT the analyst's line) to leave a message with a legislative assistant.

You may also respond by:

(1) calling the analyst/attorney's direct line (you will be connected to voice mail if the analyst does not answer); or

(2) sending us a memo or letter

Please include the LRM number shown above, and the subject shown below.

TO: Annette E. Rooney Phone: 395-7300 Fax: 395-5691
Office of Management and Budget
Branch-Wide Line (to reach legislative assistant): 395-6194

FROM: _____ (Date)

_____ (Name)

_____ (Agency)

_____ (Telephone)

The following is the response of our agency to your request for views on the above-captioned subject:

_____ Concur

_____ No Objection

_____ No Comment

_____ See proposed edits on pages _____

_____ Other: _____

_____ FAX RETURN of _____ pages, attached to this response sheet

Draft 310 11:15 am; 13 minutes <includes new sentence on NAD Bank>
Statement before the House Foreign Operations Committee
Secretary Robert Rubin
March 17, 1999

Mr. Chairman, I appreciate the opportunity to testify today about the Administration's FY 2000 budget request for Treasury's international programs. Last year, the leadership of this Committee was critical in approving the increase in our quota to the International Monetary Fund and our participation in the NAB. This year, continued support of Treasury's international programs, which have played such a critical role in the effort to resolve the recent financial crisis, and, in the overall effort to foster a healthy global economy, will promote the economic well-being of American workers, farmers and businesses.

Our FY2000 request for these programs totals \$1.523 billion, an increase of less than one percent from FY1999. Our investment in these programs supports the international financial institutions — the World Bank, the International Monetary Fund and the regional development banks — which play a vital role in three key areas of international economic policy: First, helping to restore financial stability and sustainable growth in financial crisis; second, promoting long term sustainable growth in developing countries; and third, working with developing countries committed to economic reform to reduce unsustainable levels of debt.

First, Mr. Chairman, the IFIs have played a crucial role in the effort to restore financial stability and growth during the recent financial crisis. The International Monetary Fund, in close collaboration with the World Bank and the regional development banks, has developed new programs to bolster needed structural and policy reforms in the countries experiencing crisis, and to help countries manage their responses in ways which help to protect the most vulnerable. Emergency lending instruments have been used in many cases to provide quick disbursing assistance which addresses key structural issues that are at the core of the economic crisis.

These institutions have faced enormously difficult and complex issues and I believe that, on balance, they have made sensible judgments in confronting these complexities, adjusting their judgments as appropriate. In those countries that have taken ownership of reform, for example, Korea and Thailand, there has been considerable progress toward a return to stability. For example, Korea, which had \$4 billion in reserves when the crisis came to a head in December of 1997, now has \$50 billion <ck>. Interest rates, which were 25 percent in <ck>, now are at 6 percent <ck>.

But despite these signs of progress, much remains to be done. The problems that gave rise to the crisis took a long time to develop, and they will take a long time to work through. Emerging market economies from Asia to Europe to Latin America have been severely affected and their governments face tremendous challenges in pursuing reform programs to promote growth and financial stability. Industrialized nations have felt the impact, too; the IMF forecasts reduced growth for Europe and flat or negative growth in Japan.

Here at home, although the essential strength of the U.S. economy remains unchanged and the most likely scenario in the U.S. economy remains solid growth and low inflation -- subject to the usual ups and downs -- certain segments that have felt the impact -- most notably, steel, because of increased imports, and agriculture, because of decreased exports. We cannot stand by and risk further impacts on our economy. That is why we have been enormously focused on the effort to restore stability and growth to troubled parts of the world.

Mr. Chairman, the IFIs have been one the front line in combating this crisis and have characteristics that time and again have proved their value.

First, they internationalize the burden when responding to a crisis, and, thus, the United States does not have to bear that burden alone. In 1998, \$1.4 billion in U.S. appropriations leveraged \$57.1 billion in MDB lending.

Second, they are providing more value for this country than ever. Our FY 2000 request is about 5.5 percent below last year's appropriation, even though it includes \$168 million to reduce our arrears. Ongoing U.S. financial commitments to MDBs have, in fact, been negotiated down by more than one-third since the mid-1990s without a reduction in our influence. In fact, the United States has been a leader in shaping policies in the MDBs and most of our key developmental objectives are now broadly shared by other members.

Third, because they are multilateral, these institutions have the leverage to induce a country to accept conditions that no assisting nation could impose on its own.

Fourth, each institution has unique expertise to shape effective reform programs.

We recognize, of course, that every institution needs to adapt as circumstances warrant and constantly strive to improve its performance.

The United States, in concert with the international community, has worked forcefully with these institutions to reform their operations, reduce overhead, become more open, do more to prevent corruption, promote the private sector, and become more sensitive to environmental concerns, core labor standards and human rights. Under the leadership of Jim Wolfensohn, the World Bank has taken significant steps to improve operations <ck>. The United States and the international community are also looking very closely at the role of these institutions in the future international architecture.

Mr. Chairman, let me turn now to the second area in which the IFIs play a vitally important role: the long term effort to promote sustainable growth in the developing world.

The IFIs have been instrumental in helping countries throughout the developing world embrace market-based economic systems and become more fully integrated into the global economy, a process that has intensified over the last twenty or thirty years. As a result, even taking into account the adverse impacts of the recent crisis, the last few decades have witnessed substantial improvements in living standards in most of the developing world. Infant mortality rates fell by nearly 50 percent from the early 1970s to the mid 1990s and life expectancy has risen by four months on average each year since 1970. Adult literacy has risen from 46 to 70 percent. It has also turned these nations into new markets for U.S. goods and services. In 1997, before the recent crisis, the developing world absorbed 40 percent of U.S. exports. The IFIs have been instrumental in this process.

For example, the International Development Association has been highly effective in promoting market-oriented economic reforms and investment in people in the poorest countries. IDA is the world's largest lender of concessional resources for projects in areas such as health, primary education, nutrition, safe drinking water, and proper sanitation. For every dollar the U.S. contributes IDA lends about 8.5 dollars for programs that promote higher standards of living and foster stability.

Even so, the vast economic and human potential of the developing world has barely been tapped. Just last summer, for example, I visited Africa, a continent with enormous potential and enormous challenges and still largely left behind in the global economy. Clearly, in Africa, and elsewhere, the need for -- and the importance of -- the IFIs helping to bring developing nations into the economic mainstream has not abated.

However, Mr. Chairman, bringing these countries into the economic mainstream often requires us to review the debt burden that they have accumulated over the years. Our policy tries to strike a balance with respect to debt reduction, with a focus on those countries committed to market-based economic reforms as an incentive to continue pursuing those reforms. Debt reduction has no lasting benefit if not accompanied by meaningful economic reform. The country itself must act to address the underlying causes of poverty and under-development or the funds freed-up by debt forgiveness will be wasted. Our approach is designed to support substantial reductions in debt service payments and total debt burdens to levels consistent with what these countries can reasonably be expected to

afford. Reducing debt burdens beyond that point would, in our view, be counterproductive because it could reduce the future willingness of private creditors to lend to and invest in these countries. We believe this approach helps create a culture of credit for a nation, and fosters confidence among private sector investors in that country. Such private capital is key to the long-term growth potential of these countries.

In line with this policy, our budget request includes \$120 million for debt programs and includes \$50 million for the Initiative for Heavily Indebted Poor Countries, which was launched by the World Bank and the IMF in September 1996, to reduce debts to sustainable levels for those poor countries prepared to pursue economic and social policy reforms; \$20 million for the traditional Paris Club mechanism to reduce debt, and \$50 million to finance Debt Relief for tropical rainforest countries, as called for under the Tropical Forest Conservation Act of 1998.

Before concluding, let me note that, with the leadership of this Committee, we have made great progress in clearing our arrears to the Multilateral Development Banks. If the FY2000 request is fully funded, our arrears will be reduced to \$141.9 million. Delays in paying U.S. commitments on internationally negotiated agreements come at a high price in terms of our influence and effectiveness with the institutions and their members. We want to continue working closely with the Congress to fully meet U.S. financial commitments.

I would also like to bring to your attention an item that is not before this Subcommittee this year but has been of great interest in previous years. We have worked hard to make the domestic window of the North American Development Bank fully productive. It is fulfilling its mission, and I urge you to speak to your colleagues in support of this year's request, which is before the Treasury/Postal Subcommittee.

Mr. Chairman, Ms. Pelosi, let me conclude by reiterating that our involvement in these critical institutions -- as well as in the United Nations, I would like to note -- promotes America's economic and national security interests. I very much appreciate the hard work of this Committee in furthering effective U.S. leadership in the IFIs and we look forward to working with you in the future.

Message Copied

To:

Ronald L. Silberman/OMB/EOP
Michael Casella/OMB/EOP
Theresa M. Stoll/OMB/EOP
Richard M. Samans/OPD/EOP
Charles E. Kieffer/OMB/EOP
Martha Foley/WHO/EOP
Sharon H. Yuan/OPD/EOP
Miles M. Lackey/NSC/EOP
Patricia A. Battenfield/NSC/EOP
Joseph F. Bouchard/NSC/EOP
Alphonse J. Maldon/WHO/EOP
John D. Burnim/OMB/EOP

ARMS Email SystemRECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Richard L. Siewert (CN=Richard L. Siewert/OU=WHO/O=EOP [WHO])

CREATION DATE/TIME:17-MAR-1999 18:35:22.00

SUBJECT: Debt Relief

TO: Sharon H. Yuan (CN=Sharon H. Yuan/OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

TO: Lael Brainard (CN=Lael Brainard/OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

TO: Jonathan A. Kaplan (CN=Jonathan A. Kaplan/OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

TO: Melissa G. Green (CN=Melissa G. Green/OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

TEXT:
Clinton's Debt Plan Is Opposed

By MARTIN CRUTSINGER AP Economics Writer

WASHINGTON (AP) -- President Clinton's proposal
to offer
greater debt relief to the world's poorest
countries met with
bipartisan criticism Wednesday in Congress.
Republicans charged
the plan could threaten needed economic reforms
while
Democrats complained it did not provide enough
help to the
world's poor.

Treasury Secretary Robert Rubin faced that
opposition when he
appeared before a key House Appropriations
subcommittee to
sell Clinton's plan to expand current debt
relief efforts by the
International Monetary Fund and the World Bank.

"We have a lot of concerns," Rep. Sonny
Callahan, R-Ala. and
chairman of the House Appropriations
subcommittee on foreign
operations, told Rubin. "We ask for no
accountability for the
money they borrowed. Some of that money just
disappeared.

Now we say we have to forgive all this debt."

Clinton, who unveiled Monday in a speech to a conference of top

African officials, wants to expand a current program to forgive about \$30 billion in debt, so that \$100 billion in debt relief would be covered.

Now, about 41 nations, mostly in Africa and Latin America, are eligible for the Highly Indebted Poor Countries program. That

number would grow to 50 countries under Clinton's initiative.

The president would finance part of the debt relief by allowing the sale of a portion of the gold reserves held by the IMF.

Rubin told the committee the administration's plan would require that nations follow stringent economic reforms; debt would not be erased until a nation had established a six-year track record of performance.

Also Wednesday, the secretary, in a State Department meeting with senior African ministers, said their countries could expect more private investment if they opened up their economies, maintain political stability and fight corruption.

Tanzania's finance minister, Jakaya Kikwete, was glad the United States was aware of the debt predicament many African countries face. Many nations must use scarce currency reserves to service their debts and therefore lack funds for basic health and school care programs.

"We hope the United States will use its influence with the IMF and the World Bank to move faster on relieving debts."

On Capitol Hill, some Democrats questioned the president's approach, given that the IMF and World Bank program, launched in September 1996, had so far provided significant benefits to only two nations -- Uganda and Bolivia.

Rep. Jesse Jackson, D-Ill., told Rubin he was concerned that so little debt relief was being offered. He said that Mozambique, one of the nations making an effort to qualify for help, would see its annual debt service payments reduced by only about 10 percent even after all its economic reforms.

Rep. Nancy Pelosi, D-Calif., said she believed the United States needed to ``develop a more comprehensive strategy on debt relief to address this crushing burden."

Separately, Democratic Sen. Richard Bryan of Nevada raised strong objections to the part of Clinton's proposal that would involve sales of IMF gold reserves. He said this could have a serious economic impact on Nevada, the largest U.S. producer of gold.

``The gold mining industry is too important to Nevada's economy to be so easily sacrificed by this ill-conceived proposal," Bryan said in a statement.

Rubin told reporters that under the administration's proposal, about 5 percent of the IMF's gold reserves of 103 million ounces would be sold over a period of time designed to ``minimize market intervention."

Any IMF gold sales would have to win approval from Congress and also from other wealthy nations who are major shareholders in the organization. Both France and Germany have indicated

such sales. they are reconsidering their past opposition to

given the frosty The outlook for Clinton's proposal was unclear
initial reception by Callahan's subcommittee.
But Rubin stressed
rafted and the to reporters that a formal bill had not been d
of Congress to administration was willing to work with members
come up with an acceptable plan.

James Leach, The House Banking Committee chairman, Rep.
relief proposal R-Iowa, has introduced an even broader debt
and which has received support from both Democrats
Republicans on his committee.

expected to be a key The issue of debt relief for poor nations is
the world's seven agenda item at this year's economic summit of
richest countries to be held in Germany in June.

ARMS Email SystemRECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Lael Brainard (CN=Lael Brainard/OU=OPD/O=EOP [OPD])

CREATION DATE/TIME:18-MAR-1999 17:37:50.00

SUBJECT: Debt Relief

TO: Richard M. Samans (CN=Richard M. Samans/OU=OPD/O=EOP @ EOP [OPD])

READ:UNKNOWN

TEXT:

----- Forwarded by Lael Brainard/OPD/EOP on 03/18/99 -
05:38 PM -----

Richard L. Siewert
03/17/99 06:34:20 PM
Record Type: Record

To: Melissa G. Green/OPD/EOP, Lael Brainard/OPD/EOP, Jonathan A.
Kaplan/OPD/EOP, Sharon H. Yuan/OPD/EOP
cc:
Subject: Debt Relief

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The outlook for Clinton's proposal was unclear given the frosty initial reception by Callahan's subcommittee. But Rubin stressed to reporters that a formal bill had not been drafted and the administration was willing to work with members of Congress to come up with an acceptable plan.

The House Banking Committee chairman, Rep. James Leach, R-Iowa, has introduced an even broader debt relief proposal which has received support from both Democrats and Republicans on his committee.

The issue of debt relief for poor nations is expected to be a key agenda item at this year's economic summit of the world's seven richest countries to be held in Germany in June.

ARMS Email SystemRECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Lael Brainard (CN=Lael Brainard/OU=OPD/O=EOP [OPD])

CREATION DATE/TIME:24-MAR-1999 16:32:26.00

SUBJECT: Finance Conference Calls

TO: Sonal R. Shah (CN=Sonal R. Shah/OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

TO: Bruce McNamer (CN=Bruce McNamer/OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

TO: RWESCOTT (RWESCOTT @ IMF.ORG@INET@LNGTWY [OPD])
READ:UNKNOWN

CC: Sharon H. Yuan (CN=Sharon H. Yuan/OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

TEXT:

I made a few calls on whether we should resuscitate the finance conference calls. There is a general sense these are useful, even when Treasury does not have an immediate crisis before it. Let's try to schedule Tues/Thurs at some set time as before so people can set it aside.

Can you make some calls as to which countries should be discussed when. There was some feeling a discussion about Russia is long overdue, especially to get an update on IMF talks. Might also make sense to do a Latin America call, eg Brazil, Ecuador etc. Also might make sense to do a China call. Indonesia??

Ideally, we should make calls to country experts ahead of time to get agreement that the call makes sense & develop an agenda that is circulated, so it is not simply a report by Treasury, but others have done their homework as well (eg political analysis of feasibility of certain economic reforms).

If any of these countries have a "what should we do" quality to them -- especially if it involves coordinated effort from other agencies such as State -- then we should do a meeting rather than a phone call. You might also pose this question when you are calling around.

General list of deputies is:

Ted Truman or Tim Geithner
Jim Steinberg
Leon Fuerth
Stu Eizenstat

Optional:
Richard Fisher
David Aaron

We generally try to include State regional A/S for country or region-specific call. Also occasionally NSC Sr. Director & Treasury DAS.

ARMS Email SystemRECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Sharon H. Yuan (CN=Sharon H. Yuan/OU=OPD/O=EOP [OPD])

CREATION DATE/TIME:25-MAR-1999 11:00:01.00

SUBJECT: Re: Finance Conference Calls

TO: Lael Brainard (CN=Lael Brainard/OU=OPD/O=EOP @ EOP [OPD])

READ:UNKNOWN

CC: Sonal R. Shah (CN=Sonal R. Shah/OU=OPD/O=EOP @ EOP [OPD])

READ:UNKNOWN

CC: Bruce McNamer (CN=Bruce McNamer/OU=OPD/O=EOP @ EOP [OPD])

READ:UNKNOWN

CC: Robert F. Wescott (CN=Robert F. Wescott/OU=OPD/O=EOP @ EOP [OPD])

READ:UNKNOWN

TEXT:

We are tentatively looking at Mondays and Thursdays at 5:30 pm for the conference calls. With Passover and Easter weekend coming up, we are shooting to have our first call on Monday, April 5. It would be great if we could have an agenda by mid-morning so that I can send it out to the deputies and well as invite other folks necessary for that call.

The general list of deputies are:

Robert Lawrence
David Aaron
Stu Eizenstat
Jim Steinberg
Leon Fuerth
Tim Geithner and/or Ted Truman
Richard Fisher

Thanks.
Sharon

Lael Brainard
03/24/99 04:31:15 PM
Record Type: Record

To: RWESCOTT @ IMF.ORG@INET@LNGTWY, Sonal R. Shah/OPD/EOP, Bruce McNamer/OPD/EOP
cc: Sharon H. Yuan/OPD/EOP
Subject: Finance Conference Calls

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ARMS Email SystemRECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Richard L. Siewert (CN=Richard L. Siewert/OU=WHO/O=EOP [WHO])

CREATION DATE/TIME:26-MAR-1999 17:21:08.00

SUBJECT: Brazil Story

TO: Bruce McNamer (CN=Bruce McNamer/OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

TO: Melissa G. Green (CN=Melissa G. Green/OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

TO: Lael Brainard (CN=Lael Brainard/OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

TEXT:
In Brazil, Panic Turns to Euphoria

By PETER MUELLO Associated Press Writer

RIO DE JANEIRO, Brazil (AP) -- In just two months, economic panic has given way to euphoria in Brazil as a flurry of good news has people believing the worst is over.

Stock markets are surging, the currency is stronger, inflation is lessening and investors are slowly returning. The crisis may not be over, but there's a growing sense that Latin America's largest economy is recovering.

"I believe we've seen the worst in Brazil," James A. Harmon, president and chairman of the U.S. Export-Import Bank, told a group of international bankers in Miami Wednesday.

Merrill Lynch agrees. The U.S. investment bank picked Brazil as its favorite Latin American equity market for the second quarter.

It's a dramatic change from a month ago. Brazil's currency, the real, was in free fall, investors scurried to pull their money from

went on banks, and President Fernando Henrique Cardoso
national television to plead for calm.

an abrupt It was the low point of a crisis that began with
weeks, the currency devaluation of the real on Jan. 13. In three
powerless to plunged 46 percent, and the government seemed
stop it.

new-found Today, the government's challenge is to keep the
the battle for ebullience in check and convince Brazilians that
economic stability isn't over yet.

against the On Friday, Finance Minister Pedro Malan warned
predicted the premature optimism pervading markets and
turbulence will persist for months.

signs. Still, it's hard to resist so many positive

of February, was The real, worth only about 48 cents at the end
below the 82 cents the up to 56 cents on Friday. That's still well
improvement real cost at the end of 1998, but a significant
nonetheless.

stock markets are After losing \$1.82 billion last year, Brazilian
the Sao Paulo enjoying a new bull run. The Bovespa index of
15 percent in Stock Exchange, Latin America's largest, surged
the first week of March alone.

but threatened to Inflation, which was about 2 percent last year
initial predictions. roar back with the devaluation, is way below
ent in the past Consumer prices in Sao Paulo rose just 0.8 perc
four weeks, down from 1.4 percent in January.

agreement with The optimism grew when Brazil signed a new
the International Monetary Fund, which underpins

a \$41.5 billion
billion of that
rescue plan. The country hopes to receive \$8.6
money by early April.

Cardoso has shown his strength in Congress,
winning approval
for a controversial tax on bank transactions
that is expected to
generate \$8.5 billion, a year. The tax is a key
to Brazil's
commitment to reducing its budget deficit.

Arminio Fraga, president of Brazil's Central
Bank, said foreign
perception of Brazil has "improved a lot and
will continue
improving as we move ahead" with austerity
reforms.

Fraga himself has been part of the turnaround. A
former
associate of U.S. billionaire financier George
Soros, the
market-savvy Fraga was essential in persuading
foreign bankers
to maintain credit lines to Brazil.

Yet big hurdles remain. Wholesale prices are
rising and could
feed inflation. Unions also are demanding large
cost-of-living
raises, and labor unrest promises to heat up.

An expected surge in exports hasn't happened,
and the \$11
billion trade surplus Brazil promised the IMF
looks unlikely.

The government also seems to have no solution
for its huge
domestic debt, which soared with the real's
devaluation and
grows daily, with interest rates running as high
as 42 percent.

ARMS Email SystemRECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Sharon H. Yuan (CN=Sharon H. Yuan/OU=OPD/O=EOP [OPD])

CREATION DATE/TIME:15-APR-1999 08:58:20.00

SUBJECT:

TO: jorszag@doc.gov (jorszag@doc.gov [UNKNOWN])

READ:UNKNOWN

TEXT:

Jon- Here is the latest. At the very bottom are Rob Wescott's edits which I hadn't incorporated yet.

Hope this helps.

Sharon

World Economic Growth

Q. Europe's economies are slowing down, while the U.S. economy is steaming right along. Can the U.S. continue to pull the rest of the world economy along?

A. The U.S. economy is continuing to perform extremely well, and remains a bulwark of prosperity in a troubled world economy. Last year, the U.S. economy accounted for nearly half of the growth in the entire world economy. At the same time, nearly one-third of the world's economies are in recession, and growth in Europe has weakened. It is crucial that our partners in Europe and Japan do everything they can to get their economies going.

We will continue our efforts to help restore global growth. Our work is not done, but there are some signs of progress. Just this week, Korea announced that it was paying back much of its IMF loan, and Latin American markets have stabilized over the last few weeks.

We will continue our long-term effort to work with countries in Asia and Latin America to strengthen their financial sectors. I will continue that work in the time leading up to our discussions with the leaders of the other G-7 nations in Cologne in June.

Q: With the trade deficit on the rise and quota bills, are you concerned that protectionist pressure is building in the U.S. at a time when the world needs more economic stability not less?

A. Reflects our Prosperity. First of all, it is important to keep in mind that our trade deficit is primarily a reflection of America's unparalleled prosperity. Our economy continues generate wealth, new jobs

and rising wages for Americans at a time when much of the rest of the world is mired in recession. In short, Americans can afford to buy goods from around the world, while many of our trading partners are experiencing hard times and can't afford our products.

Important to Keep Focus on Growth. America's economy has benefited enormously from our efforts to open markets around the world for American goods and services. We are enjoying a remarkable period of low inflation and high growth, and until recently, a full third of that growth rested directly on increased exports. Since the financial crisis slowed economies in Latin America, Asia, and around the world, I have been actively working to contain that crisis, and to spur renewed global growth. Working with our partners in the major economies and the emerging markets, we have made some important progress.

Must Continue to Open Markets. I am committed to working with Congress to renew traditional negotiating authority so that we can continue to open markets around the world for American goods and services. And I have done my best to keep American markets open during this difficult period for the Asian and Latin American economy. Keeping an open trading system is essential for global prosperity, but we need to make sure that trade rules are honored.

Q. At a time of such economic uncertainty, aren't you concerned that the United States is risking a trade war with its biggest ally and trade partner over bananas and beef?

A. It is important to recognize that the United States and Europe both benefit from a multifaceted and extensive trading relationship. With so much trade flowing in both directions, it is inevitable that disagreements will arise.

The issue is not bananas -- in fact not any single product -- but the integrity of the global trading system. For our citizens to have confidence in the fairness of the trading system, we must insist that all countries play by the rules. The EU has lost this dispute not once but four times. What does it take to get them to comply?

And if we do not insist on compliance, what kind of a signal does this send to American exporters in other areas where the EU is not in compliance with international rules and standards?

As the world's largest economies, the U.S. and the EU have a strong interest in the world trading system and we need to work together to ensure its integrity.

ROB'S EDITS---

On the first question on World Economic Growth ("Europe's economies...")

we might want to insert a new third sentence:

"That is, America is doing what a world leader does." or something like that.

We could also add at the end of the first paragraph:

"Certainly the recent reduction in interest rates in Europe appears to be well received by the markets."

ARMS Email SystemRECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Richard L. Siewert (CN=Richard L. Siewert/OU=WHO/O=EOP [WHO])

CREATION DATE/TIME:21-APR-1999 11:24:41.00

SUBJECT: AP Story on Clinton and World Economy

TO: Robert F. Wescott (CN=Robert F. Wescott/OU=OPD/O=EOP@EOP [OPD])

READ:UNKNOWN

TO: Sharon H. Yuan (CN=Sharon H. Yuan/OU=OPD/O=EOP@EOP [OPD])

READ:UNKNOWN

TO: Lael Brainard (CN=Lael Brainard/OU=OPD/O=EOP@EOP [OPD])

READ:UNKNOWN

TO: Melissa G. Green (CN=Melissa G. Green/OU=OPD/O=EOP@EOP [OPD])

READ:UNKNOWN

TEXT:

Also, Rubin on CNBC now.

IMF: Global Economy Will Rebound

By MARTIN CRUTSINGER AP Economics Writer

WASHINGTON (AP) -- The International Monetary

Fund

says the worst may be over in the 20-month
global financial
crisis, but President Clinton is warning that
this is no time for
complacency. He is calling for international
cooperation to
overhaul the world's financial architecture.

Clinton urged more efforts to reduce the
vulnerability of nations
to sudden decisions by investors to withdraw
their money and
he said the international lending agencies need
to do a better job
of protecting the poor when a crisis does
strike.

"In a world of 24-hour markets, we will never be
able to banish
such crises altogether," Clinton told a
gathering of economic
officials at the White House on Tuesday. "But
acting on the
lessons we have learned from this experience, we

can find a way to harness the benefits of an open global economy while taming the global cycles of boom and bust."

The president discussed the broad principles that should govern efforts to overhaul the global financial architecture and said Treasury Secretary Robert Rubin would unveil more detailed proposals in a speech today.

The administration's efforts were being made in advance of the spring meetings of the 182-nation International Monetary Fund and its sister lending institution, the World Bank.

The United States hoped to receive approval for its new ideas at a meeting Monday of finance officials of the world's seven richest industrial countries -- the United States, Japan, Germany, France, Britain, Italy and Canada.

IMF Managing Director Michel Camdessus has said some of the ideas under discussion are ways to relieve crushing debt burdens being carried by the world's poorest countries. One idea is to sell some of the IMF's huge gold reserves and devote some of that money to debt forgiveness.

Clinton in his comments Tuesday repeated a proposal he made last month to get individual nations and international lenders to forgive \$70 billion in debt.

While the U.S. economy has escaped significant harm from the global crisis that has pushed one-third of the world into recession, Clinton is coming under increased criticism because of America's rising trade deficit.

The government reported Tuesday that for the second

new record,
declined for a
consecutive month the U.S. trade deficit set a
climbing to \$19.4 billion in February as exports
fourth consecutive month.

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American manufacturing has lost 380,000 jobs
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In its latest economic outlook, the IMF said the
should stabilize this year and enjoy a solid

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For 1999, the IMF's "World Economic Outlook"
growth of 2.3 percent with a rebound to 3.4
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But for that recovery to be realized, the IMF
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Congressional and labor union critics of
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"We oppose an agenda that is headed down a low
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Economists said the worse-than-expected February
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#AP-NY-04-

ARMS Email SystemRECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Richard L. Siewert (CN=Richard L. Siewert/OU=WHO/O=EOP [WHO])

CREATION DATE/TIME:21-APR-1999 12:09:06.00

SUBJECT: rubin story

TO: Robert F. Wescott (CN=Robert F. Wescott/OU=OPD/O=EOP@EOP [OPD])
READ:UNKNOWN

TO: Sharon H. Yuan (CN=Sharon H. Yuan/OU=OPD/O=EOP@EOP [OPD])
READ:UNKNOWN

TO: Melissa G. Green (CN=Melissa G. Green/OU=OPD/O=EOP@EOP [OPD])
READ:UNKNOWN

TO: Lael Brainard (CN=Lael Brainard/OU=OPD/O=EOP@EOP [OPD])
READ:UNKNOWN

TEXT:
Rubin Supports Economic Reform Plan

By MARTIN CRUTSINGER AP Economics Writer

WASHINGTON (AP) -- The United States and other major economies have put together a "powerful program of reform" to deal with the worst economic crisis in 50 years and help to prevent future Asian-style currency crises, Treasury Secretary Robert Rubin said today.

Delivering a major policy speech on the global economy, Rubin said the United States and its allies were focusing on an approach that will more actively involve the private sector in dealing with crises and help developing countries avoid some of the pitfalls that triggered the the recent turmoil.

Rubin said that in upcoming meetings of finance officials from the world's seven richest industrial countries and the spring meetings of the International Monetary Fund, the United States will be pushing reforms to help countries handle

the huge amounts of money that can flow around the world with the click of a few computer keys.

that leveled the economies of a number of Asian nations beginning in July 1997. The contagion from that turmoil spread to Russia in August 1998 and then struck Brazil in January.

speech to the School of Advanced International Studies at Johns Hopkins University. "But over time, the steps we have taken and those we propose constitute a very powerful program of reform. ... The result should be a more robust global economy -- one less susceptible to crises, one better equipped to deal with crisis and one with greater growth, more broadly shared."

Camdessus told reporters today he believes the global economy has "come a long way" in resolving the 20-month-old financial crisis since top finance officials had last gathered in Washington six months ago.

he received At that time, Camdessus said the main questions from reporters concerned the possibility that the global financial system could experience a "systemic meltdown" in the turbulent period after Russia defaulted on billions of dollars of debt, sending the U.S. stock market and other global markets into a steep nose dive.

Camdessus said, noting "Now the climate is distinctly better," that the IMF forecast expects the world to avoid a global recession and believes the one-third of the global economy that

is now in recession will return to positive growth later this year.

Speaking specifically about Latin America, which became the latest region to fall victim to the spreading financial contagion earlier this year, Camdessus said Brazil and other nations in recession see a "V-shape" pattern in which they will quickly emerge from the sharp downturns and resume solid growth.

Echoing comments President Clinton made Tuesday at the White House, Camdessus said, "The situation is better but there is no room for complacency."

He predicted a key element of administration strategy, a proposal to set up a new lending window at the IMF to ward off a currency crisis by providing pre-emptive lines of credit, would be discussed at next week's meetings of finance ministers and should win approval.

He also expressed optimism about another Clinton administration initiative, to provide up to \$70 billion in additional debt relief for the world's poorest countries. He noted a number of nations have advanced debt-relief proposals and he said there was "widespread support" among IMF members to deal with this issue.

Camdessus called Russia "the most difficult problem we must tackle," referring to that country's deepening economic problems.

But he said that in recent days IMF staff in Moscow have reported hopeful signs in negotiations with Russia over new IMF loans. He predicted an agreement could be reached "in the next few days" that would allow the agency to resume lending to

Russia.

On Tuesday, Clinton has told a gathering at the White House that "we will never be able to banish" financial crises altogether.

He added that, "Acting on the lessons we have learned from this experience, we can find a way to harness the benefits of an open global economy while taming the global cycles of boom and bust."

The United States hopes to receive approval for its new ideas at a meeting Monday of finance officials of the world's seven richest industrial countries -- the United States, Japan, Germany, France, Britain, Italy and Canada.

While the U.S. economy has escaped significant harm from the global crisis that has pushed one-third of the world into recession, Clinton is coming under increased criticism because of America's rising trade deficit, which hit a record \$19.4 billion in February.

ARMS Email SystemRECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Lael Brainard (CN=Lael Brainard/OU=OPD/O=EOP [OPD])

CREATION DATE/TIME:21-APR-1999 11:31:56.00

SUBJECT: Re: AP Story on Clinton and World Economy

TO: Richard L. Siewert (CN=Richard L. Siewert/OU=WHO/O=EOP @ EOP [WHO])
READ:UNKNOWN

TEXT:

This is good. Post was perfect. FT was pretty good, but buried.
Phillips headline was worse than actual article. Any others that I missed?

Richard L. Siewert
04/21/99 11:24:32 AM
Record Type: Record

To: Melissa G. Green/OPD/EOP, Sharon H. Yuan/OPD/EOP, Lael Brainard/OPD/EOP, Robert F. Wescott/OPD/EOP
cc:
Subject: AP Story on Clinton and World Economy

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Congressional and labor union critics of Clinton's free trade policies said the dramatic widening of the trade deficit in January and February pointed to a critical need for new policies to make sure U.S. jobs don't go overseas to low-wage nations.

"We oppose an agenda that is headed down a low road to nowhere," AFL-CIO President John Sweeney said in a speech Tuesday in Chicago.

Economists said the worse-than-expected February trade figures were likely to shave up to 2 full percentage points from the overall economic growth rate in the first three months of this year, but that would still leave the U.S. economy expanding at a healthy annual rate of around 4 percent.

#AP-NY-04-

ARMS Email SystemRECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Lael Brainard (CN=Lael Brainard/OU=OPD/O=EOP [OPD])

CREATION DATE/TIME:22-APR-1999 14:03:56.00

SUBJECT: Re: The grand dollar

TO: Richard L. Siewert (CN=Richard L. Siewert/OU=WHO/O=EOP @ EOP [WHO])
READ:UNKNOWN

TEXT:

On a minor point, surprising that story reports Stu led the Japan Subcabinet -- although of course he briefed last night. Actually, NEC was in the lead, but not as strong on the self-promotion front.

Richard L. Siewert
04/22/99 11:00:04 AM
Record Type: Record

To: Lael Brainard/OPD/EOP, Sharon H. Yuan/OPD/EOP, Robert F. Wescott/OPD/EOP
cc:
Subject: The grand dollar

'Dollarization' Seen As Risky

By MARTIN CRUTSINGER AP Economics Writer

WASHINGTON (AP) -- If several Latin American countries decide to adopt the U.S. dollar as their own currency, American exporters would stand to benefit although there would also be risks to the U.S. economy, Deputy Treasury Secretary Lawrence Summers told Congress today. Summers and Federal Reserve Chairman Alan Greenspan appeared before a Senate Banking subcommittee to discuss the economic impact of another nation dropping its own currency in favor of using the American dollar, a development known as

"dollarization."

approach and
Mexico, have
Argentina is actively considering taking this
several other Latin America countries, including
expressed interest in the idea recently.

own is a
to be
potential benefits and
costs," Summers told senators.
"To adopt another country's currency as one's
momentous decision for any country and will need
considered with a very careful eye to the

to block a
administration
engage in extensive
consultations with U.S. authorities.
While the United States does not have the power
nation from taking this course, Summers said the
hopes that any country considering it would

Argentina has
held preliminary talks with Treasury officials.
The government of President Carlos Menem of

adopting the
expect to benefit
would not have to
rates hurting
their sales prospects.
If Argentina or other countries go ahead with
dollar, Summers said the United States could
from greater trade links since U.S. exporters
be concerned about sudden changes in exchange

of U.S.
percent when close
neighbor Mexico is excluded.
Latin America currently accounts for 20 percent
exports although this figure drops to just 7

risks for the
country was
not be able to
by lowering
the United
But Summers said there also would be downside
United States, particularly if a Latin American
experiencing hard times. Since the country would
use its own monetary policy to stimulate growth
interest rates, there could be resentment toward

control of its States because the nation would have lost
economic destiny and pressure on the Federal
Reserve to take Latin American troubles into account when
setting U.S. interest rates.

have a fixed While Summers said the administration did not
dollar as its own, view on whether a country should adopt the
that such a Sen. Connie Mack, R-Fla., told him and Greenspan
countries in choice would offer great benefits for developing
experienced difficult Latin America, a region that has often
local economic times because of sharp devaluations of
currencies.

democracy Mack said the United States has helped to export
"export price to Latin America and now it has the chance to
stability."

number of proposals The idea of dollarization is just one of a
authorities around the being circulated currently as financial
Asian-style currency globe search for ways to prevent future
crises.

unveiled a On Wednesday, Treasury Secretary Robert Rubin
of the global number of proposals aimed at continuing reforms
ideas at financial system, hoping to win approval for the
world's seven meetings next week of finance ministers of the
that will be held in wealthiest industrial countries, discussions
182-nation advance of the annual spring meeting of the
International Monetary Fund.

important, a Rubin said while work on long-term issues was
to do everything critical need remained for Japanese authorities

possible to pull Japan out of its worst recession in 50 years. Rubin noted that the IMF in its new economic outlook had presented a stark forecast that the Japanese economy, the world's second largest, will shrink by another 1.4 percent this year after contracting 2.8 percent in 1998.

"It is imperatively important for its neighbors and really very important for the rest of the world that Japan get back on track," Rubin said.

To drive that point home, an administration team led by Undersecretary of State Stuart Eizenstat held daylong discussions with Japanese officials on Wednesday seeking breakthroughs in regulatory reform in Japan's financial markets and other areas that can be announced when Japanese Prime Minister Keizo Obuchi meets May 3 in Washington with President Clinton.

"We felt the discussions were very productive," a senior U.S. official said late Wednesday.

IMF Managing Director Michel Camdessus, briefing reporters Wednesday in advance of next week's meetings, said he believed the IMF was close to agreement on one key U.S. initiative. The administration wants the IMF to make available new preapproved lines of credit for countries pursuing sound policies to help them fend off financial turmoil.

ARMS Email SystemRECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Richard L. Siewert (CN=Richard L. Siewert/OU=WHO/O=EOP [WHO])

CREATION DATE/TIME:22-APR-1999 11:00:12.00

SUBJECT: The grand dollar

TO: Sharon H. Yuan (CN=Sharon H. Yuan/OU=OPD/O=EOP@EOP [OPD])
READ:UNKNOWN

TO: Robert F. Wescott (CN=Robert F. Wescott/OU=OPD/O=EOP@EOP [OPD])
READ:UNKNOWN

TO: Lael Brainard (CN=Lael Brainard/OU=OPD/O=EOP@EOP [OPD])
READ:UNKNOWN

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By MARTIN CRUTSINGER AP Economics Writer

WASHINGTON (AP) -- If several Latin American
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American exporters would stand to benefit
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would also be risks to the U.S. economy, Deputy
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Summers and Federal Reserve Chairman Alan
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appeared before a Senate Banking subcommittee to
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economic impact of another nation dropping its
own currency in
favor of using the American dollar, a
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Argentina is actively considering taking this
approach and
several other Latin America countries, including
Mexico, have
expressed interest in the idea recently.

"To adopt another country's currency as one's
own is a
momentous decision for any country and will need
to be
considered with a very careful eye to the

potential benefits and costs," Summers told senators.

While the United States does not have the power to block a nation from taking this course, Summers said the administration hopes that any country considering it would engage in extensive consultations with U.S. authorities.

The government of President Carlos Menem of Argentina has held preliminary talks with Treasury officials.

If Argentina or other countries go ahead with adopting the dollar, Summers said the United States could expect to benefit from greater trade links since U.S. exporters would not have to be concerned about sudden changes in exchange rates hurting their sales prospects.

Latin America currently accounts for 20 percent of U.S. exports although this figure drops to just 7 percent when close neighbor Mexico is excluded.

But Summers said there also would be downside risks for the United States, particularly if a Latin American country was experiencing hard times. Since the country would not be able to use its own monetary policy to stimulate growth by lowering interest rates, there could be resentment toward the United States because the nation would have lost control of its economic destiny and pressure on the Federal Reserve to take Latin American troubles into account when setting U.S. interest rates.

While Summers said the administration did not have a fixed view on whether a country should adopt the dollar as its own, Sen. Connie Mack, R-Fla., told him and Greenspan

that such a choice would offer great benefits for developing countries in Latin America, a region that has often experienced difficult economic times because of sharp devaluations of local currencies.

democracy Mack said the United States has helped to export to Latin America and now it has the chance to "export price stability."

number of proposals The idea of dollarization is just one of a being circulated currently as financial authorities around the globe search for ways to prevent future Asian-style currency crises.

unveiled a On Wednesday, Treasury Secretary Robert Rubin number of proposals aimed at continuing reforms of the global financial system, hoping to win approval for the ideas at meetings next week of finance ministers of the world's seven wealthiest industrial countries, discussions that will be held in advance of the annual spring meeting of the 182-nation International Monetary Fund.

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