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CREATION DATE/TIME: 7-MAR-2000 19:24:36.00

SUBJECT: dissent/report -Forwarded -Forwarded

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

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TEXT:

Date: 03/07/2000 07:11 pm (Tuesday)

From: Caroline Atkinson

To: wescott

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Date: 03/03/2000 02:02 pm (Friday)

From: Bill McFadden

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To: ATKINSONC, GELPERNA, KUHLOWM, KRULAKK, BERGA, RadeletS, MCDONALDL, CROWEB, MCGREWW, SETSERB, BAUKOLA, BEASLEYM, STEDMANL, JASKOWIAKM, RoubiniN, VAUGHANL, SchuerchW, EICHENBERGERJ, MUNKR, OBRIEND

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boundary="Boundary_(ID_G7XB5UBcD5+ZrlsvgNzBIQ)"

A copy of the latest version of the IFI Commission report is attached. If any one notices important differences between the attached and the earlier version you received, please put it out on the LAN for all of us.

Thanks.

Date: 03/03/2000 12:04 pm (Friday)

From: ex.mail."alreeves@iie.com"

Subject: dissent/report

To: ex.mail("bill.mcfadden"),Dom13.DOPO8(MCFADDENB)

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- 2-29melt.doc===== ATTACHMENT 1 =====

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#Preface

In the last

two decades, large crises in Latin America, Mexico, Asia, and Russia heightened interest in the structure and functioning of international financial institutions. Calls for additional capital for the International Monetary Fund to respond to these crises raise questions about how the Fund uses resources, whether its advice increases or reduces the severity of crises and its effect on living standards.

Growth in private lending and capital investment, and the expanding objectives of the international development banks, raise questions about the adequacy and effectiveness of these banks. Repeated commitments to reduce poverty in the poorest nations have not succeeded. A large gap remains between promise and achievement.

Disputes about the functioning of the World Trade Organization have increased as its role in service industries expanded. Concerns for the environment and the welfare state clash with concerns elsewhere to maintain open trading arrangements and avoid protection.

Frequent, large banking crises focus attention on financial fragility, inadequate banking regulation, and the role of the Bank for International Settlements and its affiliated institutions. Are financial standards inadequate? How should they be improved? What should be done to reduce the role of short-term capital in international finance?

In November 1998, as part of the legislation authorizing approximately \$18 billion of additional funding by the United States for the International Monetary Fund, Congress established the International Financial Institution Advisory Commission to consider the future roles of seven international financial institutions:

The International Monetary Fund,
the World Bank Group,
the Inter-American
Development Bank,
the Asian Development Bank,
the African Development Bank
,
the World Trade Organization, and
the Bank for International Settlements.

The Commission was given a six-months life. It held meetings on twelve days and public hearings on three additional days. All Commission meetings and hearings were open to the public. And, to make its work accessible to a broad public, the Commission established an interactive web site. All papers prepared for the Commission and unedited transcripts of all meetings and public hearings are available on the Commission's web site; <http://phantom-x.gsia.cmu.edu/IFIAC>. All documents will be published as a permanent record of the Commission's work. The Commission did not join the council of despair calling for the elimination of one or more of these institutions. Nor did it decide to merge institutions into a larger multi-purpose agency. A large majority agreed that the institutions should continue if properly reformed to eliminate overlap and conflict, increase transparency and accountability, return to or assume specific functions, and become more effective. These changes are most important for the International Monetary Fund and the multilateral development banks, so the report directs

most attention to those institutions.

Since it had a short life, the Commission relied heavily on people with expertise gained through years of research or experience working with or for the seven institutions we were asked to consider. We are grateful to all who assisted us by writing papers, on very tight deadlines, to inform us and help us understand the functioning, roles, and responsibilities of these institutions, and the effects and effectiveness of their programs. We are grateful, also, for their suggestions for changes. Many of the authors of commissioned papers contributed further by testifying before the Commission and by answering questions. Other witnesses at Commission meetings and public hearings brought a broad spectrum of opinions that illuminated areas of public concern or supplemented the information in the commissioned papers. A list of the witnesses and authors is included at the end of the report.

The members of the Commission benefited also from the opportunity to meet informally with the Managing Director of the International Monetary Fund, the Presidents of the World Bank and the Inter-American Development Bank, the U.S. Executive Directors of the Fund and the Bank, the Secretary of the Treasury, and their staffs. We are especially grateful to Dr. Stanley Fischer, First Deputy Managing Director of the International Monetary Fund, and President James Wolfensohn of the World Bank who presented their views and responded to questions at one of our hearings.

The Commission operated under Treasury Department rules. We had the pleasure of working with Mr. Timothy Geithner, Ms. Caroline Atkinson, Mr. William McFadden and many other Treasury personnel.

The Commission's report recommends many far-reaching changes to improve the effectiveness, accountability, and transparency of the financial institutions and to eliminate overlapping responsibilities. These proposals should not be taken as criticism of the individuals who work in and guide these institutions. We have been impressed repeatedly not only by the dedication and commitment of many of the people we met but also by their willingness to assist us, inform us, and supply the information that helped us complete our task.

The Commission depended on the work of a dedicated staff that arranged meetings, organized material, and prepared research reports and drafts of the final report. Their names are listed in the report. Mr. Donald R. Sherk, though not a member of the staff, helped us in numerous ways, improved our understanding of the development bank and allowed us to benefit from his long experience and deep knowledge of their problems and prospects.

I am personally grateful to the members of the Commission who worked together in a spirit of comity and harmony, who gave willingly of their time and counsel, and never complained about the heavy demands placed on them. It has been my great pleasure to work with them. Each of them recognized the important contributions that the international financial institutions have made and can make in the future. They joined enthusiastically in this bipartisan effort to suggest improvements and restructuring that the majority believes will improve the functioning of financial markets, the stability of the world economy, and the incomes of people in rich and poor countries.

Allan H. Meltzer
Chair
March 2000

Executive Summary:

General Principles and Recommendations for Reform

In November 1998 as part of the legislation authorizing \$18 billion of additional U.S. funding for the International Monetary Fund, Congress established the International Financial Institution Advisory Commission to recommend future U.S. policy toward seven international institutions: the International Monetary Fund (IMF), the World Bank Group (Bank), the Inter-American Development Bank (IDB), the Asian Development Bank (ADB), the African Development Bank (AfDB), the Bank for International Settlements (BIS), and the World Trade Organization (WTO).

The economic environment in which the founders expected the IMF and the Bank to function no longer exists. The pegged exchange rate system, which gave purpose to the IMF, ended between 1971 and 1973, after President Nixon halted US gold sales. Instead of providing short-term resources to finance balance of payment deficits under pegged exchange rates, the IMF now functions in a vastly expanded role: as a manager of financial crises in emerging markets, a long-term lender to many developing countries and former Communist countries, an advisor and counsel to many nations, and a collector and disseminator of economic data on its 182 member countries.

Building on their experience in the 1930s, the founders of the Bank believed that the private sector would not furnish an adequate supply of capital to developing countries. The Bank, joined by the regional development banks, intended to make up for the shortfall in resource flows. With the development and expansion of global financial markets, capital provided by the private sector now dwarfs the volume of lending the development banks have done or are likely to do in the future. And, contrary to the initial presumption, most crises in the past quarter century involved not too little but too much lending, particularly short-term lending that proved to be highly volatile.

The frequency and severity of recent crises raise doubts about the efficacy of the system of crisis management now in place and the incentives for private actions that it encourages and sustains. The IMF has given too little attention to improving financial structures in developing countries and too much to expensive rescue operations. Its system of short-term crisis management is too costly, its responses too slow, its advice often incorrect, and its efforts to influence policy and practice too intrusive.

High cost and low effectiveness characterize many development bank operations as well. The World Bank's evaluation of its own performance in Africa found a 73% failure rate. Only one of four programs, on average, achieved satisfactory, sustainable results. In reducing poverty and promoting the creation and development of markets and institutional structures that facilitate development, the record of the World Bank and the regional development banks leaves much room for improvement.

The Commission's Aims

In 1945, the United States espoused an unprecedented definition of a nation's interest. It defined its position in terms of the peace and prosperity of the rest of the world. It differentiated the concepts of interest and control. This was the spirit which created the International Financial Institutions and which has guided the Commission's work. Global economic growth, political stability and the alleviation of poverty in the developing world

d are in the national interest of the United States.

The Commission believes that performance of the IMF, the Bank, and the regional banks would improve considerably if each institution was more accountable and had a clearer focus on an important, but limited, set of objectives. Further, the IMF, the Bank, and the regional banks should change their operations to reduce the opportunity for corruption in recipient countries to a minimum.

Accountability, accomplishment, effectiveness, and reduction in corruption will not be achieved by hope, exhortation, and rhetoric. Programs must be restructured to change incentives for both recipients and donor institutions. Each institution should have separate functions that do not duplicate the responsibilities and activities of other institutions. The IMF should continue as crisis manager under new rules that give member countries incentives to increase the safety and soundness of their financial systems. For the Bank and the regional banks, emphasis should be on poverty reduction and development not, as in the past, on the volume of lending.

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The IMF should serve as quasi lender of last resort to emerging economies. However, its lending operations would be limited to the provision of liquidity (that is, short-term funds) to solvent member governments when financial markets close. Liquidity loans would have short maturity, be made at a penalty rate (above the borrowers recent market rate) and be secured by a clear priority claim on the borrowers assets. Borrowers would not willingly pay the penalty rate if financial markets would lend on the same security, so resort to the IMF would be reduced. It would serve as a stand-by lender to prevent panics or crises. Except in unusual circumstances, where the crisis poses a threat to the global economy, loans would be made only to countries in crisis that have met pre-conditions that establish financial soundness. To the extent that IMF lending is limited to short-term liquidity loans, backed by pre-conditions that support financial soundness, there would be no need for detailed conditionality (often including dozens of conditions) that has burdened IMF programs in recent years and made such programs unwieldy, highly conflictive, time consuming to negotiate, and often ineffectual.

Three of the proposed pre-conditions for liquidity assistance that we recommend are: First, to limit corruption and reduce risk by increasing portfolio diversification, eligible member countries must permit, in a phased manner over a period of years, freedom of entry and operation for foreign financial institutions. Extensive recent history has demonstrated that emerging market economies would gain from increased stability, a safer financial structure, and improved management and market skills brought by the greater presence of foreign financial institutions in their countries. A competitive banking system would limit use of local banks to finance "pet projects," or lend to favored groups on favorable terms, thereby reducing the frequency of future financial crises.

Second, to encourage prudent behavior, safety and soundness every country that borrows from the IMF must publish, regularly and in a timely manner, the maturity structure of its outstanding sovereign and guaranteed debt and off-balance sheet liabilities. Lenders need accurate information on the size of short-term liabilities to assess properly the risks that they undertake.

Third, commercial banks must be adequately capitalized either by a significant equity position, in accord with international standards, or by subordinated de

but held by unaffiliated entities. Further, the IMF in cooperation with the BIS should promulgate new standards to ensure adequate management of liquidity by commercial banks and other financial institutions so as to reduce the frequency of crises due to the sudden withdrawal of short-term credit.

To give countries time to adjust to these incentives for financial reform, the new rules should be phased in over a period of five years. If a crisis occurred in the interim, countries should be allowed to borrow from the IMF at an interest rate above the penalty rate.

Maintenance of stabilizing budget and credit policies is far more important than the choice of exchange rate regime. The Commission recommends that countries avoid pegged or adjustable rate systems. The IMF should use its policy consultations to recommend either firmly fixed rates (currency board, dollarization) or fluctuating rates. Neither fixed nor fluctuating rates are appropriate for all countries or all times. Experience shows, however, that mixed systems such as pegged rates or fixed but adjustable rates increase the risk and severity of crises.

Long-term structural assistance to support institutional reform and sound economic policies would be the responsibility of the Bank and the regional banks. The IMF should cease lending to countries for long-term development assistance (as in sub-Saharan Africa) and for long-term structural transformation (as in the post-Communist transition economies). The Enhanced Structural Adjustment Facility and its successor, the Poverty Reduction and Growth Facility, should be eliminated. The IMF should write-off in entirety its claims against all highly indebted poor countries (HIPC) that implement an effective economic development strategy in conjunction with the World Bank and the regional development institutions. In keeping with the greatly reduced lending role of the IMF, the Commission recommends against further quota increases for the foreseeable future. The IMF's current resources should be sufficient for it to manage its quasi-lender of last resort responsibilities, especially as current outstanding credits are repaid to the IMF.

The Development Banks

At the entrance to the World Bank's headquarters in Washington, a large sign reads: "Our dream is a world without poverty." The Commission shares that objective as a long-term goal. Unfortunately, neither the World Bank nor the regional development banks are pursuing the set of activities that could best help the world move rapidly toward that objective or even the lesser, but more fully achievable, goal of raising living standards and the quality of life, particularly for people in the poorest nations of the world.

Collectively, the World Bank Group and its three regional counterparts employ 17,000 people in 170 offices around the world, have obtained \$500 billion in capital from national treasuries, hold a loan portfolio of \$300 billion and each year extend a total of \$50 billion in loans to developing members.

There is a wide gap between the Banks' rhetoric and promises and their performance and achievements. The World Bank is illustrative. In keeping with a mission to alleviate poverty in the developing world, the Bank claims to focus its lending on the countries most in need of official assistance because of poverty and lack of access to private sector resources. Not so. Seventy per cent of World Bank non-aid resources flow to 11 countries

that enjoy substantial access to private resource flows.

The regional institutions overlap with the World Bank in several ways. They compete for donor funds, clients and projects. Their local offices are often in the same cities. The regionals repeat the World Bank's organizational structure, which focuses on subsidized loans and guarantees to governments, zero-interest credits to the poorest members, and loans, guarantees and equity capital for private sector operations. Recently, the World Bank expanded its field offices, increasing duplication and potential conflict in the regions. The Commission received no reasonable explanation of why this costly expansion was chosen instead of closer cooperation with the regional banks and reliance on the regional banks' personnel.

All the Banks operate at the country level, defining their objectives within the nation-states instead of the region or the globe. Their patterns of lending over the past 3 years are very similar: to the same countries and for the same purposes. Four to six of the most credit-worthy borrowers, all with easy capital market access, receive most non-aid resource flows: 90% in Asia; 80-90% in Africa; 75-85% in Latin America.

Performance is one of the Commission's principal concerns. Ending or reducing poverty is not easy. The development banks cannot succeed in their mission unless the countries choose institutions and government policies that support growth. Developing country governments must be willing to make institutional changes that promote improved social conditions, reward domestic innovation and saving, and attract foreign capital. To foster an environment conducive to economic growth, the development banks must change their internal incentives and the incentives they offer developing countries.

The project evaluation process at the World Bank gets low marks for credibility: wrong criteria combined with poor timing. Projects are rated on three measures: outcome, institutional development impact and sustainability. The latter, central to progress in the emerging world, receives a minimal 5% weight in the overall evaluation. Results are measured at the moment of final disbursement of funds. Evaluation should be a repetitive process spread over many years, including well after the final disbursement of funds when an operational history is available.

The Banks seldom return to inspect project success or assess sustainability of results. The World Bank reviews only 5% of its programs 3 to 10 years after final disbursement for long-term policy impact. Though the development banks devote significant resources to monitoring procurement of inputs, they do little to measure the effectiveness of outputs over time.

Recommendations for the Development Banks

To function more effectively, the development banks must be transformed from capital-intensive lenders to sources of technical assistance, providers of regional and global public goods, and facilitators of an increased flow of private sector resources to the emerging countries. Their common goal should be to reduce poverty; their individual responsibilities should be distinct. Their common effort should be to encourage countries to attract productive investment; their individual responsibility should be to remain accountable for their performance. Their common aim should be to increase incentives that assure effectiveness. The focus of their individual efforts should be on the 80 to 90 poorest countries of the world that lack capital market access.

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resource transfers to countries that enjoy capital market access (as denoted by an investment grade international bond rating) or with a per capita income in excess of \$4000 would be phased out over the next 5 years. Starting at \$2500 (per capita income) official assistance would be limited. (Dollar values should be indexed.) Emergency lending would be the responsibility of the IMF in its capacity as quasi lender of last resort.

Performance-Based Grants

For the world's

truly poor, the provision of improved levels of health care, primary education and physical infrastructure, once the original focus for development funding, should again become the starting points for raising living standards. Yet, poverty is often most entrenched and widespread in countries where corrupt and inefficient governments undermine the ability to benefit from aid or repay debt. Loans to these governments are, too often, wasted, squandered, or stolen.

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In poor countries without capital market access, poverty alleviation grants to subsidize user fees should be paid directly to the supplier upon independently verified delivery of service. Grants should replace the traditional Bank tools of loans and guarantees for physical infrastructure and social service projects.

From vaccinations to roads, from literacy to water supply, services would be performed by outside private sector providers (including NGOs and charitable organizations) as well as by public agencies. Service contracts would be awarded on competitive bid. Failure to perform on earlier projects would weigh heavily against participation in future bids. Quantity and quality of performance would be verified by independent auditors. Payments would be made directly to suppliers. Costs would be divided between recipient countries and the development agency. The subsidy would vary between 10% and 90%, depending upon capital market access and per capita income.

Institutional Reform Loans

Institutional

reforms lay the groundwork for productive investment and economic growth. They provide the true long-term path to end poverty. Reforms are more likely to succeed if they arise from decisions made by the developing country.

Lending framework

with incentives for implementation, should be redesigned to fit the needs of the poorest countries that do not have capital market access. The government of each developing economy would present its own reform program. If the development agency concurs in the merit of the proposal, the country would receive a loan with a subsidized interest rate. The extent of the interest rate subsidy would range from 10% to 90%, as in grant financing of user fees. Loans would be conditional upon a precise set of reforms, and disbursement would begin after legislative enactment, the first step in the process. Auditors, independent of both the borrowing government and the official lender, would be appointed to review implementation of the reform program annually.

Division of Responsibility

To underscore the shift in emphasis from lending to development, the name of the World Bank would be changed to World Development Agency. Similar changes should be made at the regional development banks.

Development Agencies should be precluded from financial crisis lending.

All country and regional programs in Latin America and Asia should be the primary responsibility of the area's regional bank.

The World Bank should become the principal source of aid for the African continent until the African Development Bank is ready to take full responsibility. The World Bank would also be the development agency responsible for the few remaining poor countries in Europe and the Middle East.

Regional solutions that recognize the mutual concerns of interdependent nations should be emphasized.

The World Development Agency should concentrate on the production of global public goods and serve as a center for technical assistance to the regional development agencies. Global public goods include treatment of tropical diseases and AIDS, rational protection of environmental resources, tropical climate agricultural programs, development of management and regulatory practices, and inter-country infrastructure.

In its reduced role, the World Development Agency would have less need for its current callable capital. Some of the callable capital should be reallocated to regional development agencies, and some should be reduced in line with a declining loan portfolio. The income from paid-in capital and retained earnings should be reallocated to finance the provision of more global public goods.

Debt Reduction and Grant Aid to the Poorest Countries

The World Bank and the regional development banks should write off in entirety their claims against all highly indebted poor countries (HIPC) that implement an effective economic development strategy under the Banks combined supervision. Moreover, bilateral creditors, such as the U. S. government, should similarly extend full debt write-offs to those HIPC countries that pursue effective economic development strategies.

More generally, the United States should be prepared to increase its budgetary support for the poorest countries if they pursue effective programs of economic development. This support should come in several forms: debt reduction, grants channeled through the multilateral development agencies, and bilateral grant aid. The current level of U. S. budgetary support for the poorest countries is about \$6 per U.S. citizen (\$1.5 billion total), so there is scope for a significant increase in funding if justified by appropriate policies and results within the developing countries.

The Bank for International Settlements

During its 70-year history the BIS has adapted well to large changes in the financial industry and central banking practices.

Its ability to adapt was due largely to its limited and homogeneous membership. An example of such adaptation is the way the BIS quickly rose to the challenge of meeting regulatory deficiencies at the international level. The BIS has also demonstrated its ability to convince the most financially important countries to adopt its standards.

The Commission recommends that the BIS remain a financial standard setter. Implementation of standards, and decisions to adopt them, should be left to domestic regulators or legislatures. The BIS should al

ign its risk measures more closely with credit and market risk. Current practice encourages misallocation of lending.

The World Trade Organization

The WTO

has two main functions. First, it administers the process by which trade rules change. Trade ministers (or their equivalent) negotiate agreements that national legislative bodies can approve or reject. Second, the WTO serves as a quasi-judicial body to settle disputes. Part of this process involves the use of sanctions against countries that violate trade rules.

Quasi-judicial determination

ion, when coupled with the imposition of sanctions, can overwhelm a country's legislative process. As WTO decisions move to the broader range of issues now within its mandate, there is considerable risk that WTO rulings will override national legislation in areas of health, safety, environment, and other regulatory policies. The Commission believes that quasi-judicial decisions of international organizations should not supplant national legislative enactments. The system of checks and balances between legislative, executive and judicial branches must be maintained.

Rulings or decisions by the WTO, or any other multilateral entity, that extend the scope of explicit commitments under treaties or international agreements must remain subject to explicit legislative enactment by the U.S. Congress and, elsewhere, by the national legislative authority.

Chapter

1

Introduction and Summary of Recommendations

The postwar financial institutions established at Bretton Woods in 1944 are unique in many ways. The mission of the Bretton Woods institutions was to promote monetary and financial stability, to reconstruct countries devastated by war, and to expand the reach of the market system by offering open trade and market access to all countries. Never before have the victors in war established a framework to promote growth, development, and global prosperity.

These institutions, and the U.S. commitment to maintain peace and stability, have had remarkable results. In more than fifty postwar years, more people in more countries have experienced greater improvements in living standards than at any previous time. With the help of our allies, we have avoided global war. Our former adversaries are now part of the expanding global market system. They seek to achieve the benefits of freer trade and exchange in a system based on growth of personal liberty and increased ownership of private property.

The postwar economic order permitted countries to adopt a strategy of export-led growth. This policy required imports of technology, services, and raw materials that spread prosperity to other countries. The international framework provided a sufficient degree of financial stability to absorb costly oil shocks, regional wars, and occasional financial disturbances.

Expansion of trade, capital flows, and economic activity permitted improvements in health care, longevity, education, and other social indicators. Growth provided resources to solve old environmental problems and address new ones. Peace, economic and social progress, and stability contributed to the spread

of democratic government and the rule of law to many countries.

The Congress, successive administrations, and the American public can be proud of these achievements. The United States has been the leader in maintaining peace and stability, promoting democracy and the rule of law, reducing trade barriers, and establishing a transnational financial system. Americans and their allies have willingly provided the manpower and money to make many of these achievements possible. The benefits have been widely shared by the citizens of developed and developing countries.

The dynamic American economy benefited along with the rest of the world. Growth of trade spread benefits widely. Per capita consumption in the United States tripled. As in other countries, higher educational attainment, improved health services, increased longevity, effective environmental programs, and other social benefits accompanied or followed economic gains.

Serious challenges remain. The beneficiaries of globalization must include the poorest members of the world economy. Instability of the world economy must be mitigated.

The Institutions

The principal Bretton Woods Institutions are the International Monetary Fund (IMF) and the World Bank Group (Bank). The initial role of the IMF was to smooth balance-of-payments adjustment in a system of fixed but adjustable exchange rates. The Bank's original charge was to foster postwar reconstruction in war-devastated regions and to encourage economic development by lending to developing countries. Initially, neither institution had the resources or the experience to make major contributions. The Marshall Plan and other assistance from the United States, and the prodigious efforts of people in the war-devastated countries, achieved postwar reconstruction.

Beginning in the 1960s, countries created regional development banks to supplement the Bank's work. The Inter-American Development Bank (IDB, 1960), the African Development Bank (AfDB, 1963) and the Asian Development Bank (ADB, 1966) provide loans and grants for development in their respective regions.

The General Agreement on Tariffs and Trade (GATT) joined the IMF and the Bank in 1948. Through successive rounds of multilateral negotiation, GATT reduced most tariff barriers to negligible values. Nontariff barriers remained. In 1995, GATT ended, replaced by the World Trade Organization (WTO) with broader powers and expanded responsibilities to settle trade disputes. The U.S. economy continued to benefit greatly from the expansion of world trade.

New Conditions, New Challenges

The economic environment in which the founders expected the IMF and the Bank to function no longer exists. The pegged exchange-rate system, which gave purpose to the IMF, ended between 1971 and 1973, after President Nixon halted U.S. gold sales. Instead of short-term lending to finance balance-of-payment deficits under pegged exchange rates, the IMF now functions in an expanded role as a manager of financial crises in emerging markets, as a long-term lender to developing economies and former Communist countries, as a source of advice and counsel to many nations, and collector of economic data on its 182 member countries.

Building on their experience in the 1930s, the founders of the Bank believed that the

private sector would furnish less than an adequate supply of capital to developing countries. The Bank, joined by the regional development banks, intended to make up for the shortfall in resource flows. With the development and expansion of global financial markets, capital provided by the private sector now dwarfs any volume of lending the development banks have done or are likely to do in the future. And, contrary to the initial presumption, most crises in the past quarter-century involved not too little but too much lending, particularly short-term lending.

Beginning with the Latin American debt problems of the 1980s, followed by Mexico's crisis in 1994-95, and the Asian financial and economic problems of 1997-98, parts of the world economy have experienced the largest financial traumas and recessions of the postwar years. Liabilities of bank failures in crisis countries often reached 20% of annual income, a far greater financial collapse than occurred in any developed country, including the United States, during the depression of the 1930s or the banking and U.S. savings-and-loan failures in the 1980s.

The crises in developing countries destroyed large parts of the wealth of their citizens. In an interrelated global economy, financial flows and trade declined, particularly U.S. and European exports and inter-regional exports and imports. The effects spread to other developing and developed countries. The frequency and violence of these crises, and the weakness of many emerging countries' financial systems show the need for a new framework and new policies to restore and strengthen economic stability, growth and development.

The Commission recognizes that financial crises have occurred throughout history and cannot be eliminated entirely. However, the frequency and severity of recent crises raise doubts about the system of crisis management now in place and the incentives for private actions that it encourages and sustains. The IMF has given too little attention to improving financial structures in developing countries and too much to expensive rescue operations. Its system of short-term crisis management is too costly, its responses too slow, its advice often incorrect, and its efforts to influence policy and practice too intrusive.

High cost and low effectiveness characterize many development bank operations also. The World Bank's evaluation of its own performance in Africa found a 75% failure rate. Only one of four programs, on average, achieved satisfactory, sustainable results.

In reducing poverty and promoting the creation and development of markets and institutional structures that facilitate development, the record of the World Bank and the regional development banks leaves much room for improvement. Six principal reasons for the development banks' poor record in poverty reduction and institutional reform are:

- (1) By far the largest share of the banks' resources flow to countries with access to private capital;
- (2) the amount of funds provided by development banks to most countries receiving aid is small compared to the private-sector resources received;
- (3) the host government guarantee, required by all Bank lending, eliminates any link between project failure and the Bank's risk of loss;
- (4) money is fungible so that any linkage between development bank resources and specific projects or policy changes is difficult to trace and often nonexistent;
- (5) countries do not implement reforms unless they choose to do so, and they rarely sustain reforms imposed by

y outsiders; and

(6) development projects typically succeed only if the recipient country has a significant interest in the project and directs its efforts to achieve success.

IMF and Bank Assistance

In the past, the Fund has worked to achieve growth and economic stability by making loans conditional on changes in monetary, fiscal, exchange rate, trade or labor-market policies. The World Bank has added other conditions. Countries often face a long list of conditions that, if followed, would restrict the role of national political institutions and the development of responsible, democratic institutions.

While it is always difficult to know what would have happened in the absence of the IMF's or Bank's conditions, their research, as well as considerable research by outsiders, finds no evidence of systematic, predictable effects from most of the conditions. A recent summary of conditional lending concludes:

"[I]t is now well-accepted that Fund-supported programs improve the current account balance and the overall balance of payments. The results for inflation are less clear. In the case of growth, the consensus seems to be that output will be depressed in the short-run as the demand reducing elements of the policy package dominate."

A main reason for the IMF's modest success is that countries come to the IMF mainly when they have serious problems, often when they are in crisis. The IMF's relatively standard advice includes reducing domestic spending and permitting the country's currency to depreciate. Reducing spending lowers incomes. Reduced spending and a depreciated currency typically improve the current account and may reduce inflation.

If the IMF did not exist, the market would force a country in crisis to follow similar policies. Perhaps the IMF's assistance cushions the decline in income and living standards. Neither the IMF, nor others, has produced much evidence that its policies and actions have this beneficial effect. One reason may be that IMF loans permit some private lenders to be repaid on more favorable terms, so the benefits have gone mainly to those lenders. Or, the IMF's loans may permit governments to maintain spending that remains politically attractive despite its low social value.

The last possibility receives support in recent work at the World Bank. Assessing Aid summarizes the results of experience and research:

"Foreign aid has at times been a spectacular success

"On the flip-side, foreign aid has also been, at times, an unmitigated failure

"Financial aid works in a good policy environment.

"Improvements in economic

institutions and policies in the developing world are the key to a quantum leap in poverty reduction.

"Aid can nurture reform even in the most distorted environment--but it requires patience and a focus on ideas, not money."

The Commission

sion believes that the effectiveness of foreign aid and progress against poverty would increase and financial crises would be reduced in number, frequency and severity, if current programs of the IMF and the development banks change to focus attention on institutional reform, incentives for improved domestic arrangements

ements and policies, greater transparency and accountability, reduced opportunities for corruption in developing and restructuring countries, and the provision of global public goods. These improvements will yield maximum benefit only if governments continue to foster open markets with reduced barriers to trade in goods and services.

The Role of the Commission

A majority of the Commission agrees that the main problems of the international financial institutions are:

- overlapping missions and mission creep;
- lack of transparency and accountability;
- failure to prevent the increasing depth and severity of international financial and economic crises;
- ineffectiveness, corruption in developing countries, and waste of resources;
- commandeering of international resources to meet objectives of the U.S. government or its Treasury Department;
-
- failure to develop successful regional programs to confront transnational problems in agriculture, transportation, forestry, environmental, and health care;
-
- overuse of conditional lending and the imposition of multiple conditions;
-
- inability to enforce commitments on borrowers unwilling to meet them, and
-
- reluctance to reduce loans to countries that do not honor their obligations.

Recognizing that international financial institutions have often achieved results at extremely high cost to the citizens of the crisis countries, or failed to achieve their missions, and that the rhetoric of their leadership is often distinctly different from the institutions' accomplishments, Congress established the International Financial Institution Advisory Commission. Its mandate was to examine:

- the effects of globalization, increased trade, capital flows, and other relevant factors on these institutions;
 - the adequacy, efficacy, and desirability of current policies and programs at such institutions as well as their suitability for the beneficiaries of such institutions;
 - coordination or duplication of functions and responsibilities of such institutions;
- and
- other matters the Commission deems necessary to make recommendations pursuant to the preparation of its report.

Congress asked the Commission to report on:
changes in policy goals set forth in the Bretton Woods Agreements A

act and the International Financial Institutions Act;
changes in the charters, organizational structures, policies and programs of the international financial institutions;
additional monitoring tools, global standards, or regulations for
, among other things, global capital flows, bankruptcy standards, accounting standards, payment systems, and safety and soundness principles for financial institutions;
possible mergers or abolition of the international financial institutions, including changes in the manner in which such institutions coordinate their policy and program implementation and their roles and responsibilities; and

any additional changes necessary to stabilize currencies, promote continued trade liberalization and to avoid future financial crises.

At its start, the Commission agreed unanimously to consider the roles and tasks that should be assigned to these institutions if they were created anew in the year 2000. The members recognized that the new or changed roles and assignments might require changes in the institutions' charters, their size and the scope and directions of their activities. It agreed that the economic environment had changed greatly in the more than fifty years since the principal institutions began operations and that the institutions had grown and changed in response to crises and changes in the world economy. Many of these changes were unplanned or opportunistic. Some of the institutions, particularly the World Bank, have become so large and have taken on so many different tasks that effectiveness has been sacrificed. Frequent reorganization and changes of mission have reduced efficiency and wasted resources. Programs that overlap with IMF or regional bank activities have led to conflict and failure to achieve agreed-upon goals.

The Commission believes that to encourage development, countries should open markets to trade, and encourage private ownership, the rule of law, political democracy and individual freedom. Market economies work best when they operate in an environment where national governments and international institutions follow predictable policies that maintain economic stability, protect political freedom and private property, and incentives for efficient, purposeful behavior leading to wealth creation that benefits all members of the society.

The principal role of public-sector institutions is to provide global public goods, create and maintain the framework and rules that permit the private sector to function productively, generating wealth to reduce poverty and pay for social improvements. Effective international financial institutions can contribute importantly to this process.

In drafting its recommendations, the Commission sought to encourage these desirable outcomes by:

- (1) assigning specific responsibilities to particular institutions, avoiding overlap wherever possible;
- (2) increasing transparency of actions, decisions, and financial statements, and accountability for achievements and effectiveness;
- (3) relying more on incentives and local decision-making and much less on programs and conditions imposed by multilateral agencies;

(4) sustaining and expanding opportunities for trade and sustainable, long-term capital movements; and

(5) increasing incentives for institutional reform, expansion of markets, and prompt provision of reliable information about economic, financial, and political changes.

The United States has a large role in the world economy. It is a leading exporter and importer of goods and services. U.S. citizens own, directly or through corporations and institutional investors, \$2 to \$3 trillion of foreign assets.

The U.S. interest is not entirely commercial, financial or mercantile. With the help of other democratic, market economies we have been the leader in spreading democracy, the rule of law, and economic stability. U.S. efforts to restructure international financial institutions should continue this tradition of leadership by fostering arrangements appropriate to the new environment these efforts will create. Reforms are necessary to enable the international financial institutions to play an important role in promoting growth, stability, and responsible, democratic government for the next 50 years and beyond.

Chapter 2

The International Monetary Fund

Near the end of World War II, forty-four nations, led by the United States, met at Bretton Woods, New Hampshire to establish postwar economic and financial arrangements designed to prevent a return to the economic instability of the interwar years.

The common diagnosis of interwar problems found the causes in competitive devaluations of principal currencies, exchange controls on current account transactions, protective tariffs and other restrictions on trade and payments. To prevent a reoccurrence of monetary and financial instability, the Conference established the International Monetary Fund (IMF).

The Articles of Agreement state that the IMF seeks to promote international monetary cooperation, facilitate the expansion of international trade, promote exchange-rate stability and avoid competitive depreciation. The agreement established a multilateral system for international payments for goods and services that assisted member states to correct balance-of-payments problems, while avoiding measures destructive of national and international prosperity.

The IMF's early goals reflected three main assumptions that the founding countries believed would, and should, characterize future financial relations:

(1) The world economy would remain on a system of fixed, but adjustable, exchange rates tied to gold or the dollar with the gold price fixed at \$35 per ounce.

(2) After an initial postwar economic adjustment, payments for goods and services would be free of exchange controls.

(3) Capital account transactions such as lending, borrowing, investing, and repaying could be subject to exchange controls at the discretion of the home country government.

The founders expected the IMF to make short-term loans to assist deficit

it countries with payments deficits and to advise countries that failed to remove controls on current account. Over the years, the IMF has increased the frequency and scope of consultations and advice. It now engages all members annually about their economic conditions and policies. These consultations, requiring huge documentation, consume more person-hours than any of the IMF's other activities.

Two of the founders' key assumptions are no longer valid. The fixed but adjustable exchange-rate system ended in August 1971 when President Nixon closed the gold window, ending the U.S. commitment to keep the dollar price of gold at \$35. In March 1973, major countries agreed that the fixed exchange-rate system would not be restored. Thereafter, currency values would be determined in various ways ranging from freely floating exchange rates at one end to firmly fixed exchange rates at the other.

By 1973, many countries had removed exchange controls on both trade and capital movements. The international economy faced a new challenge--to reconcile growth, low inflation and high employment with open trading arrangements and international capital mobility. The oil shocks of the 1970s and the mistaken economic policies in many countries that produced large deficits and inflation increased the difficulty of achieving these goals and objectives. Nothing in the founding mission or the accumulated experience of the IMF prepared it to deal with these evolving challenges.

Seeking New Roles

The end of the gold/dollar standard meant that the IMF's central mission---supporting a fixed global exchange-rate system based on the dollar---had disappeared. The IMF interpreted its original purposes broadly as it searched for new roles. It took responsibility for dealing with financial and economic problems affecting developing countries or the international economy. It provided advice to developing countries on monetary, fiscal and foreign-exchange policies that it believed to be conducive to stability in the balance of payments, and it offered loans to countries that agreed to follow its advice. The IMF's influence grew significantly during the 1980s, especially as the result of its role in the Latin American debt crises.

In August 1982 the Mexican government announced that it could not service its external debts. The IMF organized and supervised the administration of a plan to reschedule the private commercial debts that the Mexican government had incurred over the previous decade. IMF lending did not channel net new funding to Mexico. Rather it lent the money to enable Mexico to service the debt. Mexico's debt increased, but it avoided default.

The IMF made its loans conditional on the implementation of a package of long-term economic reforms. Many of the conditions required sacrifices by the local population, loss of jobs and deep reductions in living standards.

Other developing countries, particularly in Latin America, found that net private capital inflows declined or became negative. Unable to service their debts, these countries, too, agreed to the IMF's conditions. They borrowed to service their external debts and avoid default. Establishing the conditions was straightforward; enforcing them proved difficult.

It soon became apparent that the growing debt burdens of Latin America's debtor countries were not sustainable, regardless of whether countries followed or ignored IMF advice. IMF assistance postpo

ned debt reduction. The postponement of the inevitable debt write-down and restructuring was costly. It delayed renegotiation of the debt and postponed the necessary resumption of capital inflows, investment and economic growth, and as a result living standards were suppressed longer and deeper. During the 1980s, as the unpaid principal and accumulated interest rose, Latin America remained stagnant. Many critics of the IMF policy of lending to countries that could not service their debts---lending into arrears---viewed this policy as contributing to the delay of the necessary restructuring process and subsequent recovery.

Write-downs of Latin American debts were finally agreed upon at the end of the 1980s, under the Brady plan. On average, creditors wrote off about one-third of the face value of outstanding claims.

By the early 1990s, developing economies had experienced renewed growth of international trade and widespread privatization of state-owned enterprises. Many liberalized financial sectors and reformed fiscal and monetary policies. These changes ushered in a new era of large capital flows, especially to Latin America, Asia, and the transition economies of eastern and central Europe. Capital flows of the early 1990s were larger relative to income than at any time since the end of the 19th century. Unlike the earlier postwar years, the source of the funds was mainly from private lenders and investors. Much of the capital went to private firms and banks in developing countries.

The collapse of the Soviet Union and mass privatizations in eastern and central Europe, and the establishment of new fiscal and monetary institutions throughout the region, offered another opportunity for the IMF to expand its purview. Pressed by the United States and other industrial countries, the IMF undertook to advise and support the transformation of the former Soviet Union and its allies from socialist command and control to market economies with private ownership of the means of production and distribution. The IMF was ill-equipped for this task; it had no previous experience to guide it. Moreover, reliance on IMF funding bypassed the appropriations process in the U.S. Congress and foreign parliaments, a process that is the centerpiece of democratic government.

The new tasks undertaken by the IMF in the 1980s and 1990s transformed the institution from a short-term lender to support balance-of-payments adjustment to a source of long-term, conditional lending and macroeconomic advice to developing and transforming countries. With the assumption of this new role, the number, size, type and duration of long-term loans increased markedly. With the new tasks came new requests for increases in members' quotas or subscriptions.

The IMF is currently involved in structural adjustment programs in some seventy countries. Many have received IMF credit for more than twenty years. Four countries have remained almost continuously in debt. Table 2-1 shows, for the period 1949-99, the number of years during which countries have been in debt to the IMF.

Table 2-1
Years of Indebtedness by Countries
1949-99

Number of Countries					
Less than 10	10-19	20-29	30-39	40-49	50 or more
29	25	46	20	4	

Note

: The table excludes countries that joined in the 1990s and first borrowed in 1995 or later.

Source: IMF.

Whatever the wisdom of these programs, their longevity is a clear sign that the IMF has departed from the principle of providing member states exclusively short-term balance-of-payments assistance as envisaged by its founders.

Transformation of the IMF into a source of long-term conditional loans has made poorer nations increasingly dependent on the IMF and has given the IMF a degree of influence over member countries' policymaking that is unprecedented for a multilateral institution. Some agreements between the IMF and its members specify scores of required policies as conditions for continued funding. These programs have not ensured economic progress. They have undermined national sovereignty and often hindered the development of responsible, democratic institutions that correct their own mistakes and respond to changes in external conditions.

Crisis Management

IMF assistance to developing countries increased in both scale and scope in the 1990s. These changes reflect the IMF's enlarged role in managing financial crises and the size and depth of recent crises.

1994-95: The Mexican Crisis

The 1994-1995 Mexican crisis is seen by many as a watershed in the history of the "new" international monetary system and the "new" IMF. It raised important questions about the effectiveness of IMF assistance in preventing such crises. Mexico had been the largest single recipient of IMF credit during the six years leading up to the crash of the Mexican peso in December 1994. With its loans it received frequent advice, conditions, and visits by IMF officials and staff. After the crisis, the IMF approved an eighteen-month standby credit worth \$17.8 billion, the largest financial package ever granted a member state and one clearly beyond the borrowing limits that the IMF had always maintained. The U.S. Treasury offered to provide up to \$20 billion in additional funds through its Exchange Stabilization Fund and the Federal Reserve's swap network. According to the General Accounting Office (GAO), Mexico eventually used some \$13 billion of IMF money and \$13.5 billion of U.S. official funds.

The Mexican program established several bad precedents.

Congress had shown that it opposed a large expenditure to aid Mexico. The Treasury used the Exchange Stabilization Fund to circumvent the Congressional budget process. And the IMF circumvented established procedures for approving loans and limiting their size in relation to the borrower's IMF quota.

The IMF and the U.S. Treasury view the Mexican bailout as a success. It certainly enabled the Mexican government to redeem some of its debts (tesobonos) as they matured. These were short-term, dollar-linked bonds that the government had issued in an unsuccessful attempt to avoid devaluation. Thus foreign private investors avoided large losses. The IMF-Treasury bridge loan allowed the Mexican govern

nment to maintain its debt payments, support insolvent Mexican banks, and protect many insolvent bank borrowers from being forced to repay their debts.

After the IMF, the U.S. Treasury, and the foreign creditors had been repaid, however, the Mexican taxpayer was left with the bill. The cost of the banking system bailout is currently estimated at roughly 20 percent of Mexico's annual GDP. Real income per capita in 1997, despite ups and downs, was no higher in 1997 than twenty years earlier. Real wages of the lowest paid workers, those receiving the minimum wage, have fallen 50% since 1985. Chart 2-1 shows these data. [Chart 2-1 here]

As Chart 2-2 shows, Mexico's total (public and private) external debt, expressed in 1996 U.S. dollars, has grown fivefold over the period since 1973, or fourfold when expressed on a per capita basis. Real wages are lower and the burden of financing the debt is much higher for each Mexican worker.

The IMF is not entirely responsible for these failures. Policies of Mexico's government and changes in international oil prices have a role. But Mexico is one of the IMF's largest clients. Either IMF policy prescriptions have not worked, or the IMF has continued to lend despite Mexico's past failures to follow IMF policy conditions and advice. [Chart 2-2 here]

1997-98: The East Asian Crisis

The East Asian crisis erupted in the summer of 1997 and went on to reverberate around the world. This crisis occurred for different reasons than the Mexican crisis and involved far larger capital movements. Its impact on the rest of the world was correspondingly greater and, not surprisingly, the IMF increased its promised assistance to more than \$100 billion, much more than in the Mexican program.

The IMF's actions in Asia have been criticized on several counts. First, it provided no public warning of the impending catastrophe despite evidence that the IMF was aware of the problems developing in Thailand. Second, critics of the IMF's intervention in East Asia complained that liquidity assistance was too slow and inadequate, partly as a consequence of the many conditions attached to disbursement. Third, critics claimed that the policy conditions set by the IMF were inappropriate, designed for countries with large budget deficits and high inflation. The causes of the Asian crisis were very different. Cutting government expenditure, raising taxes, raising interest rates and closing banks aggravated the crises. These criticisms were not universally accepted, but the IMF subsequently modified some of its mandates, implicitly accepting some of the criticism.

Critics also claimed that, by preventing or reducing the losses borne by international lenders, the IMF's 1995 Mexican program sent the wrong message to international lenders and borrowers. By preventing or reducing losses by international lenders, the IMF had implicitly signaled that, if local banks and other firm institutions incurred large foreign liabilities and governments guaranteed private debts, the IMF would provide the foreign exchange needed to honor the guarantees. Economists give the name "moral hazard" to the incentive inherent in such guarantees.

The IMF has repeatedly denied this charge. What can be said with certainty is that: (1) to forestall outflows, Thailand, Korea, and others followed Mexico by guaranteeing private debts denominated in foreign currencies, (2) foreign lenders made the subsequent crises much

worse by offering large short-term loans before the crisis under the guarantees and (3) as the size of the short-term debt increased, dependence on IMF or foreign government loans became increasingly likely, otherwise the guarantees could not be honored.

The importance of the moral hazard problem cannot be overstated. The powerful root of moral hazard lies in the IMF's encouragement, or lenders' perception of its encouragement, of short-term, foreign currency loans to developing countries, particularly where the domestic banking and financial infrastructure is weak. To address the core problem, the IMF should discourage excessive reliance on short-term borrowing and encourage financial institutions in the borrowing countries to adopt higher standards of safety and soundness. The IMF has belatedly accepted the importance of these problems.

Whether or not the IMF contributed to moral hazard in Asia, it did little to end the use of the banking and financial systems to finance government-favored projects, eliminate so-called "crony capitalism" and corruption, or promote safer and sounder banking and financial systems. Mexico, Asia and, subsequently, Russia and Latin America show the risk to international financial stability created by large short-term, foreign-denominated lending to countries with weak financial and banking systems.

1998-99: The Russian Crisis

Russia relied heavily on IMF lending in the mid-1990s. IMF assistance was supported enthusiastically by the G-7 governments, who sought to support Boris Yeltsin and the reform process in Russia. By using the IMF, the major donor members could supply aid without asking their legislatures to appropriate the money. Increasingly, concern about Russia's political stability---especially given its nuclear capabilities---underlay decisions to provide assistance. Aid continued even when the prospects for reform were bleak and there was little or no economic rationale for assistance. By mid-1998, a number of factors, including a fall in oil prices, a weak financial system, lack of political and economic reform, and the East Asian financial crisis, encouraged private investors in Russia to withdraw their capital. This precipitated a financial crisis for the Russian government and the ruble.

The IMF announcement in July 1998 of more than \$20 billion in emergency assistance failed to prevent the collapse of the Russian stock market and a default on Russian sovereign debt. The IMF suspended the program in late 1998 under pressure from the U.S. Congress and other critics, who viewed assistance to Russia's corrupt government as wasteful and counterproductive. In 1999 the IMF resumed assistance.

The role of the IMF in fostering large capital inflows, and the moral-hazard problem of anticipated assistance, is clearest in the case of Russia.

The IMF agrees that foreign lenders made loans and bought securities fully expecting that the IMF would facilitate the orderly repayment of hard-currency-denominated debt to foreigners in the event of a crisis. In the view of many lenders, Russia was too important, politically, to fail.

In the event, foreign investors were not protected by IMF assistance. Some observers view the losses suffered by foreign investors in Russia as an antidote to future moral-hazard plays by investors in emerging markets; others see Russia as a special case because of the extreme difficulty the IMF had in making loans to the unstable and kleptocratic Russian government at the time of its crisis. It is not clear that investor losses in Russia will prevent future moral-hazard problems elsewhere.

No less important, the economic results of the program are poor. Although private markets have developed in Russia, there is an immense poverty problem. Russia has not privatized land, reformed its tax system, established a credible rule of law, established a sound financial system with transparent accounting, or raised living standards. Chart 2-3 shows that real income (GDP) has fallen almost every year since the IMF's programs started.

[Insert Chart 2-3 here]

On the positive side, Russia has established a political democracy for the first time in its history. There are many private enterprises, no shortages of goods, and after the 1998 devaluation and the 1999 rise in oil prices, the prospect that output will start to rise.

Summary on the Mexican, Asian and Russian Crises

The crises in Mexico, Asia and Russia were large by any standard. Financial failures wiped out a vast amount of wealth. Gains in income achieved over a decade were, in some cases, destroyed in a few weeks. Poverty increased as living standards fell. This is the most serious cost of these crises.

For the United States, there were benefits as well as costs. Import prices fell, thereby permitting consumers to benefit from the decline in prices abroad and the devaluation of foreign currencies. The United States absorbed imports from the countries struggling out of crisis. This has been beneficial to consumers and purchasers of inputs for domestic production but costly to the workers and firms that compete with imports.

The role of the IMF has evolved along with the changing nature, causes and size of the crises faced. While the IMF can point to some successes, it has presided over, and fostered, a crisis-prone system. Moreover, IMF efforts have not been particularly effective, relative to resources utilized, in maintaining financial and economic stability.

There is little evidence that IMF efforts have prevented the periodic financial crises that can setback income growth for many years. IMF programs and prescriptions frequently delay necessary adjustments to emerging problems, resulting in a protracted period of growth suppression. Reform of this system is essential not only for growth and improved living standards in developing countries, but also to avoid the periodic crises that can threaten worldwide financial stability.

Broadening the IMF's Mission

While some see the crises of the 1990s as reason to limit the IMF's influence and narrow its focus, the IMF and its member governments reacted to recent problems and criticisms by seeking to enlarge the scope of the IMF's role in developing countries. Three recent expansions of IMF authority reflect this conclusion. First, in 1998, the Interim Committee of the IMF endorsed a proposal to amend the IMF charter to add yet another function to the IMF's mission: the promotion of capital account liberalization.

Second, the IMF proposed in September 1999 to transform its Enhanced Structural Adjustment Facility (ESAF) into the Poverty Reduction and Growth Facility. The principal reason for this initiative is the poor economic record of developing countries that receive

e IMF assistance. In many cases, these economies have contracted over the past twenty years. The IMF has been criticized for not taking the problem of poverty into account when it advises countries.

The ESAF is the mechanism by which the Fund provides concessional lending to poor countries in exchange for macroeconomic adjustment and structural reforms. The new plan requires governments seeking assistance to submit a poverty-reduction plan for IMF approval. With this expansion of IMF programs, the Fund has added the job of making long-term development loans to emerging countries to its long-standing practice of supervising and setting conditions for cyclical macroeconomic policies.

When the Poverty Reduction and Growth Facility is added to its traditional tasks, the IMF will be responsible for monitoring and setting conditions for virtually all aspects of developing countries' economic and social policies. Moreover, the new facility duplicates the responsibilities of the development banks, a source of potential conflict and waste.

Third, the IMF has established a Contingent Credit Line (CCL) facility to offer pre-qualified members immediate access to financing during a liquidity crisis. This was in response to a U.S. initiative to enhance the IMF's ability to provide rapid liquidity assistance to member countries during an emergency. The CCL is so poorly designed that, to date, no country has applied.

The CCL has four serious flaws. First, availability of CCL credit is not automatic but depends on the IMF's judgment that the country has not contributed to its problems. This is a subjective judgment and a possible reason for delay and negotiation. Second, the IMF does not mandate a penalty rate for CCL loans. Once again, the IMF is fostering counterproductive borrowing incentives by offering subsidies. Third, countries must apply in advance for admission to the CCL program. To date, they have been unwilling to do so, concerned that the application would be interpreted as a sign of impending or potential crisis and, therefore, detrimental to their perceived credit worthiness. Fourth, part of the reason countries have little interest in applying for the CCL is that other channels of IMF assistance remain available. This undermines the incentive for countries to undertake reforms in order to gain access to the CCL.

Old and New Criticisms

The IMF has been criticized from many different perspectives. Here we consider twelve of the principal criticisms. Members of the Commission do not necessarily endorse or subscribe to all of these criticisms. They are listed to summarize the context in which reform must occur and some of the problems that reform proposals must address.

(1) The IMF creates disincentives for debt resolution when it lends to insolvent sovereign borrowers. This is contrary to an early hope that IMF lending to insolvent countries would facilitate debt renegotiation. The opposite often seems to transpire; the provision of an apparently unlimited external supply of funds forestalls creditors and debtors from offering concessions. One commentator writes: "Rather than the policy providing the IMF with a lever to encourage burden sharing by the banks, the banks realized that they could use it as a club in their battle with governments." Indeed, it is often argued that IMF lending to insolvent sovereign d

creditors strengthens the long-run bargaining position of creditors by avoiding the short-run crisis-precipitated by default on debt service and by involving an agent of creditor country governments in the bargaining process. Countries become more resistant to writing down their debts. There are large potential gains to be achieved by hastening workouts of unsustainable levels of debt. Delay is socially costly. Lenders wait for resolution of outstanding claims, so the country cannot borrow for investment and growth. Unemployment rises and living standards fall.

(2) The IMF wields too much power over developing countries' economic policies. The use of IMF resources and conditionality to control the economies of developing nations often undermines the sovereignty and democratic processes of member governments receiving assistance. IMF staff often admit (with pride) that the executive branch of borrowing nations likes to use IMF conditions to exact concessions from their legislatures. While this mechanism may sometimes work to achieve desirable reforms, it often does so by shifting the balance of power within countries in ways that distort the constitutionally established system of checks and balances. A related complaint, often voiced by union advocates, is that the IMF's policies interfere with the rights of laborers in developing countries by promoting "labor-market flexibility" as a condition for assistance. The critics regard these policies as inimical to the growth of trade unions in developing nations.

(3) Despite its influence on developing countries, the IMF often fails to enforce its conditions. Enforcement of conditions is not uniform or predictable, and differences in enforcement may reflect the political power of recipients to avoid compliance.

(4) There are shortcomings in the ways the IMF funds itself and in the way it accounts for its funding and reports its financial position. Jacques Polak, a highly influential staff member and later an Executive Director of the Fund, described the problems: "The cumulative weight of the Fund's jerry-built structure of financial provisions has meant that almost nobody outside, and, indeed, few inside, the Fund understand how the organization works, because relatively simple economic relations are buried under increasingly opaque layers of language. To cite one example, the Fund must be the only financial organization in the world for which the balance sheet contains no information whatever on the magnitudes of its outstanding credits or its liquid liabilities. More seriously, the Fund's outdated financial structure has been a handicap in its financial operations."

One consequence of this lack of transparency is that member governments do not know whether the Fund has sufficient resources to carry out its missions. Also because many countries pay most of their quota in inconvertible currency, member countries' true shares of funding costs cannot be computed readily. The U.S. share of funding costs has been larger than its quota share and has varied over time depending on the demand for dollars as the form of borrowing from the IMF.

(5) The G-7 governments, particularly the United States, use the IMF as a vehicle to achieve their political ends. This practice subverts democratic processes of creditor countries by avoiding parliamentary authority over foreign aid or foreign policy and by relaxing budget discipline.

(6) IMF interventions---both long-term structural assistance and short-term crisis management---have not been associated, on average, with any clear economic gains to recipient countries. Numerous studies of the effects of IMF lending have failed to find any significant link between IMF involvement and increases in wealth or income. IMF-assisted b

ailouts of creditors in recent crises have had especially harmful and harsh effects on developing countries. People who have worked hard to struggle out of poverty have seen their achievements destroyed, their wealth and savings lost, and their small businesses bankrupted. Workers lost their jobs, often without any safety net to cushion the loss. Domestic and foreign owners of real assets suffered large losses, while foreign creditor banks were protected. These banks received compensation for bearing risk, in the form of high interest rates, but did not have to bear the full (and at times any of the) losses associated with high-risk lending. The assistance that helped foreign bankers also protected politically influential domestic debtors, encouraged large borrowing and extraordinary ratios of debt to equity. Further, this system encouraged unsafe banking practices including insufficient diversification, excessive political influences on the allocation of bank credit, and excessive reliance on short-term capital to finance long-term investment.

(7) The IMF's governance structure limits its independence to pursue bona fide economic objectives and insulates it from proper accountability. The IMF's management and oversight board are not distinct, its deliberations are not public, and formal votes are rare. If the G-7 finance ministers can agree on a policy that they wish to pursue, for whatever reason, they can use the IMF as the instrument of that policy. The assistance to Russia is a clear illustration.

(8) The IMF has at times encouraged countries to adopt pegged exchange-rate systems. These systems proved to be unsustainable. The reliance on pegged exchange rates increased developing countries' vulnerability to crises.

(9) Economists criticize the IMF staff's economic doctrines, which are the basis for IMF policy guidance. Edwards (1989) provided an early criticism of the IMF approach to economic modeling. Other critics allege that forecasts are biased and inaccurate and that the IMF places excessive emphasis on short-term forecasting. A recent evaluation of the research department found insufficient attention to weak financial sectors in developing countries as a cause of macroeconomic instability.

(10) The IMF's mission has expanded until it overlaps and conflicts with other international financial institutions. Its recent decision to establish a poverty facility puts the IMF into the province of the development banks, weakening accountability and increasing costs. The IMF lacks expertise in poverty alleviation, so the broadening of its mandate diverts funding from the poorer countries to pay for redundant administrative costs.

(11) The IMF is deficient as a mechanism for providing liquidity during crises. The IMF could act as a quasi-lender of last resort during bona fide liquidity crises in emerging market countries. But conditional lending under existing programs---often requiring protracted negotiations for the disbursement of staged releases of funds over a long period of time---is not an effective means of responding to a sudden liquidity crisis.

(12) The IMF relies too much on mandates and conditional lending dictated from abroad and too little on credible, long-term incentives that encourage local decision-makers to act responsibly and reform domestic regulations, laws, institutions, and practices.

This long list of criticisms reflects the enormous responsibilities the IMF has undertaken in the last two decades, the latitude it has been granted to act, the absence of provisions limiting its authority and ensuring its accountability to the public in developed and developing countries, its frequent lack of success

s in maintaining stability and the high cost of its crisis interventions. By reporting these criticisms, the Commission does not intend to voice unqualified support for each of them. Nor do we mean to suggest that the IMF always fails in its mission. As noted in the introduction, international financial institutions have played useful roles in the extraordinary postwar expansion. Many of these contributions occurred, however, under conditions that no longer exist. The Commission also recognizes many examples of the IMF's success in encouraging beneficial policies. At the same time, the Commission takes these criticisms seriously, and its recommendations to improve the IMF's effectiveness and the stability of the international economy respond to their valid aspects.

Recommendations

Six core principles guide our recommendations. These are:

- (1) "sovereignty" -- the desire to ensure that democratic processes and sovereign authority are respected in both borrowing and lending countries;
- (2) "separation" -- the desire to define a set of tasks for the IMF that are distinct from the tasks of other multilateral agencies, to avoid counterproductive overlap;
- (3) "focus" -- establishing clear priorities and placing credible bounds on authority to ensure that the IMF does not continue to experience mission creep;
- (4) "effectiveness" -- designing mechanisms that are likely to achieve desired objectives at reasonable cost while avoiding corruption and other undesirable side effects;
- (5) "burden-sharing" -- ensuring that the burden of financing IMF operations is shared equitably among nations;
- (6) "accountability and transparency" -- ensuring that the governance and accounting structure of the IMF provide accurate information about IMF actions, that IMF officials are accountable for their actions, and that reports are available and understandable.

The Mission of the New IMF

The Commission recommends that the IMF be restructured as a smaller institution with three unique responsibilities which, if properly performed, would increase global stability, improve the functioning of markets, and help countries improve domestic monetary and fiscal policies.

- (1) to act as a quasi-lender of last resort to emerging economies by providing short-term liquidity assistance to countries in need under a mechanism designed to avoid the abuse of liquidity assistance to sponsor bail outs and under a system that would not retard the development of those institutions within the recipient country that would attract capital from commercial sources;
- (2) to collect and publish financial and economic data from member countries, and disseminate those data in a timely and uniform manner that permits market participants to draw useful information about member countries' economic performance across time and across countries; and
- (3) to provide advice (but not impose conditions) relating to economic policy as part of regular "Article IV" consultations with member countries.

The IMF should be precluded from making other types of loans to member countries. The current practice of extending long-term subsidized loans in exchange for member countries' agreeing to abide by conditions set by the IMF should end. Doing so would avoid duplication with other agencies and ensure that the IMF focuses on a clearly defined set of economic objectives.

The Commission recommends that long-term structural assistance to foster development and encourage sound economic policies should be the responsibility of the reconstructed World Bank or regional development banks under a new mechanism---one designed to increase the probability of achieving bona fide objectives, and to do so without exerting excessive control over member countries' policies (see Chapter 3). The IMF's Poverty and Growth Facility Should Be Closed.

Participation in IMF Programs

All IMF members should be expected to provide accurate economic and financial information in a timely manner. Increased reliance on private capital flows makes it imperative to improve the quantity, quality, and timeliness of information. Accurate information increases the number of market participants and improves market stability and efficiency.

Developed countries report on their economies and policies to the OECD. Central bankers discuss these topics at the BIS.

Finance ministers of the G-7 countries exchange information and report on their problems and prospects at G-7 meetings. OECD members should be allowed to opt out of IMF Article IV consultations. All other countries would be required to participate.

IMF consultations are valuable. They force countries to systematically review and explain their policies and contribute to the development of data sources. To enhance the value of Article IV consultations, all reports should be published promptly. The IMF has shown leadership in recent years by encouraging publication and dissemination of its reports. We recommend that publication become mandatory.

The Commission recommends two types of restriction on the IMF's role as quasi-lender of last resort. First, the central banks of large, industrial countries should continue to function as lenders of last resort for their own currencies and financial systems. The IMF does not have, and cannot be expected to have, the resources to protect the payments systems of advanced industrial countries against an internal drain. And these countries have fluctuating exchange rates, so they do not have to respond to an external drain.

Second, to be eligible to borrow in a liquidity crisis, a member should meet minimum prudential standards. Countries that meet the standards would receive immediate assistance without further deliberation or negotiation. The IMF would not be authorized to negotiate policy reforms. The policies necessary to improve economic performance and end a crisis are well-known. The IMF's role would be to provide liquidity, promptly, in a financial crisis under strict rules. These rules reflect experience in many financial crises where fragile financial systems could not bear the strain caused by repatriation of foreign capital or reductions in foreign lending. Further, IMF assistance should be limited to illiquid not insolvent borrowers. IMF (or Development Bank) lending should not be used to salvage insolvent financial institutions, directly or indirectly, or to protect foreign lenders from losses.

Rules for IMF Lending

First, to

limit corruption and reduce risk by increasing portfolio diversification, eligible member countries must permit freedom of entry and operation for foreign financial institutions in a phased manner over a period of years. Foreign institutions hold a highly diverse portfolio of loans to borrowers in many countries and different industries. They would be expected to act in much the same way as global industrial companies with assets in many countries; they would stabilize and develop the local financial system. They would benefit by diversifying their risks on the international financial marketplace. Countries would gain from increased stability, a safer financial structure, and from the management and market skills that global banks would impart. Competitive banks would limit use of local banks to finance "pet projects," or lend to favored groups on favorable terms.

Second, consistent with the Basel Committee's recent reform proposal, the Commission believes that bank regulation should incorporate market discipline as a means of measuring and enforcing prudential capital standards. To establish market discipline in the domestic financial sector and protect the soundness of financial institutions, commercial banks must be adequately capitalized. This can be achieved in different ways including a significant equity base and the issuance of uninsured subordinated debt to non-governmental entities. The function of the subordinated debt is to encourage prudent behavior by banks and monitoring by the subordinated investors.

Third, to encourage prudent behavior, safety and soundness every country that borrows from the IMF must publish regularly the maturity structure of its outstanding sovereign and guaranteed debt and off-balance-sheet liabilities in a timely manner. Lenders need accurate information on the size of short-term liabilities to properly assess the risk that they undertake.

Under any system of minimum standards for access to assistance, including the standards used by the central banks of the industrialized countries, the entire financial structure may be put at risk by the inability of one large participant to meet the minimum standards for assistance. This "too big to fail" argument has been used to rescue many insolvent institutions. The responsibility of the lender of last resort should be to the market, not to the individual participant. In recent decades, the collapse of the Penn Central Railroad, Drexel Burnham, and Russia have been met by loans to the market and solvent borrowers. Direct assistance was not given to the insolvent entity.

Terms for Lending

The Commission envisions a liquidity assistance mechanism that would be used to alleviate crises when private market financing is temporarily unavailable. Historical experience suggests that liquidity crises typically last for a matter of weeks or, in extreme cases, for several months. To ensure that liquidity assistance is only used as a last resort, IMF loans (1) should have a short maturity (e.g., a maximum of 120 days, with only one allowable rollover), (2) should pay a penalty rate (that is, a premium over the sovereign yield paid by the member country one week prior to applying for an IMF loan), and (3) should specify that the IMF be given priority in payment over other outstanding sovereign debts. The last condition is partly ensured by the loan's short maturity and by requiring that the IMF be given a prior claim over government revenues as part of the IMF's loan agreement.

The penalty rate premium

m could increase with the length of time the loan remains outstanding. This would provide an incentive for early repayment.

Phase in

The new rules should be phased in over a period of three to five years. If a crisis occurs before the new rules are in place in most countries, countries should be permitted to borrow at an interest rate above the penalty rate. The "super penalty rate" would give countries an additional incentive to adopt the new rules.

Some countries may choose not to adopt the proposed rules. The names of the countries should be disclosed along with their ineligibility for IMF lender-of-last-resort services. Defaults should be permitted in these countries.

Ensuring Priority of IMF Claims on Sovereigns

One way to ensure priority of IMF claims is to require security or collateral. There are some practical difficulties in this approach for many countries. For example, commodity exports can serve as collateral, but this is a cumbersome process. Also, it may unintentionally encourage countries not to privatize important export-producing sectors (so that the government can retain control over exports to serve as collateral).

Second, "negative pledge clauses" may prevent some governments from effectively subordinating existing creditors by pledging government collateral on new loans. Many existing sovereign debt contracts specifically exempt from negative pledge clauses short-term debt to foreign monetary authorities and multilateral institutions and debt which is not publicly offered. There are various possible approaches to resolving the legal and practical problems of ensuring IMF priority when negative pledge clauses apply. For example, one might characterize IMF advances as "exchanges of assets," rather than as loans, to avoid the application of negative pledge clauses. Another approach would take advantage of the grace period allowed before the enforcement of negative pledge clause violations (typically 90-120 days). This would permit collateralized (securitized) IMF loans of sufficiently short maturity.

Perhaps the most promising and simple approach to ensuring IMF seniority, while waiting for markets and governments to resolve the practical and legal problems of providing collateral, would be to require IMF members to agree to three debt management rules as part of the prequalification requirement for access to IMF liquidity assistance: (1) Member countries must specifically exempt the IMF from the application of negative pledge clauses in all new sovereign debts issued by the member country. Most sovereign debt outstanding by developing economies is of relatively short maturity. Within a period not much longer than the phase in, contracts could be amended to give priority to the IMF. Issuers interested in hastening the conversion process could also repurchase outstanding debt, or ask creditors to accept an exchange of new debt (containing the exemption) for old debt. (2) Borrowers would give the IMF explicit legal priority by providing it with a first lien on all tax collections, including customs receipts or royalties, a favorite technique for granting seniority on sovereign debt in the nineteenth century. If revenues are denominated in local currency, the government must undertake to provide convertibility and maintain the foreign currency value of the collateral. This is the same obligation incurred by all members of the IMF currently. (3) Member countries that default on their IMF debts would not be eligible for loans or grants from other mul

tilateral agencies or other member countries.

Credit Limits

Credit limits are necessary to restrict the amount of assistance that a country can receive from the IMF. The limit should reflect the capacity of the sovereign to repay its debt to the IMF. A borrowing limit equal to one year's tax revenues might be a reasonable credit limit.

Other Recommendations

Extraordinary Events. The Commission recognizes that countries may need to borrow for reasons other than a liquidity crisis. In such cases, vehicles other than the IMF are available. For example, countries should apply to a multilateral development bank if emergency assistance to alleviate starvation or disease is called for. Or, if a country undertakes structural reform or poverty alleviation programs, it should apply for assistance to the development banks.

If extraordinary political events lead some group of countries to determine that they wish to act jointly to provide foreign aid or loans to another nation (as, for example, appears to have been the determination of the G-7 finance ministers in the case of Russia in the late 1990s), the lending countries---acting through appropriate constitutional and parliamentary procedures---should provide the aid directly.

Following a financial crisis, a country will often find that it wishes to undertake structural reforms. It may want to spread the burden of adjustment to the crisis differently than the market solution. For example, it may wish to shield the weakest or poorest parts of the society from bearing the full burden determined by market processes. Expenditures for these purposes can be financed either domestically, or by borrowing abroad if the country has established credit, or from multilateral development institutions, if the access to capital markets is restricted.

The IMF should not be used as a "slush fund" to satisfy decisions of the G-7 finance ministers or other groups of powerful members. Such practices undermine the IMF's role as a supplier of liquidity, distort the incentives of lenders and borrowers in international capital markets, bypass the budget process in the lending countries and, by imposing conditions, undermine the development of responsible, democratic decision-making in the borrowing countries.

Exchange Rates. A pegged exchange rate is neither permanently fixed nor flexible. A country commits to maintain its exchange rate only as long as it chooses to do so. Pegged exchange-rate systems have proved to be costly and usually unsustainable in a crisis.

Countries have spent billions of dollars and raised domestic interest rates to unsustainable levels in fruitless attempts to prevent devaluation. Stanley Fischer, First Deputy Managing Director of the IMF, summarizes the experience in the 1997-98 Asian crises.

"It is a fact that all countries that had major international crises relied on a pegged or fixed exchange-rate system before the crisis; and it is also true that some countries that appeared vulnerable but that had flexible exchange rates avoided such crises. Countries with very hard [firm, non-adjustable] pegs have been able to sustain them. Accordingly, we are likely to see emerging market countries moving toward the two extremes of either a flexible rate or a very hard peg--and in the long-run, the

trend is almost certainly to be towards fewer currencies."

A majority of the Commission agrees with this conclusion. Countries should choose either firmly-fixed rates or fluctuating rates. Neither system is ideal for all countries, at all times, and under all conditions. Mixed systems typically work poorly, as they did in Asia.

Rigidly-fixed systems require large reserves or lines of credit. They acquire needed credibility gradually, often only after the country surmounts a crisis. To increase credibility, some countries, adopting a fixed exchange rate, have chosen to establish a currency board or, in a few cases, have taken a strong foreign currency---such as the dollar or the Euro---as their domestic money. The eleven countries that joined the European Central Bank have taken a different route, a common currency internally and a fluctuating exchange rate against the rest of the world.

A critical point is often overlooked. The long-run position of an economy does not depend on the choice of the exchange-rate system. Exchange-rate systems determine how a country adjusts to external events or domestic policies. A fluctuating exchange-rate system adjusts by currency appreciation or depreciation. A fixed exchange-rate system adjusts by raising or lowering the domestic price level relative to foreign prices. The adjustment cannot be prevented in either system, and it occurs quickly with capital mobility.

Two important lessons of experience under many different exchange-rate regimes are: First, countries that follow stabilizing monetary, fiscal (and other) policies can successfully maintain either a fixed or a fluctuating exchange rate. Second, countries that adopt policies that are excessively expansive or contractive have difficulty maintaining a fixed exchange rate or avoiding appreciation or depreciation of a fluctuating rate.

Stabilizing policies are more important than the choice of exchange-rate regime. If domestic policies, or external events, destabilize a country, the country will have to adjust. It is not an accident, but instead a necessary consequence of the adjustment process, that countries with fixed exchange rates---China, Hong Kong, and Argentina---experienced deflation in the late 1990s, while Australia, Canada, the United States, and the Euro adjusted by allowing their exchange rates to appreciate or depreciate.

The Commission recommends that countries avoid pegged or adjustable rates. The IMF should use its Article IV consultations to make countries aware of the costs and risks of pegged or adjustable rates.

Debt Renegotiation. The Commission does not approve of the IMF's policies in Latin America in the 1980s and in Mexico in 1995, or in many other cases. IMF loans to these countries protected U.S. and other foreign banks, financial institutions, and some investors at great cost to the citizens of the indebted countries. The loans delayed resolution of the 1980s crises by permitting lenders and borrowers to report the debt as fully serviced.

Many suggestions have been made to change contractual terms or to impose costs on private lenders in a crisis. Most of these proposals seek to share the costs of resolving crises between the public and private sector. The Commission believes that lenders who make risky loans or purchase risky securities should accept the true losses when risks become unpleasant realities.

Proposals for bankruptcy courts, collective action clauses and other contractual changes, or other attempts to share losses between private

te and public lenders and institutions, raise many unresolved problems. None is problem free. Unlike bank debt, there are often many holders of emerging market debt, each interested in protecting their own, frequently divergent, interests.

Lee C. Buchheit, an expert on these issues, points out that debt renegotiation practices are evolving rapidly, without official intervention. The Commission believes that the development of new ways of resolving sovereign borrower and lender conflicts in default situations should be encouraged but left to the participants until there is a better understanding by debtors, creditors, and outside observers of how, if at all, public-sector intervention can improve negotiations.

Finance and Accounting Reforms. The IMF's accounting system should be simplified and rationalized to improve transparency. The recent use of gold sales and repurchases as an accounting device for forgiving HIPC debt is an example of budgetary obfuscation which is substantively unrelated to the act of forgiving debt. Contrivances of this kind have no place in a multilateral lending agency dedicated to increasing transparency of member governments' policies and operations.

IMF accounts should be reformed to mimic standard accounting procedures for representing assets and liabilities and income and expenses. Loans should be specifically identified in IMF accounts (as opposed to the current practice of including loans under currency and securities holdings), and loans should be divided according to their maturity and delinquency status unlike current practice. Other assets, mainly currency holdings should be divided into categories that make their usefulness as a funding resource clear. Currencies should be divided into G-5 currencies, other currencies considered useful for intervention purposes, and nonusable currencies. Liabilities should be separated from equity. Undrawn commitments under operative credit arrangements should be disclosed. Quotas, reserves, and deferred income should be set forward under a separate heading as equity. Quotas should be divided according to whether they represent contributions from G-5 countries, other possibly useful subscriptions, or subscriptions from countries with nonusable currencies. Undrawn borrowing capacity should be similarly divided into three groups separating G-5 currencies, other usable currencies, and inconvertible currencies. Income accounts should recognize all implicit subsidies to borrowers (which would no longer occur under the proposed lending rules.)

The "SDR Department" accounts should be incorporated into the IMF's overall accounts, recognizing countries with SDR holdings above cumulative allocations as net suppliers of credit and countries with holdings below cumulative allocations as net recipients of credit. These net positions should be combined with the countries' reserve positions in the "General Department" to obtain an accurate view of net providers and users of subsidized funding. The Appendix shows a recommended pro forma balance sheet for the IMF.

The Commission's proposal would make the IMF a stand-by lender. Lending would decline, so fewer resources would be required. In keeping with the greatly reduced lending role of the IMF, the Commission recommends against further quota increases for the foreseeable future. The IMF's current resources should be sufficient for it to manage its quasi-lender of last-resort responsibilities, especially as current outstanding credits are repaid to the IMF.

In a crisis the Fund should borrow convertible currencies as needed to finance short-term liquidity loans. IMF members would be jointly liable for its borrowings, on a pro rata basis depending on quota shares. Borrowing could either be made

from private sector or from credit lines of member countries.

Transparency.

The IMF should conduct its operations in a fully transparent manner. The IMF should maintain and publish full details of its assistance to each country in a timely manner and should publish its Article IV consultations.

The IMF should

take and record votes at Executive Board meetings and publish summaries of its meetings after a reasonable lag.

Debt Relief. Debt of HIPC countries cannot be repaid under any foreseeable future developments. IMF or other lending to make debt service appear current repeats the mistake made in Latin America in the 1980s.

Private ownership, open markets, and the rule of law encourage growth and development. HIPC debt should be forgiven in its entirety conditional on the debtor countries implementing institutional reforms and an effective development strategy.

Chapter 3

The Development Banks

At the entrance to the World Bank's headquarters in Washington, a large banner reads: "Our dream is a world without poverty." The Commission shares that objective as a long-term goal.

Unfortunately, neither the World Bank nor the regional development banks are moving rapidly toward that objective or the lesser, but more fully achievable, goal of raising living standards and the quality of life, particularly for people in the poorest nations of the world.

Collectively, the World Bank Group and its three regional counterparts---the African Development Bank, the Asian Development Bank and the Inter-American Development Bank---employ 17,000 people in 170 offices around the world, have obtained \$500 billion in capital from national treasuries, hold a loan portfolio of \$300 billion and each year extend a total of \$50 billion in loans to developing members.

Unlike financial institutions in the private sector that have measurable bottom lines and stockholders who can leave if performance is unsatisfactory, the Banks' shareholders are permanent and their objectives diffuse. Reviews of performance are subjective, but even the World Bank's self-audited evaluations reveal an astonishing 55-60% failure rate to achieve sustainable results.

There is a wide gap between the Banks' rhetoric and promises and their performance and achievements. The World Bank is illustrative. In keeping with a mission to alleviate poverty in the developing world, the Bank claims to focus its lending on the step-nations of the world, countries denied access to the private capital markets. Not so; 70% of World Bank nonaid resources flow to 11 countries that enjoy easy access to the capital markets.

The Banks claim that funding their activities is costless to donor members. We find that the costs to members reached \$22 billion a year. The Banks claim that its interest-bearing loans are made at market rates. We find that borrowers in the aggregate benefit from a subsidy of as much as \$31 billion annually, \$13 billion on interest-bearing loans.

The past decade has seen large changes in the global economy affecting the development banks. The Cold War

is over and, with its end, rationale disappeared for aid to corrupt or unstable regimes that once had strategic importance. Private capital flows now dwarf any foreseeable value of future annual flows from the four multilateral banks.

The Banks have been slow to adapt to these changes by redrawing the line between public and private activities, by identifying their comparative advantage under the new circumstances, by increasing their effectiveness, and by exploiting their individual strengths in a global effort to reduce poverty. Reform is essential to assure that every dollar of aid carries with it incentives that encourage performance and achieve results that can be monitored by independent reviewers.

One new task is paramount if the poorest nations are to be empowered to join the global economic community. There must be an intellectual infrastructure that builds and sustains an environment in which productive investment flourishes, where goods and long-term capital flow freely across national boundaries, and where human and property rights are protected. Functioning legal systems, accounting rules, corporate and financial-system governance, and other institutional reforms will mobilize funds many times greater than all of the resources multilateral institutions will ever command.

The Commission recommends a major restructuring of the four Multilateral Development Banks and the design of aid programs. Some will read our comments as criticisms of the individuals who work in these institutions or of their commitment to their tasks. That would mistake both our intent and our conclusions.

We have been impressed repeatedly by the dedication and concern shown by the staffs we met. Our criticisms are directed at the organization and the incentives under which people work. As evidence of the incentive problems, and the dedication of the staffs, we report that many current and former staff agree with the thrust of our recommended changes and volunteer that these steps would improve the effectiveness of their organizations and the lives of the poorest.

Origin and Description of the Development Banks

The origins of the development banks reach back into what now seems to be international financial pre-history. For the World Bank, at Bretton Woods in 1944, the universal view of the future was: a gold-based international monetary standard, capital controls, trade barriers in former colonies and less-developed economies, infant financial markets, and little private-sector interest beyond national boundaries. The Bank was to be the institutional meeting ground, where rich industrialized members would supply resources and AAA credit support to enable the Bank to gather money in the financial markets and redistribute the funds as loans to emerging members. The eventual goal: the alleviation of poverty worldwide.

Beginning at the end of the 1950s, members from each of the world's key borrowing regions, desiring more control of lending policy, united in three regional banks. Linked by geography, sympathetic by custom and culture, and staffed predominantly by their own citizens, they sought to serve their constituencies better than could a distant institution dominated by industrial countries. At first limited to local membership, all regional banks gradually acceded to the need for expanded funding by joining with the developed countries while retaining the majority vote in regional hands. All now have a roster of outside participants from the entire industrialized world.

Until the 1980s, the development banks were the dominant source of international resources to emerging economies. Knowledge and resource transfer went hand-in-hand to establish the conditions for productive investment. Each of the banks adopted a similar structure. One part provided development loans to governments at rates equal to the institution's cost of capital. A second offered highly subsidized long-term loans to the poorest members. The third provided loans, equity capital and loan guarantees to private-sector firms in emerging economies. The World Bank also offered insurance against political risks. Appendix A names and describes these programs. Appendix B shows the U.S.'s share of investment in each bank.

The last decade of the twentieth century saw the political and economic landscape transformed. With the end of the Cold War, lending as a strategic gesture became outmoded. The need to commit large blocks of capital for containment ended. A new generation of public and private-sector leadership in developing nations, educated in the graduate schools of the West, grew into sophisticated policymakers eager to exercise more control over the use of funds and development. Influenced by successful development and industrialization, particularly in Asia, countries opened their markets; international trade burgeoned; human, technological and financial capital moved more freely. Most importantly, the explosion of the financial markets both in scope and in willingness to assume risk challenged the comparative advantage of the Banks in development lending. In the space of 10 years, the international bond markets quintupled---from \$185 billion in 1988 to \$977 billion in 1998. The single year 1998 witnessed 170 bond issues greater than \$1 billion in value.

Countries that join a development bank make two financial commitments. They pay in 5% to 7% of their capital commitment on joining. The remainder is "callable capital," subject to call on demand by the development banks. Almost all countries pay their entire paid-in capital commitment in convertible currency. Most of the callable capital, if needed to honor the Banks' guarantees of liabilities, would come from members with convertible currencies.

The Banks differ greatly in size. Currently, the World Bank holds more than 2/3 of outstanding loans and 50% of paid-in capital. The African Bank is by far the smallest -- 5 to 10% of the total on these measures. Table 3-1 shows the comparative data on size, membership, and date of organization.

[Table 3-1 here]

Distribution of Aid and Lending

Annual World Bank Group lending continues to grow, rising from \$1.8 billion in 1969 to \$3.25 billion current dollars in 1999. After adjusting for inflation, the Bank has doubled in size in 30 years.

Despite this growth, the relative importance of the development banks has declined markedly. On average for the past seven years, lending and investments by the Banks represented 2% or less of total private-sector flows to developing countries. In the past seven years, the World Bank provided \$18 billion (net) to developing countries. This compares to the \$1,450 billion provided by the private sector. The Banks must accept that they are no longer a significant source of funds to the emerging world and that they cannot provide more than a small fraction of what the markets offer.

Official

s of the development banks claim that they devote the greater part of their efforts to countries denied access to market financing and to social projects that do not command the interest of private investors. In fact, all of the Banks lend mainly to the most credit-worthy countries, and they demand the host government's guarantee. If the government offered the same guarantee to a private lender, the private lender would be indifferent about the ultimate use of the funds. The private sector is prepared to finance socially desirable projects with limited cash flow, if the government guarantees to service the debt, as it does when countries borrow from the development banks.

The World Bank's internal auditor (OED) agrees with this conclusion. The auditor has questioned whether the Bank's loans merely substitute capital at advantageous interest rates without providing net additions to available resources (called additionality in Bank jargon), even for social-sector projects. For example, in its review of loans to Brazil's health system, the OED wrote:

"Brazil can access the private capital markets with relative ease; it is (therefore) difficult to know whether the [Brazilian] government would have obtained the funds for Bank-financed projects from other sources" [and carried out the projects without World Bank assistance].

In practice, most World Bank lending goes to countries that borrow in the capital markets. These countries have access to capital at market interest rates. A review of the World Bank Group's 4,100 operations approved over the last 7 years reveals that almost 80% of resources (excluding aid transfers) went to countries with an international bond rating of B or higher. Approximately 30% of resources flowed to nations with an investment grade rating and an additional 50% to countries with high-yield ratings at the time the loan was made. More disquieting, the share of nonrated recipients in International Bank for Reconstruction and Development (IBRD) lending has fallen from 40% in 1993 to less than 1% in 1999. The average for the period was about 20%.

The World Bank's rhetoric faults the private sector for concentrating 80% of its loans in a dozen economies. It claims that its own lending provides resources to the entire developing world. In fact, official lending closely parallels private-sector choices. At the World Bank, 11 countries commanded 70% of total nonaid resources over the last 7 years, while the other 145 developing World Bank members were left to divide the remaining 30%. The share of the favored group grew from 63% to 74% between 1993 and 1999: China received 12%; Argentina 10%; Russia 9%; Mexico 7%; Indonesia 7%; Brazil 7%; Korea 6%; India 4%; Thailand 3%; Turkey 3%; Philippines 2%. Though these nations account for a majority of the developing world's population, that criterion should not be decisive. The Banks must focus on the economies that lack access to private-sector resources, not just those with large populations.

Together, the eleven large borrowers received \$13 billion in net nonaid resources from the World Bank Group during the last six years. Though a large share of the World Bank's loans, this amount is only 1.4% of the \$880 billion originating in private-sector medium and long-term external debt, portfolio equity and direct investment in the same countries.

The skewed lending pattern is not significantly changed when the crisis lending of 1998-99 is omitted. Data for the 1995-96 period, the most prosperous period in the history of emerging economies, show the share of these 11 borrowers at 67% of all World Bank nonaid resources.

The World Bank and the Regionals

The three regional banks together offer about 50% of World Bank provisions. Table 3-2 shows the distribution of loans and credits by bank and type of program. The dominant characteristic is the relatively unchanging size and composition of the individual programs, until a crisis occurs. Inter-American Development Bank (IDB) lending rose in 1995-96, the time of the Mexican crisis and concern about spillover into other Latin American countries. The World Bank, the ADB and the IDB increased their lending to clients during the spreading Asian crisis in 1997 and 1998, and the repercussions in Latin America of Asian and other crises in 1998.

[Table 3-2 here]

Crisis lending is the responsibility of the IMF, not the development banks. Some officials of these Banks explained that, with hindsight, their involvement in crisis lending was a mistake, an inappropriate use of limited funds justified only, if at all, as an expedient solution to a pressing problem.

The Commission concurs; the mission of development banks should not include crisis lending. Their active participation in crises should be limited to institutional reform loans and poverty alleviation programs to reduce the costs borne by the poor and displaced.

The regional institutions overlap with the World Bank in several ways. They compete for donor funds, clients and projects. Their local offices are often in the same cities. The regionals repeat the World Bank organizational structure, which focuses on subsidized loans and guarantees to governments, zero-interest credits to the poorest members, and loans, guarantees and equity capital for private-sector operations. See Table 3-2. Recently, the World Bank expanded its field offices, increasing duplication and potential conflict in the regions. The Commission received no reasonable explanation of why this costly expansion was chosen instead of closer cooperation with the regional banks and reliance on the regional banks' personnel.

All the Bank's branches operate at the country level, defining their objectives within the nation-states instead of the region. Their patterns of lending over the past 3 years are very similar: to the same countries and for the same purposes. Four to six of the most credit-worthy borrowers, all with easy capital market access, receive most nonaid resource flows: 90% in Asia; 80-90% in Africa; 75-85% in Latin America. Pure public-sector finance (excluding social expenditures on health, education, urban development, infrastructure, environment, and general social sectors) received 35 to 40% of total flows across all regions and among all institutions. Table 3-3 shows these data.

[Insert Table 3-3 here]

Countries with Little Market Access

Many countries have either very limited access to capital markets or none at all. IDA, the aid arm of the World Bank Group, assists mainly countries without capital market access. Countries not rated for capital market access receive 68% of IDA's loans and assistance. IDA's assistance was about 25% of World Bank Group lending in the years 1993-99. See Table 3-2.

More than half of the countries receiving IDA's assistance do not have the economic and political infrastructure needed to attract private borrowers. Many of these countries remain poor because their political system is unstable, private prop

erty rights are very limited, the judicial system is weak or subservient, or the government is corrupt. Tariffs, duties, and taxes may be high. Inadequate institutional frameworks are, of course, not the sole cause of poverty. Endemic health, population growth, and geographic location contribute also.

Capital

Capital Remains Scarce

Much of IDA's assistance (and comparable programs at the regional banks) goes to such countries. At its best, it provides relief. At its worst, when IDA funds are misused, it supports corruption or programs that waste scarce local and external resources.

The IBRD also assists countries that are not rated for capital market borrowing; 22% of IBRD loans go to these countries. The total resource flow to public-sector activities in countries without capital market access, but with stabilizing policies and institutions, was \$2.5 billion for the seven years 1993-99. This is less than 2% of World Bank Group financing, excluding aid.

Counter-arguments

The Banks advance two claims to counter our concerns about the misdirection of financing. One claim is that the private sector follows where the Banks lead. Without the Banks' signal of approval, private-sector funding would languish. That was a more plausible argument in the 1980s. The Banks' argument has lost its appeal now that private-market lending is fifty times the size of Bank lending.

The signaling role, now shared by the private-rating agencies, need not entail resource transfer. The Banks could continue to signal through their reviews of institutional and policy environments by country. These reviews would be a useful supplement to IMF Article IV reports. In Chapter 2, we recommended that the IMF improve the quantity and quality of data, and publish the results, to remove this impediment to private-sector resource flows.

The second claim is that, in times of financial crisis, private lenders may run for the exits. In contrast, the Banks claim to offer a steady flow of official funding. It is true that private financial markets may close to emerging market borrowers when crises start. However, a review of the last two years, beginning with the Asia crisis in 1997, shows that the global marketplace recovers quickly. Private equity and foreign direct investment have accelerated in recent years. Three months after the crisis, Korea obtained \$4 billion in the capital markets by selling debt with 5- and 10-year maturities. During the 3 months following Brazil's financial disruptions, 20 issues totaling \$12 billion were sold to international investors by Latin American sovereign borrowers, \$2 billion by Brazil itself. These securities had medium- to long-term maturities, 5 to 20 years.

Foreign lenders were much more inclined to run in Asia, where financial systems in several countries collapsed as banks became deeply insolvent. The solution to this problem is not to increase the role of the development banks as crisis lenders or to encourage private lending to insolvent financial institutions. In Chapter 2, we recommended incentives to encourage countries to increase the safety and stability of their banking systems. The contrast between the viability of Brazil's financial system, after

er the 1998 devaluation, with the failures in Asia in 1997-98, supports this conclusion. Foreign banks that were long-term direct investors in Brazil did not run; they acted as safe havens for frightened residents. Banking stability reduced capital flight, thereby limiting currency depreciation.

The Cost of Membership in the Development Banks

Multilateral agencies generally insist that the donor nations that provide the Banks' resources bear no cost. The development banks claim to be self-supporting, with operating expenses paid through surcharges on loans. More careful consideration shows that this claim is false. It ignores both the risk that member governments bear and the alternative uses for the funds the Banks receive or can call upon. A conservative estimate shows a current annual cost to members of about \$22 billion; \$14.6 billion of the total is the cost of the World Bank, the remaining \$7.4 billion is the annual cost of the regional institutions. The U.S. share of these costs exceeds \$5 billion.

One way to assess the cost of these institutions is to ask: what would be the savings to world taxpayers if the Banks were liquidated and funds allocated to alternative uses? Table 3-4 answers that question. Table 3-5 shows the U.S. share of the Banks' costs to taxpayers. The tables show four components of total cost. We discuss them individually.

[Insert Table 3-4 and 3-5 here]

Interest on Paid-in Capital

Member governments deposit 5% to 7% of their subscriptions to form the operating capital of the development banks. The first line of Table 3-4 uses a 7% long-term cost of capital and the \$24 billion of paid-in capital to compute this annual component of total cost (\$1.7 billion). The U.S. share (\$0.3 billion) in Table 3-5 is a weighted average based on its share of the paid-in capital at each Bank.

Interest on Concessional Capital

The development banks extend long-term, interest-free loans to the poorest members. To finance these concessional credits, the Banks ask member governments to replenish the concessional fund. The cumulative sum paid to date is \$140 billion. Table 3-4 shows the \$9.8 billion annual cost of maintaining this capital at the development banks. In Table 3-5, the United States has a larger share of the cost of concessional funds (\$2.1 billion) than its share of paid-in capital. G-5 countries pay 70% of the costs of concessional capital.

Compensation for Risk

Markets treat the Banks' debts as low-risk obligations because the Banks are unlikely to default. They have the right to call on member governments to furnish additional capital to repay the Banks' indebtedness. This "callable capital" was committed by the member governments and remains available in an emergency such as defaults by the Banks' borrowers. To date, the Banks have not cal

led any of the capital, but the possibility remains. Although they explicitly deny doing so, the Banks avoid possible defaults by extending new loans to countries in financial difficulty.

Only a few of the richer members could supply convertible currencies on demand. These members would be the main resource in an emergency. Callable capital committed by the richer countries is \$181 billion; they bear the risk on the \$183 billion pool of loans to high-risk sovereign borrowers. Accepted accounting principles for private financial management requires that allowances for potential loss be made annually.

A private-sector evaluation of the risk of medium- to long-term emerging market sovereign debt is obtained using the yield spread between riskless U.S. Treasury securities and emerging market sovereign debt. Over the 5-year period, July 1994 through June 1999, the average spread was 8.1% per annum. This premium varied from 4.3% for Asia, to 8.2% for Latin America, to 10.5% for Africa. Table 3-6 reviews the private-sector evaluation of sovereign risk. Based on a conservative per annum allowance for loss equal to one-half of the premium that capital markets assign, the value generated would be \$7.1 billion per annum. The share of each member is determined by the risk of the total loan portfolio and the country's proportion of the callable capital supplied by non-borrowers. The conservative allowance for risk provision is in part justified by the Banks' preferred creditor position.

[Insert Table 3-6 here]

The G-5 countries provide 70% of this support

. The U.S. share ranges from 17% for the African Development Bank to 62% for the Inter-American Development Bank, much larger than its 6% and 31% share of paid-in capital. The U.S. cost of risk is \$2.4 billion annually. This estimate varies with the assumed risk premium. A number higher (or lower) than 1/2 would change the values in Tables 3-4 and 3-5 in proportion.

Cost of Retained Earnings

ings

The Banks receive donor funds and borrow in the market but do not immediately relend. In the interim, they hold earning assets unrelated to development lending and receive the difference between their borrowing cost and the return on investment. Recently, the four Banks held \$76 billion in this form, equivalent to 1-1/2 years of total lending. Of this total, the Banks hold \$12 billion of the funds received for concessional lending, such as IDA appropriations. Unlike the borrowed funds, these funds have zero cost to the four Banks. The annual opportunity cost of foregone interest to the donors is \$3.3 billion.

Subsidies

Another Measure of Donor Costs

The Banks divide their lending into market-based and concessional loans. Both are subsidized. All recipients of "market-based" lending pay the same interest rate, equal to the Bank's cost of funds plus 1/4 to 1/2% depending on the Bank and year. There is no allowance for differences in a borrower's risk or credit rating. All borrowers at the "concessional window" receive a 100% interest subsidy. They pay no interest, but the Banks charge a fee of less than 1% to cover administrative costs.

To calculate the subsidy on market-rate loans, we take the difference between the average rate on medium- to long-term sovereign emerging market bonds for each region fr

om July 1994 to June 1999, 10.5% to 16.7%, and the average rate on loans by the development banks, 6.9 to 7.4%. The difference is about half the market rate, so countries with market access received subsidies equal to half the market cost of funds. Using the four banks' sovereign loan portfolios of \$183 billion at the latest year-end as the base, the subsidy on interest-bearing loans is approximately \$13 billion.

Concessional credits of \$112 billion pay no interest. Using a 16.7% interest rate on loans to the poorest countries gives an annual subsidy of \$18.7 billion on these loans. Countries are obligated to repay the loans 30 or more years from the time of the agreement. Allowing for the present value of these prospective payments, and assuming they are made, leaves the subsidy on the concessional loans at about 85% of the face value. It is not surprising, therefore, that countries are reluctant to graduate from the concessional window.

Table 3-7 shows the total subsidies and the distribution by lender and type of loan. If the Banks used grants instead of loans to carry out part of their mission, as proposed in our recommendations, in time many of these subsidies would be available to fund future grants.

[Insert Table 3-7 here]

The principal beneficiaries of the subsidies are the countries with the largest outstanding debts to the development banks. The annual gift received by each of these borrowers is:

	India	\$2.5	billion
	Mexico	1.1	
1.1	Indonesia		
	Brazil	1.0	
	Argentina	1.0	
	China	0.8	
	Russia	0.5	

Performance

Performance is one of the Commission's principal concerns. Ending or reducing poverty is not easy. The development banks cannot succeed in their mission unless countries choose to develop and grow their economies. Governments must be willing to make structural changes that attract foreign capital and reward domestic saving.

Internally, the banks should change their incentive systems and improve their methods of evaluating performance. Externally, in their dealings with client countries, the Banks have a role in encouraging the institutional reforms that are necessary for sustained development. Their dedicated personnel and abundant expertise are important resources. But expertise and dedication are not enough, if there are poor incentive structures, weak managerial controls, or misdirected effort. The Banks' systems for project evaluation, performance evaluation and project choice must be improved.

Incentives

In 1992, the World Bank's Wapenhans Report pointed to the Bank's excessive interest in "moving money" as a main reason for the deterioration of project quality. The r

report said the Bank had developed a lending culture. Rewards were closely related to the amount of lending, not to a project's value or program accomplishments. Subsequently, an Asian Development Bank portfolio review found that dedication to client interest was undermined by an "approval culture" aimed at achieving yearly lending targets.

Incentives to lend for lending's sake are built into the structure of the Banks. Internal budget resources are awarded where loan volumes are high, not where the number of worthwhile projects is highest or where technical assistance and knowledge transfer are favored over funding. Long project cycles of 5-10 years render accountability at the operational level difficult to assess; those responsible for allocating funds will often have moved on before the results of lending are known. Often they are rewarded based on the amount of funds disbursed.

Although several of the Banks recognize the problem and call attention to the need for change, there is, at most, weak counterbalance to the incentive to lend. Host government guarantees, required on all loans, separate project failure from risk of loss to the Bank. Rewards for lending, and no penalties for project failure, dilute concern about project performance. The result of an open-handed and often uncritical disbursement is a 55-60% failure rate to achieve sustainable results based on the World Bank's own evaluation. Interim improvements in measured performance by the World Bank during the 1996-97 period were in large part due to general prosperity in emerging economies.

Project Evaluation

It has always been difficult to evaluate the outcome achieved with any particular loan. Money is fungible. The marginal project that a Bank loan makes possible is generally not the project that the Bank evaluates. When the Banks financed mainly infrastructure, they could, at least, assess the project's success. As the Banks moved away from project-based investment lending to adjustment financing and large-volume pure public-sector loans, now 63% of all World Bank operations, it has become easier to blur measures of project performance. By adding many new objectives in recent years the Banks made it possible to claim success on one dimension and ignore failures to improve living standards or reduce poverty.

The project evaluation process at the World Bank gets low marks for credibility: wrong criteria combine with poor timing. Projects are rated on three measures: outcome, institutional development impact, and sustainability. The latter, central to progress in the emerging world, receives a minimal 5% weight in the overall evaluation. Results are measured at the moment of final disbursement of funds, a time which the Wapenhans Report criticized as "just the beginning of operations." Final disbursement often occurs more than one year before the project begins operating. The start of operations is too early to judge sustainability of achievements. For structural programs, improvements often develop slowly. Evaluation should be a repetitive process spread over many years.

Table 3-8 shows the World Bank's evaluations of project performance for the 1990s. The Bank includes "marginally satisfactory" outcomes as successes. Using their ratings, 59% of investment programs failed in the years 1990-99. The Bank audits 25% of its projects shortly after it makes its final disbursement on the loan. If it reevaluated projects using independent auditors a number of years later, Asian bank experience suggests failure rates might worsen but would not improve.

[Insert Table 3-8 here]

As the prosperity of recipients falls, so does achievement. Table 3-8 shows that the vast majority of World Bank "successes" are concentrated in upper-income countries that have significant domestic resources and access to private-sector funding. Here, failure is in the 30-40% range. In contrast, the poorest countries have failure rates between 65 and 70%. The same pattern is found regionally. The 40% failure rate in the strong economies of East Asia contrasts with the 60-75% failure rate in South Asia and Africa. For total project-based investment lending, failure rates reach 59%; more generalized adjustment loans have a 47% failure rate.

Performance Evaluation

In addition to evaluating the successes of its lending, the World Bank evaluates its own performance using three criteria: project identification, project appraisal, and project supervision. More than 40% of all projects failed to receive a satisfactory rating on all three criteria. Table 3-9 shows the Bank's evaluations.

[Insert Table 3-9 here]

The Banks seldom return to inspect project success or assess sustainability of results. The World Bank reviews only 5% of its programs 3 to 10 years after final disbursement. These Impact Evaluations focus on such poorly defined and qualitative measures as improvements in the environment, the role of women, the interaction of societal institutions, income distribution and general welfare. Thirty percent of the investigators found that lack of monitoring of project results precluded valid judgments. Though the agencies devote significant resources to monitoring the procurement of inputs, they do little to measure the effectiveness of programs over time.

The Asian Development Bank is an exception. It is more concerned about sustainability, the sine qua non of success. Initial reports are made only after projects are fully operational. Presently, 30% of projects are audited 2 to 3 years later. The Asian Bank expects that all "successful" projects will soon be revisited to learn whether improvements continue. The Asian Bank has found that "unsuccessful" projects rarely improve, so later audits are not useful.

Choice of Direction

The Banks have an important role in reducing poverty and promoting growth. Although their resources are a small part of global capital flows, more effective resource use can raise the Banks' contribution. This will happen only if the Banks gain a better understanding of their comparative advantage, where and how they can most effectively use their limited resources.

Assessing Aid, a 1998 World Bank report, concludes that aid can help a country develop only if the country adopts appropriate public policies that promote growth and encourage foreign investment. Earlier, the Wapenhans Report concluded: "Even very well designed projects cannot succeed in a poor policy environment."

The World Bank has not embraced this message. A 1997 World Bank review found that among 41 low-income countries, only one had a satisfactory institutional environment. Many of the Bank's failures result from lending to countries unprepared or unwilling to adopt wealth-creating policies.

The Banks can improve their performance and the living standards of their clients by asking three questions:

Will the private sector perform this function?

Will the local public sector perform this function?

Will the Bank provide resources not otherwise available?

To show how the World Bank answered these questions in recent years, we divide the developing world into two sets of countries and two types of activities:

	Countries with capital- market access	Countries without capital- market access
Activities directly profitable to private sector	A 48%*	C 16%*
Activities not directly profitable to private sector (public interest)	B 30%*	D 6%*

*Per

centage of World Bank Group operations (excl. aid) during 1993-99 period. Lerrick, Adam: "Whither the World Bank" IFIAC, Washington: October 1999.

The Bank

banks should provide resources for global public goods and socially valuable activities which the private sector would not finance in countries with positive institutional environments, but without capital market access. There is no role for any public-sector lender, including the development banks, in region A. The private sector can and should finance these activities. The World Bank should not continue to devote half its funding to projects of this kind. Region B, public-interest activities in countries with capital-market access, is the domain of local governments, financed by tax revenues and market borrowing. Regions C and D are the appropriate targets for Bank efforts. Region C includes profitable private-sector activities in countries without capital-market access. Countries should identify the obstacles that prevent the private sector from fulfilling its role and remove the impediments. These may take the form of a risk (including political risk) that private participants cannot assume efficiently, an institutional bottleneck, a distorted economic framework, a lack of information or an absence of clearly defined public policies. The development banks can help by financing the reforms that the government decides to undertake. Finally, region D has public-interest activities in countries without capital-mark

et access. Often these require subsidization or the elimination of barriers to private-sector provision of services.

The World Bank's allocations show that only 22% of the activities it financed were in countries without capital-market access. Even if some allowance is made for incomplete or limited market access, most of the World Bank's resources go to countries and projects that the market would finance.

Countries without capital-market access include those most in need of institutional reform. The Banks' goal should be to increase funding of activities in the poorest countries, while reducing funding of activities in regions A and B. The development banks should provide incentives for countries without capital-market access to reform their economies or political processes.

Recommendations

Evolution of the world economy since 1945 has changed the main suppositions and beliefs on which the World Bank and the regional banks were founded. The resources available for countries, that demonstrate by their policy choices that they desire to grow, greatly exceed any sums that the founders of the development banks imagined. The multilateral development banks have been slow to adapt to their changed relative position as suppliers of capital and to the lessons learned about development over the past half century.

An important role for development assistance remains. The development banks must increase their effectiveness in alleviating the consequences of poverty and encouraging institutional reforms that permit growth, development and release from poverty. Major reforms of the development banks are needed to increase effectiveness, accountability and transparency and eliminate overlapping responsibilities.

Five observations guide our recommendations:

- the dominant share of the Banks' resources is devoted to a small number of countries with ready access to private-sector capital;
- the total funding provided to these countries by the Banks is a small fraction of the resources received from the private sector;
- the host government guarantee, required to approve all Bank lending, would render private-sector investors indifferent to the end use of borrowing proceeds, whether they concern investment, institutional reform or social-safety nets;
- the fungibility of money eliminates any link between Bank financing and specific projects or promised policy changes;
- change cannot be imposed from the outside; countries implement and sustain only those reforms to which they are themselves committed.

To function more effectively, the development banks must be transformed from capital-intensive lenders to sources of technical assistance and facilitators of an increased flow of resources to the emerging countries. Their common goal should be to reduce poverty; their individual responsibilities should be distinct. Their common effort should be to encourage countries to attract productive investment; their individual responsibility should be to remain accountable for their performance. Their common aim should be to increase incentives that assure effectiveness.

If the development banks remain as they are, they will be relegated to an insignificant role in the development process. If they reform, they can assume a valuable role that will justify the commitment of more resources by taxpayers in developed economies.

Targeting the Poorest Nations without Access to Private-Sector Resources

The Development Banks should be renamed Development Agencies.

The new name would underscore a change in the defining role of the development institutions -- no longer the lending of money but the alleviation of poverty in the developing world. Although the Banks would continue lending for structural reform, the advent of deep global capital markets, open to risk and prepared to channel substantial resources to emerging economies, has destroyed the rationale for much of the costly financial intermediation function that has been the Banks' main activity.

All resource transfers to countries that enjoy capital-market access (as denoted by an investment-grade international bond rating) or with a per capita income in excess of \$4000 would be phased out over the next 5 years. Starting at \$2500 (per capita) levels, official assistance would be limited. (Dollar values should be indexed.)

The focus of institutional effort should be on the 80 to 90 poorest nations without access to private-sector resources. As the World Bank has noted: "Much of aid continues to go to middle-income countries that do not need it. It is possible to make aid more effectively targeted to poor countries" Table 3-10 lists the countries affected by this change in 1999.

[Insert Table 3-10 here]

When operations are confined to low income countries with little capital-market access, additivity of resource transfer is enhanced. Funds for the poor would grow dramatically if flows to countries with easy capital market access or high-income levels ceased and were reallocated to the poorest members: 100% at the Asian Development Bank; 640% at the Inter-American Development Bank; 70% at the African Development Bank. When concessional flows are included, augmentations are 63%, 390% and 40% respectively.

When inept policies and negative institutional frameworks restrict market access for middle-income economies, the absence of official assistance will be a powerful incentive to implement reform.

An investment grade rating (Baa/BBB) is used to denote substantial capital market access. Poor countries with high-yield ratings (Ba/BB/ or B), which may have limited access to private sector financing during times of uncertainty, will continue to be eligible for aid when the private sector withdraws.

Performance-Based Grants

For the globe's truly poor, the provision of improved levels of health care, primary education and physical infrastructure, once the original focus for development funding, should again become the starting points for raising living standards. Yet, poverty is often most entrenched and widespread in countries where corrupt and inefficient governments undermine the ability to benefit from aid or repay debt. Loans to these governments are too often wasted, squandered, or stolen.

Outright grants rather than loans provide a realistic vehicle for poverty alleviation. Grants would be funded openly as direct subsidies provided by the industrialized nations. Performance would be audited by independent agents. In contrast to the current system of subsidy transfer, concealed through below-market financing, an explicit approach to aid would be more willingly supported if donors were assured that funds are used for an effective poverty-reduction program.

Auditors can quantify improvements in primary education skills, vaccination rates, miles of passable roads, provision of electricity, delivery of water and sanitation. Skilled international suppliers in the service sectors are increasingly mobile. The domestic public sector would be aided by the development banks, but their role would be limited to partial payment for services, the mitigation of political risk, and the provision of public goods.

The share of the cost paid by the country would depend on its per capita income level and credit ranking. The poorest nations without capital-market access would receive grants equal to 90% of the service cost, while the development agency's contribution would fall to 10% as the country's income level or capital-market access increased. For example:

A country with \$1,000 per capita income qualifying for 70% grant resources decides that vaccination of its children against measles is a desired goal. If the development agency confirms the need, the government would solicit competitive bids from private-sector suppliers, nongovernmental organizations such as charitable institutions, and public sector entities such as the Ministry of Health. Suppose the lowest qualifying bid is \$50 per child vaccinated, the development agency would agree to pay \$35 (70%) for each vaccination directly to the supplier. The government would be responsible for the remaining \$15 (30%) fee. Payments would only be made upon certification by an agent independent of all participants -- the government, the development agency and the supplier of vaccinations.

Under a system of user fees, grants are paid after audited delivery of service. No results, no funds expended. Payments would be based upon number of children vaccinated, kilowatts of electricity delivered, cubic meters of water treated, students passing literacy tests, miles of functioning roads. This system eliminates the distortionary effects of financing cost subsidies (traditional development bank loans and guarantees) by maintaining the relative prices of inputs. It creates a revenue guarantee for the vendor. Execution is substantially free of political risk. The supplier of the service, not the government, receives the payment. Since payment is directly ensured by the development agency's commitment, the supplier can borrow any required interim funding. From the supplier's standpoint, the proposed system has the distinct advantage of giving them clear responsibility to deliver a product they understand, while eliminating the need to negotiate financing with several official lenders.

The same framework has the potential to extend beyond national projects to regional programs where cooperation between participating governments would provide economies of scale. Contractors would be compensated directly by the development agency for their share, on evidence of performance. Subsidies would vary according to the income and capital-market access of each country.

The development establishment resists grant-funding on two counts. First, they claim, the borrower would have no obligation to repay, leading to a lack of discipline. On the contrary, an obligation to pay an assigned portion of user fees on a current basis imposes discipline on the country that

receives assistance. This current obligation replaces the deferred 20-50 year repayment schedules of the development credits now in use. Further, the receiving country initiates the program. It commits to a program that it finds valuable; it acquires "ownership" of an effective program. Decisions are made locally to meet local needs.

Second, for the multilateral development banks, grant funding is a less certain source of funds than current arrangements that are based to a much greater extent on permanent capital commitments. As the share of grants rises, the development agencies would have to ask the legislatures of the donor countries for increased support.

The risk exists that legislatures would reduce funding. That risk has a positive aspect. The development agencies would have an incentive to increase effectiveness. They would develop more careful procedures to assure the effectiveness of programs. This would strengthen accountability at the development agencies and concentrate their attention on results achieved, not dollars lent. Donor countries should be encouraged to increase aid for effective programs.

Many of the failures of development programs originate in perverse incentive systems created by the Banks in both the recipient countries and in the lending institutions themselves. As the Wapenhans Report remarked: "...the first measure of success for the [World] Bank [should] not [be] commitment of resources, but their effective use" and "the cost of tolerating continued poor performance [of World Bank projects] is highest not for the Bank, but for its Borrowers." The burden of irresponsible programs is unfortunately borne by taxpayers--by the poor recipient-country citizens if loans are repaid or by donor member constituents if the debt is forgiven.

In poor countries without capital-market access, poverty alleviation grants to subsidize user fees should be paid directly to the supplier upon independently verified delivery of service. Grants should replace the traditional Bank tools of loans and guarantees for physical infrastructure and social-service projects.

From vaccinations to roads, from literacy to water supply, services would be performed by outside private-sector providers (including NGOs and charitable organizations) public-sector entities, and awarded on competitive bid. Quantity and quality of performance would be verified by independent auditors. Payments would be made directly to producers. Costs would be divided between recipient countries and the development agency. The subsidy would vary between 10% and 90%, depending upon capital-market access and per capita income.

The amount of money requested from legislatures to fund explicit grants should rise. Increased outlays will gradually be offset as outstanding loans, with hidden subsidies of \$20-30 billion per annum in below-market interest rates, are repaid. Most of the repayments will be complete in the next 15 years. Grants would be given only to poor countries without capital-market access. This would increase funds available for bona fide poverty reduction.

Institutional Reform Loans

Institutional reforms lay the groundwork for productive investment and economic growth. They provide the true long-term path to end poverty. Reforms are more likely to succeed if they arise from decisions made by recipient nations. In the words of Gustav Ranis, a development expert, "It seems clear that the lending cum conditionality process works well only when local polities have decided, largely

on their own to address their reform needs and approach the international community for financial help in getting there."

Good intentions are not enough. Developing and emerging countries need incentives to continue long-term reform programs until they achieve sustainable results. In the past, the borrowers had access to total disbursement of funds long before execution. There were no means to enforce penalties for failure to perform and no incentives to continue, or even start, the reform process. Many countries have agreed to accept conditional assistance but either did not try or did not succeed in carrying through the reforms.

A new mechanism is needed to promote steady implementation rather than superficial change. It must create incentives to sustain reform programs until reforms have become established. The mechanism should also reduce financial costs of reform until benefits have been realized.

Institutional lending frameworks can be redesigned to fit the needs of the poorest countries that do not have capital-market access. As an example, each developing economy would present its own reform program. If the development agency concurs in the merit of the proposal, the country would receive a 10-year maturity, equal annual amortization loan, with a subsidized interest rate based upon the agency's own cost of capital. The extent of the interest subsidy would vary from 10% to 90% as in the grant financing of user fees. Loans would be conditional upon a precise set of reforms, and disbursement would begin after legislative enactment, the first step in the process.

Auditors, independent of both the borrowing government and the official lender, would be appointed to review implementation of the reform program annually. If performance is positive, repayment of the entire principal schedule would be deferred for one year. The loan would become an eleven-year loan with principal payments due in years 2 to 11. Interest would be paid on a current basis. Eligibility for deferrals, based on continuing implementation, would be renewable each year for up to ten years. In this example, if the program is successfully implemented and sustained, principal and interest would be paid on a fixed schedule in years 11 to 20. Continued execution can thus transform a 10-year loan with repayment spread over years 1 to 10 into a 20-year loan with repayments in years 11 through 20.

Failure to meet standards in any year would trigger a mandatory start on repayment of principal and the elimination of the interest subsidy. Repayments would continue until compliance resumed. The borrower would have an incentive to choose a program it wants to implement, and to continue it long enough to establish the new rules or procedures as part of the local policy environment.

Lending for structural reform in poor countries without capital market access should be conditional upon implementation of specific institutional and policy changes and supported by financial incentives to promote continuing implementation. Results should be independently monitored to assess performance.

Division of Responsibility

Development

Agencies should be precluded from financial crisis lending.

In the Commission'

As an overview of all multilateral entities, the IMF has exclusive responsibility for financial crisis lending by multilateral institutions. Recently, the development institutions have been called upon to step outside their mandates and div

ert significant resources to crises in Korea, Indonesia, Thailand, Brazil, Argentina and Russia. Although this new role may have been a means for major shareholders to execute "off-balance-sheet" foreign policy without submitting to the budget process in the appropriate legislative venue, this use of development funds should not be repeated.

All country and regional programs in Latin America and Asia should be the responsibility of the Asian and Inter-American Development Agencies. The transfer should be accomplished within five years.

Costly duplication and confusion arise from the overlap of function and resource flows between the World Bank and its regional partners. The comparative advantage of the regional development banks resides in strong relationships with borrowing members based upon a mutual understanding, common language, and common culture. Both the Asian Development Bank and the Inter-American Development Bank have reached a level of maturity and professionalism which qualifies them to take sole responsibility for the tasks of poverty alleviation and structural reform in their respective regions.

The World Bank should become the principal source of aid for the African continent until the African Development Bank is ready to take full responsibility. The World Bank would also be the development agency responsible for the few remaining poor countries in Europe and the Middle East.

In the past, the development institutions have focused almost exclusively on country-specific agendas. Economies of scale and expanded results can be achieved from transnational programs that address shared issues of environment, natural resources, infrastructure and health.

Regional solutions that recognize the mutual concerns of interdependent nations should be emphasized.

The World Development Agency should concentrate on the production of global public goods and serve as a centralized resource for the regional agencies. Global public goods include improved treatment for tropical diseases and AIDS, rational safeguarding of environmental resources, inter-country infrastructure systems, development of tropical agricultural technology, and the creation of best managerial and regulation practices.

The production of international public goods, as opposed to country and region-specific programs, has been conspicuous by its absence in the work of the Banks.

"Knowledge is costly to create but inexpensive to transmit," said Ann Krueger, former chief economist at the World Bank. And it is in the gathering of knowledge, subsidized by grants and revenue guarantees and shared in international forums, that a new and demanding role is found for the World Development Agency.

There is much to address in agendas that confer benefits across society and beyond regional boundaries. Technical and scientific knowledge must be produced for: the environmental challenges of air, water, and earth; sustainable management of natural resources; diversification of agriculture in tropical climates; restoration of the agricultural base in Africa; forestalling of health epidemics; development of vaccines and treatments for AIDS and tropical diseases; and, for economic growth, the design of best practices that will facilitate the flow of private sector funds to the emerging world. The Bank should provide technical assistance on the creation of legal systems that support clearly defined property rights and fair judicial processes; transparent accounting, tax and public administration regimes; policies that promote

the free flow of goods and long-term capital; and sound financial system regulation and corporate governance rules.

The World Bank's role as lender would be significantly reduced. Repayments on the World Bank's existing IBRD portfolio will amount to \$57 billion (49% of loans outstanding) over the next 5 years and \$102 billion (87% of loans outstanding) over the next 10 years.

In its reduced role, the World Development Agency would have less need for its current callable capital. Some of the callable capital should be reallocated to regional development banks, and some should be reduced in line with a declining loan portfolio. The income from paid-in capital and retained earnings should be reallocated to finance the provision of more global public goods.

National governments could redeploy the callable capital released to the regional development agencies, if the regional banks' capital bases require augmentation to meet the needs of their expanded role. World Bank IBRD loan repayments over the next 5 and 10-year intervals are equivalent to 85% and 153% respectively of the \$67 billion combined outstanding regional bank portfolio.

Private-sector involvement by the development institutions should be limited to the provision of technical assistance and the dissemination of best practice standards. Investment, guarantees, and lending to the private sector should be halted.

The International Finance Corporation should be merged into the World Development Agency to more closely integrate its function into the Bank's activities. Equivalent changes should be made at the regional agencies.

The International Finance Corporation should become an integral part of the redefined World Development Agency. Its capital base would be returned to shareholders as existing portfolios are redeemed. The U.S. share of the IFC's \$5.3 billion capital is \$1.3 billion. The capital of the Inter-American Investment Corporation should return to the ordinary capital of the Inter-American Development Bank. MIGA should be eliminated.

Many countries have their own national political insurance agencies. In addition, private-sector insurers have entered the market. The Commission did not find sufficient rationale for continuing MIGA.

The United States should increase its support of effective programs to reduce poverty. The six dollars per capita currently spent is too much for ineffective programs but too little for effective programs.

Appendix A Multilateral Development Banks: Operating Financial Entities

World Bank Group:
the International Bank for Reconstruction and Development (IBRD) provides loans and guarantees to developing member governments;

the International Development Association (IDA) focuses on aid transfers (zero interest credits) to the poorest nations;

the International Finance Corporation (IFC) provides loans and equity capital to private-sector activities in emerging

ing economies;

the Multilateral Investment Guarantee Agency (MIGA) provides political insurance to private-sector projects.

Asian Development Bank:

the Asian Development Bank (ADB) provides loans and guarantees to developing member governments;

the Asian Development Fund (ADF) focuses on aid transfers (zero interest credits) to the poorest members;

the Asian Development Bank provides loans and equity capital to private-sector activities in regional emerging economies.

Inter-American Development Bank:

the Inter-American Development Bank (IDB) provides loans and guarantees to developing member governments;

the Inter-American Development Bank Special Operations Fund (FSO) focuses on aid transfers (1% interest credits) to the poorest members;

the Inter-American Development Bank Private Sector Program and the Inter-American Investment Corporation provide loans, guarantees and equity capital to private-sector activities in regional emerging economies.

Africa

African Development Bank:

the African Development Bank (AfDB) provides loans to developing member governments;

the African Development Fund (AfDF) focuses on aid transfers (zero interest credits) to the poorest members;

the African Development Bank provides loans and equity capital to private-sector activities in regional emerging economies.

Chapter 4

The Bank for International Settlements

T

he Bank for International Settlements (BIS) is one of the world's oldest international financial organizations. It started operating in 1930, mainly to facilitate Germany's reparations after World War I. The bank's other original tasks included acting as a bank for central banks and promoting central bank cooperation. It is viewed widely as a club of central bankers.

The BIS's main mission, reparations, ended at World War II. The 1944 Bretton Woods Conference considered liquidation but made no decision. Instead of expiring, the BIS undertook new duties.

Central bankers comprise the BIS membership and meet monthly to discuss matters of relevance to economic and banking policy. The success of the organization, it is often said, derives from the secrecy of its meetings and the trust created among central bankers through their frank discussions at their frequent meetings.

In the mid-1960s, the BIS started to analyze international financial markets, including the new Eurocurrency markets, and it developed ne

w databases on international capital and currency stocks and flows. During the 1970s, the BIS began to study potential country risk in developing economies. It was among the first to warn of the possibility of a sovereign debt crisis.

The BIS also took a prominent role in establishing committees to recommend standards of practice in various areas. The most influential of these is the Basel Committee on Banking Supervision, formed by the G-10 central bank governors in 1974. The Basel Committee sets voluntary standards for the international banking industry, and operates as an autonomous organization, not as part of the BIS.

Membership

The BIS is a publicly-owned international entity, chartered in Switzerland. Central banks own 86 percent of the bank's issued share capital. Private shareholders own the rest. The private shareholders do not have a right to attend, or to vote at, the BIS's general meetings.

BIS membership has expanded in the past five years. Prior to 1996, the members of the bank's board were drawn from the 11 countries that comprise the Group of 10 (G-10). After 1996 nine additional central banks from Asia, Latin America, the Middle East and Europe joined the BIS, reducing the previous heavy European concentration of members. As of March 1999, 45 central banks were represented and could vote at general meetings.

The bank has no legislative power; its committees simply offer guidance to financial institutions and their supervisors. After they are issued, BIS standards may or may not be adopted by each country's legislative or regulatory bodies.

Current Functions

BIS's current tasks can be divided in to three categories: (1) international monetary and financial cooperation, (2) agent and trustee activities, and (3) financial assistance to central banks.

I International Monetary and Financial Cooperation

The BIS plays a unique role in fostering international cooperation among central bankers and in setting financial standards through the facilities the BIS provides for various committees. Both standing and ad hoc committees meet "to promote stability and mutual understanding." The BIS acts as secretariat for several committees, including the Basel Committee on Banking Supervision. These committees propose international standards and offer guidance on so-called "best practices." Other committees include the Committee on Global Financial Systems---a new name for the former Euro-currency Standing Committee---and the Committee on Payment and Settlement Systems. The three committees participate in the newly created Financial Stability Forum.

Except in a few instances, BIS officials are not active members of the Committee. The membership usually consists of national technical experts. The BIS staff performs secretarial functions and helps with organization.

In 1988, the Basel Committee on Banking Supervision issued minimum capital requirements (the Capital Accord). These are now under revision. The Capital Accord marked the first decisive step in the BIS's participation in setting minimum c

capital standards for international banks. Eventually more than 100 countries adopted the standards, not only for internationally active banks, but also for domestic banks.

The Accord called for linking capital requirements to a crude measure of the banks' risk by assigning different risk weights for different categories of bank assets or commitments. The quality of the standards set by the Accord has been criticized for years for its crudeness, lack of effectiveness in promoting the maintenance of adequate capital (as illustrated by Japan's recent banking collapse), and for politicization. Some critics also question whether establishing a "level playing field" for capital standards will promote fairer competition among banks, given that capital is only one dimension of bank regulation.

A new capital adequacy framework was first circulated in June 1999, as a draft to obtain comments by the industry and academics. A final document is expected by the end of 2000. The tentative plan calls for implementing the new standards around the end of 2001. The new approach is expected to give banks more choice in assessing credit risk by allowing them to adopt an internal rating system for setting capital requirements and by linking required capital, where possible, to credit-rating agencies' ratings of bank borrowers. The new proposals, like the preexisting standards, have received substantial criticism. Despite the flaws in current and proposed capital standards, the Basel Committee's work has undoubtedly helped to advance the discussion of how to achieve more effective prudential regulation of banking.

A central concern of the BIS and the Basel Committee has been finding ways to limit systemic risk in international banking. In 1997, the Basel Committee on Banking Supervision issued 25 core principles for Effective Banking Supervision, applicable to all countries.

The principles cover conditions for supervision, licensing, and structure of the banking system, prudential regulation, methods of ongoing supervision, information gathering and use, powers of supervisors and cross-border banking. G-10 central bank governors and G-7 finance ministers endorsed the document.

The BIS has created a very useful forum for central bankers and regulators of financial institutions by hosting frequent meetings for a common core of participants. Once a month the governors of member countries' central banks meet. The central bankers discuss common problems and exchange information about economic events in their countries. The stability of the international monetary and financial systems is a continuing concern at these meetings.

Agent and Trustee

The BIS acted as an agent (1986 to 1999) for the private clearing and settlement system of the European Currency Unit when the European Monetary Union was first established. The BIS also acts as an agent for some international loan issues and as the trustee, holding the collateral, for some international bond issues. The BIS served as agent in the rescheduling of the Brazilian external debt in 1993, and played a similar role for Peru in 1997 and Cote d'Ivoire in 1998.

Acting as agent, the bank arranges bridge loans for member states and emerging market countries. At various times since the early 1980s, the BIS has provided transitional or bridge funds to countries to which the IMF or World Bank has agreed to lend. These loans speed countries' access to IMF or World Bank credits. For example, in late 1998, the BIS arranged a \$13.28 billion credit facility for Brazil as part of a financial support program.

Financial Assistance to Central Banks

The BIS acts as a bank for central banks, assisting them in the management of their reserves. The banks' assets are invested in international bank deposits, securities, and government Treasury bills. BIS purchases and sales for central banks are confidential and are kept secret. Currently about 120 central banks and international financial institutions use the BIS as a bank. The total deposits placed with the BIS reached \$112 billion on March 31, 1999, representing about 7 percent of world foreign-exchange reserves.

Two recent initiatives augment the mission and the global reach of the BIS. One, the Financial Stability Institute, provides a venue for international discussions, where heads of state, heads of central banks and supervisors can confer. Its stated focus is to promote better and more independent banking, capital markets, and insurance supervision based on the implementation of core principles for financial-sector supervision.

The second is the Financial Stability Forum, which gives the organization and, in particular, Andrew Crockett, its general manager, the ability to expand its reach to countries not previously involved in the BIS or its various committees.

The BIS staff numbers 485 and is drawn from 32 countries.

Challenges and Recommendations

During its 70-year history the BIS has adapted well to large changes in the financial industry and central banking practices. Its ability to adapt was due largely to its limited and homogeneous membership. An example of such adaptation is the way the BIS quickly rose to the challenge of meeting regulatory deficiencies at the international level. The BIS has also demonstrated its ability to convince the most financially important countries to adopt its standards.

The Commission recommends that the BIS remain a financial standard setter. Implementation of standards, and decisions to adopt them, should be left to domestic regulators or legislatures. The BIS should align its risk measures more closely with credit and market risk. Current practice encourages misallocation of lending.

The monthly meetings of central bankers are held behind closed doors. This is widely regarded as an advantage. It facilitates discussion and comments within the group. The BIS keeps a low profile and is not well-known outside the circles of central bankers. Its accounting---using the arcane "gold franc" as a unit of account---and its loosely defined strategies and objectives also limit transparency. The BIS would improve external understanding of the bank if it expanded the quantity and quality of information about its activities.

The BIS might benefit from significant restructuring. The bank currently consists of a wide array of committees that report to different bodies, with different memberships and different sponsors. This structure creates confusion about the allocation of responsibilities and the particular missions of each committee or group within the BIS. It contributes, also, to the lack of transparency noted above. While it is difficult for the Commission to make specific recommendations about how to restructure the BIS, it is our sense that some streamlining of the BIS bureaucracy would be desirable.

ble.

The BIS's success as a meeting ground for central bankers has been facilitated by its small, homogeneous and cohesive membership. For that reason, membership expansion through the Financial Stability Forum, or other means---while potentially useful as a way of facilitating communication across more countries---is a potentially disruptive development for the BIS, and should be undertaken cautiously. The risk is that inclusion may come at the expense of efficacy.

The Commission recommends that any expansion of membership in the BIS or its committees or groups be undertaken gradually and deliberately to avoid disruption of the information exchange that central bankers find valuable.

Chapter 5

The World Trade Organization

At the end of World War II, officials in many countries shared two perceptions about tariffs and trade. Most considered that high average duties mandated in the U.S. Smoot-Hawley Tariff Act contributed to the depth and severity of the Great Depression. They believed, also, that countries would not reduce tariffs or trade restrictions unilaterally. Experience with most-favored-nation clauses in the 1930s showed, however, that countries could reach bilateral agreements that extended benefits to others based on the most favored nation clause.

From 1949 to 1995, GATT, the General Agreement on Tariffs and Trade, was the institutional embodiment of this consensus. The GATT was an interim agreement, not a treaty. In the United States, its legal standing was based on the President's authority to negotiate reciprocal trade agreements. Congress retained the right to approve the agreements as Executive Agreements, not treaties, so they were approved by majority vote in both branches of Congress, rather than by a 2/3 vote of the Senate.

The GATT had two principal activities. Under its umbrella, a growing group of countries reached agreements on nondiscriminatory reductions in tariff duties, quotas and other quantitative restrictions on trade in goods. Also, it managed dispute settlement procedures arising under the agreements. In its later years, the GATT worked to reduce barriers to international trade in services and nontariff barriers to trade in both goods and services. These new activities raised more complex issues than the earlier negotiations limited to tariffs and other quantitative restrictions.

Despite the absence of a formal treaty structure, GATT played a very useful role in the world economy. By creating and, to a degree, enforcing rules for trade, it encouraged trade expansion. Countries that adopted a strategy of export-led growth looked for their comparative advantage, and adopted new technologies to develop or enhance their competitive edge, thereby encouraging practices that increased living standards.

Postwar recovery in Europe and growth in Asia owe much to the gains from specialization and trade. Countries receiving exports from emerging economies gained from the spur of increased competition in their markets, from lower import prices, and from the expanding world market for their exports.

Governments in some countries, particularly Latin American countries, chose a different strategy, known as import substitution. Instead of seeking competitive advantage in global markets, these countries restricted imports in the interest of developing home production. For a time Latin American

countries grew about as fast as the developing Asian countries, in part because they invested in new industries to replace imports.

By the 1970s, growth in the more open Asian countries surpassed growth rates in the import-substituting Latin American countries. A main reason was the competitive test that trade imposed on Asian countries. Their capital was more productive, their production more efficient.

Start of the WTO

Under GATT, nations reduced tariffs on goods to very low levels. Nontariff barriers, quotas, and restrictions on trade in services became the frontier for further relaxation of barriers to trade. After almost a decade of negotiation, GATT members agreed to increase the role, expand the scope, formalize the constitution, and change the name of the trade organization. On January 1, 1995, the World Trade Organization (WTO) replaced GATT.

The WTO agreement incorporated and extended earlier GATT agreements. It made two important additions: the General Agreement on Trade in Services and the Dispute Settlement Understanding. Also, it reached agreement on trade-related aspects of international property rights.

The WTO makes special provision for developing least-developed and transitional economies. These include technical assistance and training to enable these members to participate more fully in the work of the WTO. Here its role overlaps slightly with that of the development banks and to some extent that of the International Monetary Fund as it presently operates.

Structure of the WTO

The headquarters of the WTO is in Geneva,

Switzerland. As of November 13, 1999, there were 135 members (states or, in exceptional cases customs territories like the European Union, Hong Kong, or Macao.) All of the large trading nations, except Taiwan, are members or have applied for membership. Some thirty applications for membership are pending.

The WTO is a relatively small organization. The Secretariat staff of around five hundred is responsible to the director-general, currently Mike Moore of New Zealand. Its 1999 budget was about 122 million Swiss francs, approximately \$75 million. Unlike other international bureaucracies, the Secretariat has no decision-making role. It provides technical and legal support and a public voice for its activities. Top-level decisions are taken at Ministerial Conferences, held at least every two years, and other decisions are made by the General Council, three subsidiary councils that report to the General Council, and numerous specialized committees, working groups, and working parties.

Powers of the WTO

Trade in Services

The General Agreement on Trade in Services (GATS) took effect in 1995 covering areas such as banking, insurance, telecommunications, tourism, hotels, and transport. States that are signatories to GATS commit themselves to provide access to their markets in these services. GATS also contains lists showing where signatories are temporarily not applying the "most-favored-nation

on" principle of nondiscrimination. A full new round of negotiations will seek to extend the scope of these agreements no later than 2000.

The fifth protocol

1 of GATS concerns financial services. This protocol seeks to eliminate or relax limitations on foreign ownership of local financial institutions in banking, securities, and insurance, limitations on the juridical form of commercial presence, and limitations on the expansion of existing operations. As of September 30, 1999, sixty-one signatories to GATS had accepted the protocol and ten had not.

Allowing foreign participation in the financial services sector improves the operation of local financial markets, lowers the costs of these services and reduces risk. Presence of competing foreign banks and financial institutions works to reduce corruption and favorable treatment of politically connected borrowers. Further, many economies are too small to diversify production over a wide range of activities. If domestic banks are limited to financing local industry, and foreign competition is prohibited, the portfolios of banks and financial institutions have too little diversification. There is too much risk that a decline in a major local industry, or other disruption, would weaken local financial institutions, increasing failures and capital flight, followed by a banking and exchange-rate crisis. Part of this risk would be avoided by opening local markets to foreign competitors.

International banks diversify their assets and liabilities by lending to a wider range of industries and countries and taking deposits in many places. This enables them to reduce risk. Further, diversified banks can absorb local losses. Defaults in one country are balanced by profitability elsewhere.

In Chapter 2, the Commission recommended that the IMF require countries to open their financial markets as a precondition for IMF assistance in a crisis. This would both prevent the IMF from lending to countries with weak financial systems and encourage countries to reduce risk. Thus it serves the interest of developing countries and the world economy to encourage governments to accept the fifth GATS protocol.

Foreign competition not only improves the variety and quality of financial services while making them available at lower prices, it also increases the productivity of nonfinancial enterprises by increasing access to credit markets and tailoring the types of lending more closely to the borrowers' requirements. Thus the WTO's program of opening up financial services to foreign competition contributes to the growth of international trade and investment, world output and living standards, and economic stability.

Employment Effects of Trade Agreements

Critics of trade liberalization

often argue that the adjustment to more liberal trading rules imposes a heavy burden on workers and firms that face increased competition from imports. By concentrating on firms and workers that are displaced, and neglecting consumers and those who gain, critics appear to deny that there are net benefits to a country from opening markets.

A common complaint is that the United States has lost manufacturing jobs. Chart 5-1 shows that the share of manufacturing workers as a percentage of the nonfarm labor force has, indeed, declined in the postwar years. In nearly fifty years, the share of manufacturing jobs has fallen from 35% to less than 15%. In the same period, the share of manufacturing output in total output declined much less. Manufacturing productivity increase

d: more manufacturing output is produced with fewer labor inputs.

[Insert Chart

5-1 here]

The trend rate of decline in the share of manufacturing jobs is close to constant for the last fifty years. There is no indication that successive multilateral trade agreements, or passage of NAFTA, had any effect on the trend, contrary to frequent claims about job loss from this agreement. In fact, since the passage of NAFTA, the actual share of manufacturing jobs has been above the trend. This is partly the result of the strong economy.

Trade liberalization does not affect the level of employment -- it does not create or destroy jobs in the aggregate. It affects the composition of the labor force and real wages. By making the economy more efficient, liberalization raises wages. Any resulting change in the composition of jobs is more accurately related to the ebb and flow of industry and commerce.

The Department of Commerce estimates that jobs supported by exports---jobs in trading companies and companies that export---pay 13 to 16% more than the national average of non-supervisory, production jobs. This supports the implications of the economic theory of trade: workers in the aggregate gain from trade expansion.

Dispute Settlement

Five hundred or more years ago, as trade expanded within nation states, rules for trade began to evolve. Courts developed procedures for enforcing rules and settling disputes within national boundaries. Trade agreements and enforcement encouraged the postwar expansion of trade by extending the rule of law to international disputes. With increased rules and laws, the need for interpretation, adjudication and dispute settlement encouraged the development of new institutions.

Dispute settlement activities developed slowly under GATT. Between 1947 and 1994, members brought only 300 disputes. Between 1995 and September 1999, members brought 179 cases. Three reasons explain much of the increase.

First, early GATT rules mainly regulated tariffs, so violations were more easily checked and settled. As GATT, and later WTO, expanded into nontariff barriers, beginning in the 1970s, different and more complex issues arose. Are health standards valid regulation or hidden protection? Does a restriction help mainly to preserve local culture or prevent foreign competition? Do foreign trucks meet local safety standards, or do local safety standards serve to protect local suppliers?

Second, the original GATT had 23 member states, many with broadly similar trading rules. Disputes were settled by negotiation among the contracting parties. As new countries entered after the 1960s, new problems arose. Countries had different standards of conduct and different orientations. For example, government procurement and subsidies to state-owned enterprises were much more important in some countries than in others. Some countries support or permit local cartels, and the local law may favor them. Other countries prohibit monopoly and cartelization.

Third, countries could veto adverse decisions, and they often did. Time to decision was long, procedures cumbersome, and decisions were often unenforceable.

In 1994, the Uruguay Round made major procedural and substantive changes. First, a more or less unified system replaced the fragmented system that

that had developed. Most disputes are now handled in a similar way, unlike the practices that developed in the 1980s. Second, an appellate body can review the legal basis for decisions made by the panels that adjudicate disputes. Third, decisions cannot be vetoed by a party to the dispute. Decisions stand unless there is a consensus of the members that the decision should not be enforced. Fourth, the length of time to settle disputes has been shortened.

Recommendations

The WTO is a relatively new organization subject to change as experience with its strengths and weaknesses accumulates. The Commission had neither the time nor the expertise to evaluate all the changes that have occurred or the many proposals for future changes. It confined its recommendations to two areas: general principles of operation and the role of the WTO in promoting financial stability, safety and soundness.

Some General Principles

The WTO has two main functions. First, it administers the process by which trade rules change. Trade ministers (or their equivalent) negotiate agreements that legislative bodies can approve or reject. Second, the WTO serves as a quasi-judicial body to settle disputes. Part of this process involves the use of sanctions against countries that violate trade rules.

Quasi-judicial determination, when coupled with the imposition of sanctions, can overwhelm a country's legislative process. As WTO decisions move to the broader range of issues now within its mandate, there is considerable risk that WTO rulings will override national legislation in areas of health, safety, environment, and other regulatory policies. The Commission believes that quasi-judicial decisions of international organizations should not supplant legislative decisions. The system of checks and balances between legislative, executive and judicial branches must be maintained.

Ruling
Sanctions or decisions by the WTO, or any other multilateral entity, that extend the scope of explicit commitments under treaties or international agreements must remain subject to explicit legislative enactment by the U.S. Congress and, elsewhere, by the national legislative authority. There should be no "direct effect" on U.S. (or other) law.

Enactment of this recommendation would limit the WTO's authority, and the authority of other international agencies, to impose sanctions on a country for violation of rules to which it did not agree. We recognize that this would weaken the application of the rule of law internationally. Its principal benefit is that it strengthens democratic accountability and maintains the legislative function from delegation and erosion.

If countries do not accept WTO decisions, injured parties have the right to retaliate by putting restrictions on imports from the offending country or region. The injured country then suffers twice---once from the restrictions on its exports, imposed by foreign governments, and again when tariffs or duties raise the domestic cost of the foreign goods selected for retaliation. To compensate for the injury done by others, we impose costs on ourselves as well as them.

The Commission proposes that, instead of retaliation, countries guilty of illegal trade practices should pay an annual fine equal to the value of the damages assessed by the panel.

l or provide equivalent trade liberalization.

Retaliation is contrary to the spirit of the WTO. Sanctions increase restrictions on trade and create or expand groups interested in maintaining the restrictions. Domestic bargaining over who will benefit from protection weakens support for open trading arrangements.

Rules for Financial Stability

The Commission recommends rules to enhance financial stability. Such rules can reduce risk, spread best managerial practices, increase competition, and reduce the role of government in the allocation of bank loans. The Commission recommends that explicit minimum financial standards be phased in as a condition for assistance from the IMF in a financial crisis.

Chapter 2 discusses these preconditions. Enforcement of the preconditions should remain the IMF's responsibility.

We believe that proposals and recommendations to improve financial standards should be the responsibility of the groups on banking and financial standards associated with the BIS. Chapter 4 discusses the groups responsible for these proposals and recommendations. These responsibilities should remain with the Basel-based organizations, such as the Basel Committee on Banking Supervision.

The WTO is an adjudicative organization that has proved effective in settling disputes about tariffs and quantitative trade restrictions. The WTO should not extend its procedures to set domestic policies and regulations, including regulation of banking services, accounting practices, or financial standards. These should remain the responsibility of specialized agencies.

Members of the Commission

Allan H. Meltzer, Chair, is the Allan H. Meltzer Professor of Political Economy at Carnegie Mellon University and a Visiting Scholar at the American Enterprise Institute. He has served as an Acting Member of the President's Council of Economic Advisers, 1988-89, a Member of the President's Economic Policy Advisory Board, and an adviser and consultant to central banks, governments and international financial institutions.

Charles W. Calomiris, Fred Bergsten, has been Director of the Institute for International Economics since its creation in 1981. He also served as Chairman of APEC's Eminent Persons Group from 1993 through 1995 and as Chairman of the Competitiveness Policy Council, created by the Congress, from 1991 to 1997. He was a member of the Independent Task Force sponsored by the Council on Foreign Relations on The Future International Financial Architecture (1999). Dr. Bergsten was Assistant Secretary of the Treasury for International Affairs during 1977-81 and also functioned as Under Secretary for Monetary Affairs during 1980-81.

Charles W. Calomiris is Paul M. Montrone Professor of Finance and Economics at the Columbia University Graduate School of Business, and a Professor in the Department of International and Public Affairs at Columbia University's School of International and Public Affairs. He co-directs the Project on Financial Deregulation at the American Enterprise Institute, is a member of the Shadow Financial Regulatory Committee, and is a Research Associate of the National Bureau of Economic Research.

His research spans several areas, including banking, corporate finance, financial history, and monetary economics.

Tom Campbell is a member of Congress from California's 15th district and Professor of Law at Stanford University. Congressman Campbell serves on the House Banking and International Relations Committees where he has worked on international trade and economic issues. A special interest is the promotion of democratic institutions in developing countries.

Edwin J. Feulner, Ph.D. is president of the Heritage Foundation and trustee of Regis University, George Mason University, the Acton Institute and International Republic Institute. He is the former vice-chairman, National Commission on Tax Reform and Economic Growth; past president, The Mont Pelerin Society; and author of *Conservatives Stalk the House*, *The March of Freedom*, *Intellectual Pilgrims*, and *Leadership for America*.

Lee W. Hoskins, was Chairman and CEO of Huntington National Bank, 1991-97. From 1987 to 1991, he served as President and CEO of the Federal Reserve Bank of Cleveland and from 1980 to 1987 as Senior Vice President and Chief Economist, PNC Financial Corporation. He holds B.A., M.A., and Ph.D. degrees from UCLA.

Richard L. Huber, is Chairman, President and Chief Executive Officer of Aetna, Inc., a \$30 billion global health benefits and financial services company. Prior to joining Aetna, he had extensive banking experience in Latin America and Asia. He is a director of the Foreign Policy Association, the Japan Society, and a Trustee of Trinity College.

Manuel H. Johnson, became co-chairman and senior partner in the consulting firm of Smick Medley International in September 1990. Prior to assuming his current duties, Dr. Johnson was Vice Chairman of the Board of Governors of the Federal Reserve System where he served for four and a half years beginning in February 1986. Dr. Johnson served as Assistant Secretary of the Treasury 1982-1986, and Deputy Assistant Secretary 1981-82. From 1977 to 1994, Dr. Johnson was a professor of economics at George Mason University where he held the Koch Chair in International Economics.

Jerome I. Levinson, is a graduate of the Harvard College, '53 and the Harvard Law School, '56. He was a Fulbright scholar in India, '56-57. He is presently the Distinguished Lawyer in Residence at the Washington College of Law, where he has been for the last five years. Professor Levinson previously served as Assistant Director of the Agency for International Development Office in Brazil in charge of the capital assistance lending program (1964-66), and then was Deputy Director of the AID Latin American Capital Assistance program (1966-68); Chief Counsel to the Senate Foreign Relations Committee, Subcommittee on Multinational Corporations and U.S. Foreign Policy, (The Church Subcommittee), 1972-77; General Counsel to the Inter-American Development Bank (1977-1989); On Counsel to the Washington law firm of Arnold & Porter, 1990-92. Professor Levinson is also currently a research associate of the Economic Policy Institute. He co-authored, along with Juan De Onis, the leading work on the Alliance for Progress: *The Alliance That Lost Its Way*, (1970).

Jeffrey D. Sachs, is

the Director of the Center for International Development and the Galen L. Stone Professor of International Trade in the Department of Economics at Harvard. He has served as economic advisor to governments in Latin America, Eastern Europe and the former Soviet Union, Asia and Africa.

Esteban Edward Torres, served in the U.S. House of Representatives, D-CA 1983-99, House appropriations Committee, Subcommittee Foreign Operations and Export Financing and the Committee on Banking, Finance and Urban Affairs where he was Chairman, Subcommittee on Consumer Affairs and Coinage. Earlier, from 1979 to 1981, he was White House Special Assistant to the President, U.S. Ambassador to UNESCO (1977-1979) and International Representative UAW (1963-77).

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(Based on World Bank data from the Banks web site.

Und

erlying data are from the World Bank's web site.

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World Bank Operations Evaluation Department, Impact Evaluation Report 18142: The Brazil Health System, Washington: June 30, 1998, paragraph 12.

Data in this sentence are for the 6-year period (1992-97), most recently available.

This is the residual after eliminating World Bank nonaid resource flows to countries (1) with capital market access, (2) private sector activities but no market access and (3) public sector activities without capital market access and institutional infrastructure to absorb the resources.

The weights are based on Appendix B.

The IDB charges 1-3/4% and calls the fee interest.

There are now two measures of the subsidy, \$31.4 billion in Table 3-7 and \$22 billion in Table 3-4. The main source of the difference is the different evaluations of risk. The \$31.4 billion, assuming the market prices these risks correctly, is the likely upper bound.

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The United States brought 49 of 179 disputes in the first 4-1/2 years. Twenty-two were settled in favor of the U.S., by consultation or adjudication by panels. The United States lost six cases. The rest are in process.

A very useful discussion of these and related issues is in Claude Barfield, "More Than You Can Chew? The New Dispute Settlement System in the World Trade Organization," available from the Commission's web site, <http://phantom-x.gsia.cmu.edu/IFIAC>.

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

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SUBJECT: here is another one from the apec trip- both gene and lael briefed

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

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THE WHITE HOUSE

Office of the Press Secretary

For Immediate Release

November 12, 1998

PRESS BRIEFING BY
ON PRESIDENT'S TRIP TO APEC CONFERENCE

The Briefing Room

3:54 P.M. EST

MR. TOIV: Good afternoon, everybody. As you all know, the President is scheduled to leave Saturday for his long-awaited trip to Asia for the APEC conference in Malaysia, as well as visits to Japan and South Korea and Guam. Here today to brief you on those subjects are Gene Sperling, the President's National Economic Advisor -- and Gene will talk to you about our goals for the APEC conference. Lael Brainard, our Deputy National Economic Advisor for International Economic Affairs -- Lael will tell you about the trip schedule. Ken Lieberthal, who is the National Security Council's Senior Director for Asia -- you may remember Ken from an earlier briefing he did in an earlier life, before President Jiang Zemin's trip here to the U.S.

Also here to take questions are Ambassador Steve Sestanovich who is over here from the State Department to talk about the bilateral meeting with Prime Minister Primakov. Steve may have to leave early; if so, he'll be replaced by somebody else and we'll let you know. Tim Geitner is here; he is the Treasury Under Secretary Designate for Economic Affairs.

And I think that is it. Let me just tell you one thing -- or not tell you one thing I know the question that is uppermost on your minds is the one that Joe took earlier today and that is the question of whether the President is going on this trip. None of these briefers will be able to elucidate the situation any further than Joe did. So I'll leave you with that.

Q Is he going? I'm serious. You say the President plans -- how did you put it --

Q You said "is scheduled."

MR. TOIV: Yes, and as Joe said, the President is looking forward to going, has been looking forward to going. He is, obviously, watching events elsewhere in the world, particularly Iraq, very closely. And if we have any schedule changes to let you know about, we will let you know about them.

Q Would someone go in the President's stead if the President were unable to attend APEC?

MR. TOIV: That's a hypothetical question that I don't think Mr. Lockhart would have answered.

MR. SPERLING: I apologize up front in that I have to leave in about 10 minutes, though we're well-equipped here. APEC provides a particularly good forum for the President to continue the process of forging consensus on the practical and immediate steps needed to deal with the Asian financial crisis and growth issues, and the widespread poverty and economic harm that have accompanied this situation.

In particular, at APEC we hope to continue the process of trade liberalization that is important for continued worldwide growth. As you know, in Vancouver the President and APEC leaders asked the trade ministers to deliver -- make progress on further liberalization in nine key sectors, and we hope to follow through on the commitment to make further liberalization in those areas.

We think this is critical at this time in the world economy to show that further progress on trade liberalization can and should be made to serve as a strong signal that we should not be turning back or closing up even at this difficult time in the world economy, that the benefits of open markets are too important to sacrifice at this time.

The President also will be discussing many of the steps he has been working on over the last year, and particularly laid out in his Council on Foreign Relations speech, particularly the need to help private companies restructure their debt in Asia and return to growth and expansion; the need for further social safety net reform to help deal with the transitions that are needed in this difficult time; and taking actions to ensure that we're spurring our own exports into the region.

Clearly there will also be discussion on further efforts on long-term architectures. As you know that at this -- at APEC the President called for the special finance ministers meeting that is sometimes referred to as the G-22, but the basic notion that emerging markets should be brought into the discussion with the G-7 on the

long-term issues. And it's worth noting that Vietnam, Russia and Peru will be at APEC for the first time.

On the trade liberalization, which I mentioned, which goes by the initials EVSL or Early Voluntary Sectoral Liberalization, the nine areas are all areas that the United States is quite competitive in -- chemicals, energy goods, environmental, technology goods, fish-forestry, gems and jewelry, medical equipment, toys, and telecom. Just example -- environmental technology in the United States has \$14.5 billion in exports, and over \$20 billion in medical equipment and scientific products.

The goal is to press forward on these and continue in six other areas over the following year. As you know, APEC in the context of the information technology agreement -- the ITA -- served as the form that helped bring that together and brought to the WTO for the eventual agreement.

It has been a disappointment to us that at this stage Japan has not made more progress and, in fact, has been resistant in the areas of fish and forestry. These are the two areas that -- which are most relevant to Japan. Even though they only have between five and six percent tariffs in these areas, there's been significant resistance. Outside of these two areas, there's very little tariff reduction required of Japan, and we feel that if we -- to make progress and to discourage other countries from making excessive reservations, we are hopeful that we will be able to pull together and make progress on the trade liberalization that was hoped for at this time.

I will turn it over to Lael. I will say that obviously some of the President's bilaterals are important on the economic front. Ken will go over some of those more. Certainly with China we not only want to discuss their economic reform efforts and some of the difficult reform efforts as they make transitions from their state-owned enterprises, but certainly the further trade progress and liberalization progress that must be made for them to be able to join the World Trade Organization.

And certainly in our trip to Japan there will be continuing discussions on the agenda that is quite familiar to all of you now, which will be particularly important in the area of the implementation of their banking program where the size of the funds put forward has certainly been significant, but significant questions remain as to the implementation -- questions and certainly the issues of stimulating growth and some of the trade issues that are still between us, whether implementing sectoral agreements as flat glass or some of the issues on steel that have arisen recently.

So let me, with that, turn it over to Lael Brainard. Lael, if not all of you know her, is the Deputy International Economic Affairs. She is the third to hold that position after Bo Cutter and Dan Turillo, and has been with us for a few years and is formally a professor of economics at MIT.

MS. BRAINARD: That's probably more than you needed to know to hear about this schedule. (Laughter.) We're leaving Saturday evening en route to Kuala Lumpur. We arrive mid-morning on Monday. The President has a very full schedule that day. He has a bilateral with Jiang Zemin of China -- also, with Prime Minister Chuan of Thailand, and Ken Lieberthal will speak about both of those in a minute.

That evening, he's going to give remarks at the APEC Business Summit. The next morning -- Tuesday morning -- he will be meeting with Prime Minister Primakov from Russia. He then starts the full agenda for APEC, and it goes through the traditional APEC agenda that's been established over the last few years.

It starts off with an agenda briefing among all of the leaders -- as Gene mentioned, we'll have new members there this year. That is essentially a chance for the host to go through the schedule and talk about the issues on the agenda. That will be followed by a meeting with the ABAC -- the APEC Business Advisory Council -- which is the private sector advisory group from which each economy appoints three members. We have three members there who will be participating in that along with the leaders.

The next morning starts the Leaders' Retreat. They will go off to a place called Cyberview Lodge. And there will be two sessions and a lunch. I believe the morning session will focus more on the growth agenda for the region and the specific trade liberalization initiative on the table. The afternoon session will focus more on a broader trade agenda, in particular the WTO process that kicks off next year as well as some issues like electronic commerce.

That evening, Wednesday evening, they depart Kuala Lumpur and they go on to Tokyo. Thursday morning in Tokyo, the President is planning to do a meeting with some local members of the business community. I believe some American business leaders will be there as well. And it will be followed with a town hall meeting with Japan's sort of next generation of leaders, young people. He has a call on the Emperor midday, and then the afternoon is devoted to bilateral meetings with the Prime Minister, and a dinner that evening.

Friday morning will replicate a little bit of the feeling of Tarrytown in the sense that Prime Minister Obuchi wanted to go off campus and spend a little bit of time with the President in a more relaxed environment. So they will go off to Hakone together and they are also expected to spend a little time on environmental issues during that day.

Friday evening they depart, arriving in Seoul. Saturday morning is the official bilateral with President Kim Dae-Jung, followed probably by, I think, a discussion with civil society -- members of civil society and a dinner later that evening.

Sunday the President will be spending some time with troops in Korea. I believe he leaves now Sunday evening, arriving in Guam. In Guam -- actually, I'm mistaken. He's leaving Monday morning, arriving in Guam Monday morning. There he will do three events. He will have a meeting with community leaders and Governor Gutierrez. He will visit the War in the Pacific World War II Memorial, and he will also have an opportunity to speak to the people of Guam. At that juncture I think he gets back on a plane and we are estimating that he returns Monday evening.

Did we lose Steve already? Carlos is coming? Okay, why don't we flip to the bilaterals that Ken Lieberthal will go through.

Q Can you describe more the audience at the town hall meeting in Tokyo and also who is at the meeting with members of civil society in Seoul?

MS. BRAINARD: Why don't I let Ken do that when he goes through the actual sort of bilateral events.

MR. LIEBERTHAL: Thank you, Lael. Let me take up an array of issues that are kind of more the political and security side of all of this. First, some questions have been raised as to why we should attend the APEC meeting, given that it is taking place in Malaysia. And the answer to that is very simple. The APEC meeting is important. It's a major international group in which the U.S. has played a central role all along. That meeting is taking place in Kuala Lumpur, but we are going to Kuala Lumpur in order to attend the APEC meeting.

This is, therefore, not a bilateral U.S.-Malaysian situation. The Malaysians have not asked us for bilateral meetings. We have not asked them for bilateral meetings. Our rubbing shoulders with Malaysian officials will be totally in the context of the APEC meeting itself. But we regard that meeting as warranting American participation and support.

While the President is in Malaysia, he will hold several meetings with other leaders there. Shortly, we'll have a briefer in to tell you about the meeting with Primakov. Let me tell you about the two other major leaders. One is with Chuan of Thailand. The meeting with him will primarily give us an opportunity to congratulate him on pursuing the IMF agenda for economic recovery in a rigorous fashion.

We think Thailand has moved along very substantially. If you look at their economic performance, they're in what could be called a virtuous cycle. In other words, they have essentially stabilized their foreign exchange rate; interest rates have come down. They are beginning to attract foreign direct investment. They still have a lot to go, but this is the kind of path that we anticipated and we want to show our support for what they have done there.

In the process, they have, if anything, become a more democratic country. And an underlying theme of the President's trip is the kind of intersection, if you will, or compatibility of moving in a more democratic direction and doing better in economic performance with the kind of information-based market economy that will be key to prosperity in the 21st century.

The President will also meet with Jiang Zemin of China while at APEC. That meeting is one that is seen as essentially laying out between the two men an understanding of where our bilateral relationship will head over the course of the coming year. So this is not merely to kind of sustain the summit diplomacy and to pat each other on the back. It is not simply to check the boxes of what we have done since the last summit. It is rather to see where we can really move forward in our agenda and make this constructive partnership work.

Q Where does the President want it to go, if you'll elaborate a little?

MR. LIEBERTHAL: Some of the key issues here are WTO accession -- I'll say a word about each of these, if you wish -- but WTO accession, cooperating with regard to North Korea, Chinese consideration of membership in the Missile Technology Control Regime, MTCR, and the human rights agenda.

Why don't we save for Q&A my specific comments on any of those, but you've noted them down. I'm happy to elaborate on each of them in response to your questions, but we want to run through the basic brief here and then let you focus on where you want.

So the meeting with China we regard as an important meeting and as a kind of looking to the future. It will not produce a press statement, but hopefully it will produce some real energy in the relationship as we go into the next year.

We then move on to Japan. In Japan the President will have the opportunity, in no small part through that town hall meeting, to carry the message of APEC to the people of Japan. That message, we anticipate, will be a message that favors open markets, but also that recognizes the critical importance of Japan's developing demand-led growth domestically as a core element in Asian regional economic recovery and indeed in global economic growth. And coming from APEC, this will give the President a good opportunity in an interactive fashion with citizens of Japan to make those points and also to hear what they have to say.

Someone asked about the composition of that group. It's basically young people, ages 21 to 45, from different walks of life. There is a mix of professionals and just an array of people from very different sectors. There will be two different locations -- live, I believe, and plus citizens of Japan will have the opportunity to submit questions in advance by Internet. So most of this will be the

President responding to questions that people in Japan raise either live or through the Internet.

In addition, the President will be talking with the Japan about security issues on the bilat. Those security issues will focus in part on how to deal with North Korea, because North Korea has been behaving in ways that none of us would really like to see -- and also some alliance issues that are very well-known to people who follow the U.S.-Japan alliance. These are longstanding issues that I'll get into again if you wish to raise them in the Q&A.

On the economy, I think Gene basically covered what he plans to do on the bilat on the economy, but the economic bilat is quite important.

He then moves over to Korea. In Korea, the economic side of the issue is more -- kind of similar to what he's doing in the bilateral meeting with Chuan of Thailand, which is to say to congratulate the Koreans on sticking to a course that is a very difficult course; that while it is the right prescription we think for long-term growth and prosperity, in the short-term it produces an enormous amount of social dislocation and pain. He wants to say essentially that he understands that and to encourage them to stick with that course.

He also regards Kim Dae-Jung rightly as one of the outstanding democratic figures of Asia and wants to acknowledge that, and there will be discussion of democracy issues in Asia and there will I think a program on democracy -- or a forum on democracy that will be discussed.

And then, finally, on the security side, he again wants to go over the Korea situation -- the North Korea situation -- with the people in Seoul. So to sum up, one of the underlying security issues for China, Japan and Korea is how to deal with North Korea, and it's important for us to get coordination and mutual understanding and cooperation among all three -- two of whom are alliance partners of us, one of whom cooperates with us -- in order to handle the North Korea issue effectively.

And then we have econ issues that go all the way through these meetings and then some other particular issues in each bilat.

With that, let me turn it over to Carlos Pascual, who is Senior Director for -- covers Russia -- I've forgotten what your whole directorate is called -- but, anyway, covers Russia, to go over the bilat with Primakov. And then we'll open it up to your questions.

MR. PASCUAL: Just very briefly, the President will see Prime Minister Primakov on Tuesday. It will be the first meeting that we have with the Prime Minister since he's taken on his new position and moved from being the Foreign Minister. This will be for us an opportunity to hear from Prime Minister Primakov about his

economic strategy, about how he sees Russia moving ahead and dealing with the current kind of economic crisis it has, what his thoughts are about promoting economic stability, and what Russia's plans are to try to restore economic growth over time.

It's also going to be an opportunity for us to talk about specific steps that could be taken on the nonproliferation front and addressing concerns that we've had in the past. All of you have seen recent indications that there may be movements on START II. That will certainly be an issue for discussion. We hope that we can mark some additional progress, moving along on that front.

Obviously, it's been discussed in recent days in the press the situation of records of POWs and MIAs. Depending on what final information we get today from Senator Smith and Ambassador Toon who have been in Russia and have been working on this issue, that will be -- may be an issue that requires additional follow-up as well.

It's a relatively short meeting of just about an hour, so we don't expect any major developments coming out of it, but it is an opportunity for us to continue to work on these issues which have been a longstanding part of the bilateral agenda.

Q Carlos, as long as you're -- what does this say about Yeltsin that he's not there --

MR. PASCUAL: Well, we're glad that President Yeltsin did come back from Sochi and has begun to reengage again. We hope his health is better. It's obviously of concern that -- if he isn't well, but we don't have additional information from what you've actually seen. This evening, I understand that he did not participate in the dinner with Obuchi. That probably shouldn't be surprising because he hasn't been engaging in an extensive schedule.

Most clearly, in terms of authorities and responsibilities, it's been most clearly placed by the Kremlin itself, when Mr. Sysuyev, the spokesman for the Kremlin, indicated that responsibility for day-to-day economic issues and for economic strategy is going to be with the government and with the Prime Minister, and President Yeltsin is going to be the guarantor of the Constitution. Exactly how that breaks down into specific responsibilities over time we still don't know. These are sort of a general statement of principles that they've laid out, but I don't have much more for you than that.

Q What about Iraq -- any discussions with Primakov?

MR. PASCUAL: Obviously, in terms of the developments on regional issues, there may be a whole range of regional issues that come into play -- Iraq, Kosovo -- and we will decide on what the specific items are as we're close to the time.

Q Carlos, can you give us an update on how things are looking from the Russian perspective as far as any kind of military

action -- conversations with them recently and how are they going?

MR. PASCUAL: I can't comment on that, sorry. I haven't been directly involved in the Iraq issue, so I'll pass on the question.

Q On the economic front, is there going to be an agreement on this debt relief proposal that was written about I guess yesterday in the Wall Street Journal?

MS. BRAINARD: You're referring to the APEC meeting? I think Gene was talking earlier about our broad recovery agenda which I think is shared by most of the leaders in the region, and we are hoping to make progress on all of the priorities, all of the different pieces that he talked about -- Japan's critical role, the need for it to expand its own economy, absorb more of the exports from neighboring economies in the region. We want to make some progress on the need for stronger social safety net spending in the region.

As you probably know, as the IMF programs have taken hold in many of the crisis-stricken economies, they've been able to expand their fiscal spending on social safety net kinds of programs. And there has also been an initiative for the World Bank and the ADB to augment financing for that.

We certainly -- among those priorities, the one of getting the corporations and companies in the region out from under crushing burdens of debt and the associated connection to strengthening the banking system; alleviating the credit crunch is very important, and we would like make some progress in that area.

Q Has Japan agreed to that?

MS. BRAINARD: At this juncture there is a variety of discussions on this important issue. This is a priority that the President laid out in the Council on Foreign Relations speech. And subsequent to that, there has been a lot of work on this area. But at this juncture there is just a large work program as opposed to a specific initiative.

Q So Japan has not agreed? That would be a no?

MS. BRAINARD: No, that would not be a no. There is a work program. This is something that will be discussed at the meeting. Japan is a very important part of our work, our cooperative work in this area, and that will continue to be true.

Q Is the United States willing to put forward any of its own funds to back such an effort, or would it seek funds exclusively from other countries and multilateral agencies?

MS. BRAINARD: Again, there is a work program that

involves a variety of initiatives. There is no specific funded initiative at this juncture.

Q So the U.S. is open to the idea of using its own money for this?

MS. BRAINARD: I think what we're looking for is the best way of moving forward the corporate sector restructuring and the financial sector restructuring.

Q On the corporate debt restructuring, the debt was announced today -- not announced, but that was proposed -- Japan has also announced a plan, the Miyazawa plan. And I was wondering how you envisioned the plan that the U.S. is proposing different from the Miyazawa plan. What are the differences in the two?

MS. BRAINARD: The Japanese government has announced that it has a certain amount of money that it wants to make available for a variety of initiatives in the region, which I believe you're referring to as the Miyazawa plan. The priorities that they have discussed in using that financial assistance is very much similar to the priorities that we have articulated. And indeed we're working cooperatively with them on those priorities, bilaterally and also multilaterally.

The other thing that is, of course, extremely important for Japan to contribute to the region's recovery is getting its own domestic economy moving again based on domestic demand-led growth.

Q But where do you see it being used? Is it for the corporate debt overhang or social safety net, or both?

MS. BRAINARD: My understanding is that the specific uses of that money are still being discussed. As I understand it, though, the priorities that they have articulated are very similar to the ones that I just articulated -- things like trade finance, things like credit enhancements to get private investment flowing again, things like social safety net spending, and things like corporate and financial sector restructuring.

Q A scheduling issue -- when the President meets with U.S. troops in Korea, where will they meet? At the DMZ, or someplace else?

MR. LIEBERTHAL: No, they will not meet at the DMZ. There will be two places where the President is on military ground, if you will. One is the Korea Training Center, the KTC, and the other is Osan Base. He will -- depending a little bit on the weather. If the weather is kind to us, at the Korea Training Center, he will view U.S. and ROK troops together and have a chance to address the troops, have lunch with them and so forth.

He will then leave Korea from Osan Air Base, which is also the site of anti-chemical weapons, Patriot battery, and so

forth. While there, he'll address the people at the air base in a brief set of remarks, and then leave from Osan.

Q I didn't understand the meeting with civil society in Korea. Who is the meeting with?

MR. LIEBERTHAL: This again is a roundtable discussion with a group of individuals from various sectors of Korean society. It is, as much as anything, for the President to understand some of the social consequences of the changes that Korea is now going through -- those consequences are very severe -- to both understand that better himself and to express his concern about that.

So it's an opportunity for him to get out of the kind of standard official setting where he's standing up there and telling people what he thinks, and instead to learn something directly from people who are involved in various sectors of Korean society.

Q Are they supposed to be talking about the consequences of the economic downturn in the region, or more generally about life in Korea?

MR. LIEBERTHAL: They will be to talk about anything they want to talk about, but I think the idea is to focus on Korea. This is not seen as an opportunity for him to hear economists talk about what has to be done for the region as a whole; it's an opportunity for him to talk to people in various sectors of Korean society about what they think is going on in Korea, and to talk with them about what he thinks probably needs to happen in the future and get some sense of how they react to that.

Q Could you talk about what the President or other people traveling with him will be saying to the Malaysians about the treatment of Anwar? And will anybody, particularly Secretary Albright -- I know there has been talk that she might meet with Anwar's wife -- has any decision been made on that?

MR. LIEBERTHAL: Let me say first, we have had a number of our top officials specifically comment on the situation in Malaysia, bemoan the apparent movement away from democratic principles and toward more authoritarian methods there. Secretary Albright has made a statement of her own. Secretary Rubin has made a statement. Vice President Gore has made a statement, and so forth. So we've been relatively vocal on that issue. I think it is quite possible that Secretary Albright, while in Kuala Lumpur, will find an opportunity to meet with Anwar's wife. That is not confirmed, but that is certainly something that she would like to see occur if it can be arranged in an appropriate fashion.

Q Can you address the parallel situation of the host country, in this case Malaysia, opposing free market principles advocated by the United States?

MR. LIEBERTHAL: Well, you know, the choice of Malaysia

as host was made four years ago, and no one anticipated four years ago that this kind of situation would arise. The U.S. wants to go into this meeting with a positive message. That positive message has a core economic component that Gene and Lael have laid out. There is also, to my mind, a tightly related political component that we will articulate, and that is the compatibility -- I mentioned this briefly; let me just take an additional moment on it -- the compatibility between democratic forms of government, if you will, democracy and good governance, and doing well with a free market economy in the Information Age.

When you think about it, more democratic societies have a stronger commitment to the rule of law. They allow for decentralized decision-making and individual initiative. They allow for the free flow of information. They produce governments that are more responsive to the needs of society, and also more legitimate in the eyes of the people when they have to make tough decisions.

These are all elements of a mix that enables you to do better in response to economic crisis, and we think is a mix that enables you to do better given the nature of the international economy that is developing out there for the coming century.

So that if you look historically, countries in deep economic crisis have tended to go either toward a much more authoritarian kind of system. The most dramatic example, obviously, is Nazi Germany in response to the Great Depression. Or in a more democratic direction, if you will, the New Deal in response to the Great Depression.

We are encouraging countries to go more toward the democratic side. And if you look at the countries with whom the President is having bilateral meetings and whom he's visiting, the Thais have gone in a more democratic direction. He will meet, although not for the same length of time as with the Thais, he'll meet with the Indonesians. Secretary Albright will be going to Indonesia and Thailand after the APEC meeting. The Indonesians have moved in a more democratic direction. He'll be going to Korea. They have moved in a more democratic direction. This is something that we want to highlight, both kind of conceptually and in terms of where the President chooses to spend his time.

Q Did the United States ever seriously consider not going to this meeting because of its opposition, its disapproval of the way the government of Malaysia is tending?

MR. LIEBERTHAL: I am not sure what is required to qualify for "seriously considering," but let me say all the way through we have felt that it is very important for the United States to be well represented at the APEC meeting and to play a significant role at this meeting.

Keep in mind, please, that APEC is the one multilateral organization that both includes all major economies of Asia and,

historically, has included the United States as a major player. You do not walk away from that kind of vehicle, if you will, because of some other set of political concerns. Rather you try to stress what you need to stress in order to achieve long-range, major goals that are important for this country and you deal with the other elements as they come up.

Q But just to be clear, to follow up on a previous question, you don't expect the President himself to directly express in any way his dissatisfaction with the Malaysian government, other than by not meeting one-on-one with -- Mahathir.

MR. LIEBERTHAL: I, frankly, cannot tell you exactly what the President will and will not say. He will have the opportunity while in Kuala Lumpur to make various remarks and he may choose to comment on the Malaysian situation. But we'll have to wait to see what his actual comments are.

Q To clarify in Indonesia, you said that the President would be meeting with the Indonesians. Is that sort of a pull aside with Habibie, rather than a formal, sit-down --

MR. LIEBERTHAL: It is a shorter meeting with Habibie, and it's a shorter meeting with Habibie in part because Secretary Albright will be going to Indonesia shortly afterwards and there's a limit to how many long meetings you can have while you're attending the APEC meeting within the constraints of time that he's in the city. But he did -- let me stress, if I can, he did want to meet with Habibie because he does want to encourage the Indonesians to continue to move down a path toward the elections this coming year, which will produce, presumably, a legitimate government that has the political stability necessary to attract foreign direct investment and to improve the lives of their people.

Q What day is that meeting?

MR. LIEBERTHAL: The meeting with Habibie is on the 17th, at 5:00 p.m.

Q Any other short meetings?

MR. LIEBERTHAL: Yes, although I don't want to give you a definitive list because the short meetings can change a little bit. But he certainly will be meeting with the Sultan of Brunei, with President Estrada of the Philippines and with Habibie.

Q You had mentioned North Korea is going to be a threat, a security threat going through the meeting with Japan, the meeting with China. What direction are you trying to get everybody to go on board toward? What do you want everyone to agree to?

MR. LIEBERTHAL: Good question, I'm glad you raise it. There is not a single direction -- we don't have a set of answers that we want to lay out for everyone and get them kind of marching

along our path here. As I'm sure most of you know, the U.S. Congress mandated in the closing days of its last session that we appoint a policy coordinator for Korea and undertake a serious review of policy toward Korea.

Part of what the President will do is to explain that situation and what the policy review entails to the Chinese, to the South Koreans and to the Japanese, and will stress that in the process of this policy review we want to fully consult with our allies and friends in the region. The fundamental issue here is not one of moving away from what's called the agreed framework, the basic architecture, if you will, of how we try to prevent the North Koreans from making nuclear weapons and from threatening their neighbors, but rather how do we strengthen that by getting the North Koreans to actually act in the way that they have committed themselves to act.

We view the way we approach that with a view to strengthening the agreed framework and putting it on a solid base politically here and, in reality, in Northeast Asia. And we want to do that with the full knowledge and participation of our Asian friends and allies. So that's what I intended to signal by commenting on North Korea.

Q Is the President going to be appointing somebody to lead that review?

MR. LIEBERTHAL: Yes, he is mandated to appoint a policy coordinator for that review, so he is appointing a policy coordinator. I, frankly, can't remember whether I'm allowed to comment further on that or not, so let me not, no.

Q Will the President be doing a news conference during this trip?

MR. LIEBERTHAL: Yes, there will be a news conference at the very end of the trip, at Korea -- right before departure from Korea. I think that's -- is that the only one? It's a joint press conference at the end of the trip in Korea. Lael, do you want to flush that out at all?

MS. BRAINARD: Saturday, before the Civil Society dialogue, he's doing a press conference.

Q Will there be a press statement after the Primakov meeting -- you said there wasn't one after Jiang Zemin.

MR. PASCUAL: Probably not. (Laughter.)

Q -- right after a meeting with China you -- four areas of discussion. Do you expect any tangible progress, like --

MR. LIEBERTHAL: As I mentioned, we do not plan to have a press statement at the end of that meeting. Our purpose in going into that meeting is to try to get the best feel that we can between

the two leaders as to where progress can be made, some sense of the pace of that progress and how best to proceed from where we are now to where we want to be.

In that sense, do I hope for some progress in this meeting? In that sense, I do; but it's not in the sense of signing any kind of agreement or having something to announce at the end of the meetings. It's rather, in my view, so the President will come out of that meeting and will direct me and others who deal with China on where we should be moving, what our priorities ought to be and what the benchmarks are as we go forward.

Q Do you have an assessment of how the various leaders who the President will be meeting with view the impeachment process ongoing and whether or not it will have an impact on the President's credibility or his ability to deal with these leaders, which will be going on at the same time that the President is in Asia.

MR. LIEBERTHAL: No, I don't know what's in their heads about that. I do know that the President remains, I believe certainly in any area I deal with, he remains extremely effective. And I think the other leaders -- just judging by how anxious they are to meet with him and how full the agendas are when they sit down with him -- I think they take him extremely seriously. But I can't comment.

Q On the nine sectors that you had mentioned Japan has shown resistance, particularly on fishery and forestry, but the momentum for most countries seems to be going towards not coming to full agreement on liberalization and something less than full agreement. Is this an up or down situation for the United States? Is there anything that you can envision that would be less than full agreement on these nine sectors?

MS. BRAINARD: The agreement that we hope to reach is to make progress, as much progress as possible. As you may recall from the information technology agreement on the tariff side, this is the first step of a two-step process. And so what we hope to do is take the results we achieve this year into the WTO framework and use it to get multilateral commitments.

So, in that sense, this will be an ongoing project or an ongoing challenge. We certainly hope to get as many countries participating in as many sectors with as ambitious targets as possible. But I think as Gene mentioned earlier, the environment in the region is a difficult one. A lot of economies are experiencing substantial declines in growth, many of them substantially negative growth. So it will be difficult for them to make progress.

I think if we can make some progress on the trade liberalization front it would be really quite important, an important signal of the region's determination to stay integrated into the world trading system and to get back on a recovery track.

Q Can you comment on what your latest information is on what the Japanese have been doing to try to get some of the other countries to side with them in this dispute and what your reaction is to what they're doing?

MS. BRAINARD: I think what we are engaged in is a sort of regional negotiating process with a large number of trading partners. And I believe there is, to some degree, a calculation on the part of each economy that their offer will, to some degree, depend on the ambitiousness, the quality of other country's offers. So it's in that sense that we keep saying that we would like to see Japan try to make some progress on those two vital sectors, where they really have the most to give.

Q Can you give us any sort of benchmark on what that would mean? I'm sorry to be dense about this, but I don't know, when you say progress on those two sectors in particular, is there some sort of number you're looking for?

MS. BRAINARD: There is not a particular number. I think as Gene said earlier, they have tariff averages that are substantially higher in those sectors than in their other sectors, which is why it would be nice to see them putting their tariffs -- some tariff offers on the table, some substantial volume of products in each of those two sectors. But in terms of precise numbers, no, we don't have particular targets.

Q How do you respond to the Japanese assertion that any trade liberalization efforts should be voluntary? Nobody should force anybody to do anything, that's a basic principle --

MS. BRAINARD: Well, arguably, all trade liberalization is voluntary. So we would hope that they would recognize it is in their interest, as the second largest economy in the world and the largest economy in the region, to really participate in this. I think Japan does recognize they have a special responsibility in the region, and that's why participation by them is so important.

Q But they have -- difficulties facing the domestic industry in Japan, the Japanese government is now saying that they can't do this at this moment. What's the point of forcing them to do this, if what you're saying is it's voluntary efforts?

MS. BRAINARD: Again, I think we recognize that the environment in the region, the financial economic environment is particularly difficult this year for many economies. Many economies are suffering a great deal and a great deal more than Japan. And it's difficult, I'm sure, for everybody to make any kind of movement on open trade. But by the same token, that's why it is so very important to show that APEC really is capable of continuing to move forward, even in the trickiest of times.

Q This meeting is going to take place now in an

environment where -- in previous meetings it was enough to sort of get together, but now you've got a major regional crisis. If you fail to convince the Japanese government to do this, and you don't get your private sector financial arrangements out in time or they're not approved, is there any standard by which the success or the degree of success of this meeting should be judged? Or is just going to be sort of ambiguities and vague talk of progress as has been somewhat the case at previous meetings, and we'll all go on? How should we measure what you do?

MS. BRAINARD: I will leave to you to decide how to characterize whether or not this meeting is successful. We're hopeful that it will be an important forum for the leaders of this region to talk about the financial crisis.

Again, as Ken was suggesting earlier, this is quite a unique forum. The President has invested a lot of his own time and energy in it. As you know, he convened the first leaders' meeting. And over time, this forum has become very relevant to the key economic issues of the day. And I think we want to see leaders really grappling with the economic challenges and agreeing on a set of priorities for addressing them. And I think we are hoping to see that coming out of this meeting.

MR. LIEBERTHAL: Can I add just one line to that, if I may? Most of you have a great deal of experience in traveling with the President and so forth. You know how difficult it is to have a time that is somewhat unstructured when leaders can really talk to each other. And the leaders' meeting at this conclave allows leaders of 15 economies to spend literally hours together with a lot of fluidity in what they say.

And so it's an almost unique opportunity to get together key people from the most -- what to my mind is the most important region of the world and have them interact on an intensive basis. You're always looking for measures of success, and you're right to do so. But one of the underlying elements of this that make it important is precisely, simply the opportunity to, face to face, bat things around.

Q Some of the countries are countries in Latin America. They worry how the crisis will affect them. How is the President going to address this fear in this particular forum? Is it going to be --

MS. BRAINARD: I think that we have, from our Latin American partners, Peru will be in attendance for the first time, and Mexico and Chile are members of APEC. In terms of the crisis, I think the President has spoken to the crisis in a variety of fora and really has spoken on the short-term measures and the long-term measures which I think pertain to Latin America as they do to other regions of the world.

One of the things that I think was very important is the

attempt to strengthen the IMF and to give it new tools for the new types of financial situations we see in recent years, and in particular the precautionary financial facility, which was really put in place to help countries ward off crises, countries that are already carrying out good policies.

In addition, he wants to continue discussions and progress and a work program towards significant reforms to the international financial architecture. I'm sure the leaders will talk about some of the transparency surveillance issues that are important for Latin America as much as they are for Asia, indeed as they are for this country.

Q Thank you.

END

4:35 P.M. EST

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TEXT:

TOKYO, March 23, Kyodo

Japan, U.S. fail to iron out differences on NTT issue

Japan and the United States finished three days of high-level deregulation talks Thursday having failed to iron out differences over the size of planned cuts in interconnection fees charged by Nippon Telegraph and Telephone Corp. (NTT), Japanese officials said.

"I was briefed that the talks ended in failure because of considerable gaps" over the telecom issue, Chief Cabinet Secretary Mikio Aoki told a regular press conference.

TOKYO, March 23, Kyodo

Land prices in Japan fall for 9th straight year

Land prices in Japan declined 4.9% on average in the year to Jan. 1, 2000, dropping for the ninth consecutive year as a result of Japan's long-term economic doldrums, the National Land Agency said in

a report released Thursday.

The report on the "listed prices" of land per square meter across Japan showed average prices of residential land falling 4.1% last year, compared with a decline of 3.8% in 1998.

Foreign workers Japan's 'best bet'

Asahi Shimbun

By SHINICHI MURAKAMI

March 23, 2000

NEW YORK- Japan will have to accept about 10 million immigrants annually or raise the mandatory retirement age to 77 to maintain its 1995 ratio of working people to retirees, according to a report released by the United Nations on Wednesday.

In its calculations, the U.N. Population Division assumed that Japan would maintain the ratio-4.8 workers supporting one retiree-for the next 50 years and took into account the lowering birth rate and aging population.

If Japan does not accept 10 million workers from abroad each year, its population would exceed 800 million by 2050, the report said. Statistics for 1995 put the country's population at 125 million.

According to the report, if the country refuses immigration, its population will drop to about 105 million by 2050 after hitting a peak of 127 million in 2005.

The working population-people between the ages of 15 and 64-will drop to about 57 million in 2050 from about 87 million in 1995, while the number of people aged 65 or older will increase to about 33 million from about 18 million, the report said.

Consequently, the ratio of workers to retirees will plunge to 1.7 in 2050 from 4.8 in 1995, the report said.

To maintain the ratio at the 1995 level, Japan requires 10 million immigrants a year. This means that 90 percent of the population would be immigrants or descendants by 2050, according to the report.

Without immigration, people would have work to the age of 77 to maintain the 1995 workforce level, the report said.

According to Labor Ministry estimates, the working population will decrease to about 67 million in 2010 from about 68 million in 1998 after peaking at 69 million in 2005. The ministry defines the working population as people aged between 15 and 64 who are currently employed or are looking for employment.

Workers aged between 15 and 29 will decrease by 4 million by 2010 while workers aged 55 or older will increase by 3.8 million.

OECD official says joint fund difficult

Mami Tsukahara Daily Yomiuri Staff Writer,

3/23/2000

It may be difficult for donor countries to set up a common fund for development aid in the near future, due to divisions in the donor community, a top official from the Organization for Economic Cooperation and Development said Wednesday.

"In some cases, it would be very useful to revise the financing system and for all donors to pool their resources and act together in joint programs...(However) it may be difficult for some donor countries to do that, because they have their own rules and policies," Jean-Claude Faure, chairman of the OECD's Development Assistance Committee (DAC), said during an interview with The Daily Yomiuri.

While stressing that it would be efficient for donor countries to integrate their aid programs, Faure admitted: "Harmonization has its own limits. We have national interests, national conditions and numerous rules. So it's not easy to move in that direction."

Faure also stressed that it is important

for the donors to continue discussion on the subject.

"I understand it is important for the sake of coordination for closer harmonization and simplification," he said.

Japan has been cautious over the idea of a common fund or harmonization, in which donor countries would work together on aid projects, an issue being discussed by the DAC.

As for the growing presence of social democratic forces in the DAC, which are trying to strengthen the organization's humanitarian role, Faure said poverty reduction is the top priority.

"If developed and developing countries are not able to decisively tackle the problems and reduce poverty together, it will be very difficult to imagine that globalization will benefit everyone," he said. "Poverty reduction is a very central element."

To reduce poverty, Faure pointed out that the international community should tackle social problems, such as education, health and gender discrimination, as well as economic development.

"Poverty reduction depends very much on economic growth...However, we know that growth sometimes bring inequalities. So I think that social sectors are important," he said.

/ Can U.S. economy land softly?

Yomiuri Shimbun, 3/23/2000

The U.S. Federal Reserve Board has raised key short-term interest rates--the federal funds rate and the official discount rate--by 0.25 percentage point each, repeating the move it made in February.

In June last year, the Fed tightened its monetary policy, believing the U.S. economy had overheated as a result of overinflated stock prices, which in turn were increasing inflationary pressures.

The latest interest rate hike is the fifth since then, but, with Wall Street shrugging off the Fed's announcement and

pushing stock prices higher Tuesday, the hikes appear to have had little effect.

The more the economic overheats as the excessive stock market surge continues, the greater the impact of any economic downturn will be. A downturn under these circumstances would deal a massive blow to the global economy, which is being pulled along by the locomotive force of the United States.

This year, the New York Stock Exchange has frequently yo-yoed, showing that, while market players on the one hand have been bullish, they also have grown increasingly jittery over the economy's immediate prospects.

U.S. govt, Fed must act

It is hoped the U.S. government and the Fed will cool the market down and guide that country's economy to a slower, stable growth phase through flexible policies based on sound economic analysis.

The U.S. economy last month marked a record-long period of expansion--eight years and 11 months--with high-tech companies riding the wave of the information technology revolution and other firms restructuring.

The potential growth rate suitable for achieving stable growth is said to be about 3 percent. However, up until 1999, the United States' real growth rate had stood at about 4 percent for three years. The growth rate for last year's October-December quarter reached an annualized 6.9 percent.

The currently overheated U.S. economy is being buoyed by rising stock prices. Individual investors' joy at seeing their assets rise as a result of surging stock prices has bolstered their consumption--a phenomenon known as the assets effect--which in turn has pushed up overall personal consumption and produced further economic expansion. Going full cycle, that has lifted stock prices still further.

However, with the 30-issue Dow Jones industrial average having broken through the 10,000 barrier, stock prices are too high given current corporate earnings and interest rates, and, according to an estimate by one major bank, need to be modified downward by more than 30 percent. If the current growth without inflation that is supporting bullish sentiment founders, stock prices may plummet.

Another problem with the U.S. economy is the sudden expansion in the current-account deficit. Last year's deficit reached the 300 billion dollars level, surpassing the previous record set two years ago by more than 50 percent. The deficit has reached that level due to an increase in imports on the back of strong domestic consumption and the rise in the price of crude oil.

Flow of funds must be diversified

Until now, global funds have been intensively concentrated in the United States, which has been able to balance its

books by offsetting its current-account deficit with them. However, a reversal in the flow of funds might accelerate a plunge in the U.S. stock market.

The speeding U.S. economy must be slowed to keep import levels under control and correct the current-account deficit. Doing so would also ensure the stability of the global economy.

It is important for Japan and Europe to put their economies onto a recovery track and bring about a system under which they and the United States are the driving force behind the global economy.

While increasing imports from the United States to help correct the U.S. deficit, Japan and Europe must try to make the flow of global funds better balanced, to include three key areas--Japan, the United States and Europe--as well as the rest of Asia and Latin America, instead of concentrating the flow on the United States. Such efforts are also indispensable if the global economy is to achieve stable growth.

(From March 23 Yomiuri Shimbun)

Miyazawa reminds IMF chief Asia needs more voting power
Japan Times, 3/22/2000

Finance Minister Kiichi Miyazawa on Wednesday reminded the next head of the International Monetary Fund of the need to give Asian countries more voting power at the IMF.

The reminder was addressed to Horst Koehler, head of the European Bank for Reconstruction and Development, during the German's meeting with Miyazawa in Tokyo.

But in a news conference after the meeting, Miyazawa declined to reveal Koehler's response because his appointment as IMF managing director has not yet been made official.

When the United States expressed support earlier this month for Koehler, Europe's second candidate for the IMF's top position, Japan followed suit and withdrew its nomination of Eisuke Sakakibara, former vice finance minister for international affairs.

In a telephone conversation Wednesday with German Finance Minister Hans Eichel, Miyazawa said he told Eichel that Asia's voting share at the IMF remains unreasonably low.

Haruhiko Kuroda, Sakakibara's successor, pointed out the same problem

Monday during a speech in Hong Kong before finance officials from Asia.

"Despite the fact that many Asian countries have emerged as important economic powers, the voting share and (the IMF board's) representation of Asian countries have been extremely limited," Kuroda said. "We believe that the member countries of the IMF urgently need to consider the redistribution of quotas."

Domestic slump cuts Brazil's chances of gaining funds

By HISANE MASAKI

Staff writer, Japan Times, 3/22/2000

Brazil is turning to Japan to raise badly needed funds for a new four-year development program that went into effect this year.

Martus Tavares, the Brazilian budget and planning minister, will visit Tokyo in late April to brief executives of the Japan Bank for International Cooperation on the PPA, as the development program, worth some 1.1 trillion Brazilian reais, or \$630 billion, is commonly called, according to sources familiar with the deal.

The sources say that in June, four other Brazilian ministers, including the finance minister, plan to visit Tokyo for a seminar aimed at selling the PPA to private-sector Japanese corporate executives and at luring Japanese investments in infrastructure and other projects to be covered by the PPA.

The JBIC was created in October through a merger between the Overseas Economic Cooperation Fund and the Export-Import Bank of Japan -- the two major government-affiliated foreign lending agencies. But it is doubtful whether the planned PPA-promotion campaign by the Brazilian officials will bear fruit, as most Japanese companies are more cautious than ever before about investing abroad amid the prolonged economic slump at home.

Brazil is the world's fourth most-populous developing country -- after China, India and Indonesia -- with some 160 million people. The country also has the world's eighth largest economy in terms of gross domestic product.

Japanese government officials say Japan should strengthen economic ties with Brazil through increased investment, not only for purely economic reasons but also to ensure its "food security" in the long term. Japan is the world's largest food-importing country, while Brazil is a major agricultural products exporter.

But this view does not seem to be shared by many private-sector Japanese corporate executives, who still have a negative perception of Latin America as a whole.

Foreign direct investment in Brazil is rising sharply, totaling some

\$29 billion last year. In stark contrast with their American and European counterparts, however, Japanese companies remain shy about investing in the potentially lucrative Latin American market.

Although Japan accounted for 9 percent of the cumulative foreign direct investment in Brazil in terms of value in 1990, that share is believed to have dropped below 1 percent last year.

In the 1990s, Latin America emerged with East Asia as one of the world's two most dynamic regions despite suffering through the "lost 1980s," a period during which Latin American countries suffered a foreign debt crisis, a prolonged economic slump and other dire economic hardships.

Since the end of the 1980s, Latin American countries -- with the sole exception of Cuba -- have established democratic political systems after years of military dictatorships.

They have also pushed ahead with free-market reforms, economic liberalization and fiscal reforms, including privatization of inefficient and unprofitable state-owned enterprises.

These efforts have produced noticeable results. Despite such hiccups as the Mexican peso crisis that erupted at the end of 1994 and the Asian financial and economic crisis that began in the summer of 1997, Latin America remained on a relatively sound growth path in the 1990s, helped by strong domestic consumption and investment and a smooth inflow of foreign investment.

In many countries, the scourge of hyperinflation is now a thing of the past as sharp price rises have been tamed or brought down to controllable levels.

"Japanese private companies are just like burned children who dread fire," one senior government official quipped.

TOKYO, March 23, Kyodo

3rd new runway in operation at Tokyo's Haneda airport

The third and last new runway for Tokyo's Haneda airport began operations on Thursday, accelerating a plan to relocate the facility closer to Tokyo Bay.

Two new runways have already begun operations as part of the relocation plan, which has been ongoing since 1984 to deal with noise pollution disturbing nearby residents and to increase the number of flights arriving at or departing from Haneda.

Thursday, March 23, 2000 Food self-sufficiency The nation's food self-sufficiency ratio, measured in caloric terms, has declined from 73 percent in 1965 to 40 percent in 1998. Today, Japan has

the lowest food self-sufficiency ratio among the advanced industrialized nations and is the world's largest net importer of agricultural products. By some estimates, 17 million hectares of arable land are needed to grow the food consumed by the population, so the nation is forced to rely on 12 million hectares of arable land in foreign countries. Since 800 million people from around the world suffer from malnutrition, it is unlikely that this country will be able to remain so highly dependent on foreign producers for its food supply. The nation's low food self-sufficiency ratio raises pressing food security concerns. These concerns led to the insertion of a clause into an agricultural bill that was enacted last July calling for the establishment of food self-sufficiency targets. An agriculture panel that advises Prime Minister Keizo Obuchi responded with a report establishing a food self-sufficiency target of 45 percent by the year 2010 and also set a long-term target of above 50 percent. It is the panel's desire to raise the ratio to as high a level as possible. If we extrapolate from current consumption and production trends, however, the self-sufficiency ratio will decline to 38 percent by 2010. To boost the current ratio by 5 points, we will have to not only reverse the present trends but also take additional measures to boost domestic production. Two-thirds of the decline in the food self-sufficiency ratio can be attributed to the Westernization of the Japanese diet. Today, consumers eat less rice and more meat, oil and fat. Changes in eating habits have contributed to increased imports of feed grains and plants which are used to produce oil and fat products. The failure of domestic producers to keep up with changes in the marketplace accounts for one-third of the decline. A concerted effort by producers, consumers and policymakers will be necessary to achieve the target of 45 percent. Producers will have to increase domestic production of wheat, soybeans and feed grains, most of which are now imported. The panel hopes to achieve a 3-point increase in the wheat self-sufficiency ratio to 12 percent over the next 10 years. Consumers will need to develop healthier eating habits. Our fondness for Western-style dishes has led to unbalanced diets and excessive consumption of fatty foods, many of which are made from imported ingredients. And households, restaurants, and food retailers will have to find ways to save some of the nearly 7 million tons of food that are discarded every year from trash bins. The government will have to consider new programs to utilize land that now lies fallow due to rice-paddy acreage reduction policies. But subsidies would have to be kept to a bare minimum, however, to avoid a backlash from critics at home and abroad.

Thursday, March 23, 2000
Big U.S. Auditing Firms Expand Services In Japan TOKYO (Nikkei)--The Big Five U.S. auditing firms are expanding their consulting services in Japan in a bid to take advantage of preparations by Japanese companies to shift accounting priorities to consolidated results and also to support the growth of electronic commerce. Consulting services offered by the auditors are based on U.S. management models making the most of the Internet and information technology. Specifically, they help Japanese clients by making their computer systems and business models suitable for e-commerce and consolidated accounting rules by using enterprise resource planning (ERP) and other software. To expand its presence in the Japanese market, PricewaterhouseCoopers Consultants Co. will increase its number of consultants from the current 1,200 to 1,600

this year.KPMG Global Solution KK will integrate its various consulting services under KPMG Consulting on April 1 and triple its consulting staff to 400 a year later.Asahi Arthur Andersen Ltd. plans to double the number of consultants to 1,000 in two years, while Ernst & Young Consulting Japan Co. plans to create a consulting force of 500 in three years.Apart from the expansion of consulting forces, Deloitte Tohmatsu Consulting Co. will shortly set up a wholly owned subsidiary to break into the application service provider (ASP) business, which leases software to smaller and venture businesses online.Deloitte Tohmatsu will form two more subsidiaries to accept outsourcing orders and provide technical support. The three new units combined are planned to have 400 to 500 staff members and chalk up 10 billion yen in annual sales.Japanese companies recognized the importance of IT consulting services since late last year, although they were cautious about actual investment out of concern about possible Y2K computer glitches.The entrance by the Big Five auditing firms into Japan reflects their strategy to spin off consulting operations so as to minimize regulatory effects on auditing services, enabling them to raise funds and tie up with clients more flexibly.But it is not easy to recruit consulting staff. The difficulty of hiring competent manpower was demonstrated by Microsoft Co., the Japanese unit of the U.S. software giant, which kicked off a campaign in late October last year to treble the number of consultants from 100 by offering 3 million yen to each recruit as a signing bonus.Although the campaign lasted throughout the rest of the year, Microsoft secured only 70 consultants because of a shortage of engineers well versed in both business models and information technology.Consulting services bring relatively high profits to hardware and software companies in Japan where the consulting market is not fully developed. With the five big U.S. auditing firms entering the market in a big way, competition, including recruitment of competent consultants, is expected to intensify.(The Nihon Keizai Shimbun Thursday morning edition)

Thursday, March 23, 2000Free-Wheeling Cash Outflanks Monetary Policy
TOKYO (Nikkei)--Stock prices worldwide continue to surge ahead even as Western central banks lean toward tightening credit, and warnings over rising equity investment risks stream from regulators in a variety of markets.Traditional monetary policy, which targeted commercial banks as intermediaries of credit supply, appears blunted in an age when direct financing through the capital markets, has taken center stage in the global financial system.At the core of the phenomenon is a mutually feeding cycle of the wealth effect of buoyant shares and powerful flows of money into stock markets. In the U.S., mutual stock funds are posting net inflows exceeding 40 billion dollars monthly, and outstanding purchases of stock on margin hit an all-time high at over 260 billion dollars in February.Europeans are now net buyers of American shares to the tune of more than 10 billion dollars a month, while U.S. investors are increasing exposure in Asian equities. High-tech-oriented growth funds are taking the lion's share of investor interest in Japan, the U.S. and Europe. Wall Street-style IT booms are reproduced in markets as different as those of Hong Kong and Scandinavia.Not to miss out on the bonanza, major U.S. bank holding companies have set up venture-capital subsidiaries focused on businesses yet to be publicly traded. In the meantime, bank lending in America has shown no notable growth.The problem for the U.S. Federal Reserve Board is that its traditional policy tightening tool of raising

rates in 0.25% increments is being upstaged by widespread euphoria over stocks multiplying several-fold in value within a short space of time. Moreover, investor money can simply shrug off Fed policy intentions by hopping untrammelled across national boundaries. There are growing arguments in the U.S. and Canada that tightened restrictions on trading on margin are necessary to quell speculative fever. There are also emerging demands that capital adequacy requirements for banks be lifted in view of the high risks pertaining to bank-led venture capital activities. But the danger is that such direct market intervention could spark the kind of hard landing Japan experienced in the early 1990s after curbs on property lending were introduced. Besides, speculation is not necessarily the only force behind the global market upswing, with some analysts defending current stock valuations on grounds of expected economic growth. Credit Suisse First Boston estimates real growth in 2000 at 4.6% for the U.S. and 3.7% for the euro bloc of the European Union. A Japanese gain of 1% or so would complete a best-case scenario for balanced growth across the world. Still, there is no denying that global money supplies have swelled out of proportion to the expansion of the real economy. Economic policy management worldwide may be battered by torrents of footloose money until there is convincing evidence that U.S.-European credit tightening is finally getting the upper hand, guiding the global economy onto the orbit of stable growth. (The Nihon Keizai Shimbun Thursday morning edition) Thursday, March 23, 2000

Japan, U.S. Fail To Reach Accord In NTT Access Fee Talks TOKYO (Nikkei)--Japan and the U.S. ended Thursday working-level talks on lowering the interconnection fees charged by Nippon Telegraph and Telephone Corp. (9432) without any compromise being reached. The talks were part of three-day bilateral negotiations on deregulation. The breakdown resulted from Tokyo's refusal to budge from its position to carry out a phased reduction of the fees by 22.5% from their fiscal 1998 level over four years, starting at the end of this year. The U.S. urged Japan to come up with a compromise plan to slash the charges by 22.5% within two years, and by more than 40% sometime in the future. The Ministry of Posts and Telecommunications rejected Washington's demand since "accepting the proposal will lead to a rise in basic telephone charges to ordinary users and seriously damage the management of the two NTT companies that provide regional telephone services." NTT levies the fees on long-distance carriers who hook up to its local lines. Both Japanese and overseas telecom firms say the charges are too high and a barrier to industry newcomers. A solution to the issue will now have to be found in talks by higher-ranking officials, including ministers. (The Nihon Keizai Shimbun Thursday evening edition) Thursday, March 23, 2000

E-TRADE TAXATION: Levying Downloads TOKYO (Nikkei)--Japan's legal, tax and regulatory systems lag behind the swift progress of information technology, which has been driving the economy and offers the potential to improve corporate productivity and consumer purchasing power. Music downloaded via the Internet is of as high a quality as that on CD. But imported CDs of value exceeding a certain amount are subject to the consumption tax at the customs clearance, while music downloaded from abroad is not. "Like any domestic transaction or import, in theory downloaded content ought to be taxed. But this is not done, however, because there's no way to collect taxes from foreign companies," said a Ministry of Finance source. The MOF has begun discussing ways to tax online transactions, while companies are forced to develop new business on a field riddled with land mines -- tax regulations. Sony Computer

Entertainment Inc., which just launched PlayStation2, plans to deliver visual and game software via the Internet starting in 2001. Securities analysts worry about SCE's planned network of servers independently located in Japan, the U.S. and Europe. If the company uses a high-speed, high-capacity network, a single server could suffice, with higher efficiency and less investment. A server's location is all important for tax purposes. Even a company headquartered in Japan "would not have to pay consumption tax" on Internet-delivered content if the server was located abroad, said a MOF source. "It's best to pay taxes in each country," said SCE President Ken Kutaragi. An executive at Sony Corp. (6758) admitted that "If a multinational concentrates its servers in one location, it will provoke tax authorities." Sega Enterprises Ltd. (7964) is moving in the opposite direction, concentrating all its servers in the U.S. for international delivery of the interactive games it began offering this month to Dreamcast users worldwide. The service is still free, but "the tax savings will be enormous when they start drawing profit from paid services," said a tax strategist. Last month, the European Commission, announcing an Internet taxation plan, said an estimated 10 billion euro (about 1 trillion yen) worth of tax was being avoided through international Internet transactions. The OECD is also considering whether taxing online transactions is the right path to follow, and if so, how to go about it. But differences among the economic scale and Internet development of OECD member nations is complicating things. "A fair taxation system may be needed when Internet revenues grow large. But in the start-up stages, the government will do better to set policies that encourage infrastructure-building and investment," said Sega President Shoichiro Irimajiri. "A tax-free system should be considered to nurture these new growth markets," said a MITI executive. That opinion is gaining currency within the government. An executive at a start-up firm agreed, "When an Internet business is profitable, we only have to move the server to a country where taxes are low." (The Nihon Keizai Shimbun Thursday morning edition)

DaimlerChrysler Closes In On 33% Stake in Mitsubishi By Akiko Kashiwagi Special to The Washington Post Thursday, March 23, 2000; Page E03 TOKYO, March 22 ?DaimlerChrysler AG is close to acquiring a major stake in Japan's fourth-largest carmaker, Mitsubishi Motors Corp., a move that would create the world's third-largest auto group. Mitsubishi Motors said today that its board has granted President Katsuhiko Kawasoe the authority to make a final decision on a proposed alliance with Western auto companies. Mitsubishi officials declined, however, to confirm Japanese media reports that directors have agreed to allow DaimlerChrysler to buy a 33.4 percent stake in the ailing Japanese carmaker. The deal with Mitsubishi, if it goes through, would give DaimlerChrysler a strategic foothold in Asia. DaimlerChrysler Chairman Juergen Schrempp has repeatedly said he hopes Asia will eventually account for a quarter of his company's sales. For Mitsubishi, the alliance would provide ready cash. The company is struggling under debt of nearly \$18 billion even as sales are slipping. Notably, that benefit cannot be provided by fellow members of Mitsubishi's keiretsu, or industrial group. Mitsubishi's need to seek financial support from foreign rivals demonstrates how severely a decade of recession has weakened institutions at the core of Japan's postwar economic model. But with their own financial difficulties to worry about, Mitsubishi group companies have come to view outside ownership in a different light. Under Japanese corporate law, a 33.4 percent stake would give DaimlerChrysler veto power

over all Mitsubishi management decisions, and thus considerable leverage over corporate strategy. Japan's leading business daily, Nihon Keizai Shimbun, reported that under terms of the proposed alliance, the Japanese carmaker would keep the Mitsubishi brand and be spared the need for mass layoffs in exchange for ceding management control to DaimlerChrysler. Analysts said a union would allow the two companies to offset each other's weaknesses in both regional presence and types of cars produced. But some cautioned that a 33.4 percent stake might not give DaimlerChrysler enough control over Mitsubishi Motors. Mitsubishi has produced several vehicles with Chrysler in the past 20 years. Mitsubishi shares have risen nearly 20 percent since reports of the possible deal first appeared in the Japanese press in early March. A DaimlerChrysler stake in Mitsubishi would be the latest in a series of major realignments in the global auto industry. In the past week, General Motors Corp. announced that would buy a stake in Fiat SpA's auto unit, and on Thursday the German carmaker BMW AG announced it would sell its Britain-based Rover subsidiary to an investment company, Alchemy Partners Ltd. In addition, South Korea's finance minister said today that Renault SA will probably take over Korea's troubled automaker, Samsung Motors Inc. In Japan, the auto industry has been reduced to two viable independent manufacturers--Toyota Motor Corp. and Honda Motor Co. , Copyright 2000 The Washington Post Company Thursday March 23 5:52 AM ET Japan, U.S. Fail to Solve Telecoms SpatBy Elaine Lies TOKYO (Reuters) - The United States hinted on Thursday that it could take further action against Japan after the two countries failed to reach an accord on promoting telecoms competition and slashing Japanese connection fees. U.S. Deputy Trade Representative Richard Fisher, speaking to reporters after three days of talks on the issue failed to bring an agreement, said he hoped common sense would prevail and that the issue would not escalate into a trade conflict. But he warned that Washington ``reserves all options" on future talks. ``There are international conventions under the World Trade Organization (WTO) that govern the cost of conductivity," he said, adding that whether Washington raises the issue there depends on ``what the Japanese government does." He said there were also bilateral measures the United States could take, but did not go into details. The telecoms issue, currently the thorniest between the two powers on the trade front, was at the center of deregulation talks between U.S. and Japanese officials that began here on Tuesday. Failure to iron out differences over the size of planned cuts in connection fees charged by Japan's incumbent monopoly, Nippon Telegraph and Telephone Corp (NTT), had led to the talks being extended for an extra day Thursday. Speak your mind Discuss this story with other people.[Start a Conversation](Requires Yahoo! Messenger) (go to http://dailynews.yahoo.com/h/nm/20000323/bs/telecoms_japan_3.html to access this box) ``We are at an impasse," Fisher said. ``The government of Japan is proposing a policy that would reduce the costs by too little over too long a period." An adviser to Japanese Prime Minister Keizo Obuchi said he had passed on a message to Obuchi from Fisher that President Clinton was closely watching the issue and may raise it at the July Group of Eight summit in Japan. Disagreement On Fee Cuts NTT, still 59 percent government-owned, is under intense U.S. pressure to slash interconnection fees for carriers using its networks. Washington is pressing for an immediate 41 percent reduction in the charges, saying this would not only benefit U.S. firms seeking access to the Japanese telecoms market but would provide a much-needed lift for Japan's fragile economy.

Tokyo has offered a 22.5 percent cut implemented over four years, arguing that bigger cuts would jeopardise NTT's profits and threaten its workers with unemployment. "We do not accept the fact that jobs will be destroyed," said Fisher, noting that the breakup of similar monopolies in both the United States and Britain actually worked to produce jobs. "The inefficiencies of NTT are being borne by consumers and by their competitors, and they are a significant drag on the economy," he added. A Japanese official told reporters earlier Thursday that the world's two biggest economic powers would try to resolve the issue by the end of March. "We will make our utmost efforts to settle the issue by the end of this month... But we cannot predict how it will be settled," the official said. Japanese officials blamed the U.S. side for the blockage on Wednesday, accusing Washington of raising extreme demands. NTT controls more than 90 percent of local lines connecting Japanese homes, giving it an iron grip on the huge Japanese telecoms market. The United States says Japan's connection costs are triple what they would be under open competition. Analysts agree the rates are higher than in the United States but many question U.S. methods of calculation. While Tokyo has adamantly refused U.S. demands so far, such a stance may not bode well for Obuchi, who has called for an "information technology revolution" as a means to give the recession-mired economy a badly needed boost. Several domestic firms, including Sony Corp, have also complained about the costs and called for more competition.

March 23, 2000 Japan Remains at Odds
With U.S. on Telephone Deregulation By STEPHANIE STROMOKYO, March 22 --

After two days of meetings, the United States and Japan failed to reach any agreement today on further deregulation of the telecommunications market here and extended their talks to a third day. Other areas of the Japanese economy are also under discussion -- drugs, medical equipment and construction, among others -- but it is the telecommunications debate that has become heated because its outcome has important implications for future economic growth here. The United States contends that Japan is hurting itself economically by not creating the basis for more competition in its telecommunications market, the most expensive such market for users in the industrial nations. The Americans have successfully framed the debate as multilateral, affecting not only United States companies but their European and Japanese competitors. Even the Keidanren, Japan's traditional business lobby, has sided with the United States, not to mention blue-chip Japanese companies like Sony. "Persistence in the old ways threatens to transform Japan into a fading giant," Richard W. Fisher, a deputy United States trade representative, told journalists here on Tuesday. Washington is demanding an immediate 41 percent reduction in the fees that telecommunications companies pay to hook up to the network owned by Nippon Telegraph and Telephone, the former government-owned telephone monopoly that is a member of the NTT Group. NTT controls more than 99 percent of local phone traffic. The fees, according to the Japanese government, eat up as much as 40 percent of the revenue of NTT's competitors. But the government says it can cut the fees only by 22.5 percent over a four-year period, contending that a more aggressive move would deal a crushing blow to NTT. The election year presents a further complication because the ruling party's popularity is waning, and NTT and its subsidiaries employ 224,000 workers directly and probably as many indirectly. The United States is threatening to take the matter to the World Trade Organization if some agreement is not reached by the end of the month, an escalation of the dispute that the Japanese want to avoid in advance of a meeting of the

leading industrial nations in Okinawa in July. "There is a wide gap between the two sides on the so-called reduction rate," said Akitaka Saiki, a spokesman for Prime Minister Keizo Obuchi, referring to the interconnection fees. "I think the Japanese negotiators are trying to persuade their American counterparts of the difficult domestic circumstances surrounding NTT." Mr. Saiki said the reductions demanded by the United States could force NTT to reduce employment and increase management turmoil at a company where opinions are divided over strategy. NTT has already begun an overhaul aimed at reducing the work force by 21,000 and curtailing investment over three years, but the job cuts are regarded by many as cosmetic since they will be achieved through attrition. The Japanese government is having trouble making its case, however, because NTT is an extraordinarily rich company, owning controlling stakes in the NTT Mobile Communications Network, or NTT DoCoMo, Japan's largest mobile phone company, and the NTT Data Corporation. The regulators are further hampered by their own efforts to make a case to politicians for supporting sharply reduced interconnection fees. Having convinced politicians that any further reduction in the fees would hurt NTT and its callers, the regulators are now unable to easily change their stance.

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on NTT issue</H3>
 Japan and the United States finished three days of high-level
deregulation talks Thursday having failed to iron out differences over the size of planned cuts in interconnection fees charged by Nippon Telegraph and Telephone Corp. (NTT), Japanese officials said.</PRE>
 "I was briefed that the talks ended in failure because of considerable gaps" over the telecom issue, Chief Cabinet Secretary Mikio Aoki told a regular press conference.<!-- End of asahi.com only --></DIV>

4.9% on average in the year to Jan. 1, 2000, dropping for the ninth consecutive year as a result of Japan's long-term economic doldrums, the National Land Agency said in a report released Thursday. The report on the "listed prices" of land per square meter

across Japan showed average prices of residential land falling 4.1% last year, compared with a decline of 3.8% in 1998. </DIV>

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<TD>Foreign workers Japan's `best bet'</TD></TR>

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<P>By SHINICHI MURAKAMI
<P>March 23, 2000
<P>NEW YORK- Japan will have to accept about 10

million immigrants annually or raise the
mandatory retirement age to 77 to maintain its

1995 ratio of working people to retirees,
according to a report released by the United
Nations on Wednesday.

<P>In its calculations, the U.N. Population
Division assumed that Japan would maintain the

ratio-4.8 workers supporting one retiree-for th

next 50 years and took into account the lowerin

birth rate and aging population.

<P>If Japan does not accept 10 million workers

from abroad each year, its population would
exceed 800 million by 2050, the report said.
Statistics for 1995 put the country's populatio

at 125 million.

<P>According to the report, if the country
refuses immigration, its population will drop t

about 105 million by 2050 after hitting a peak

of 127 million in 2005.

<P>The working population-people between the
ages of 15 and 64-will drop to about 57 million

in 2050 from about 87 million in 1995, while th

number of people aged 65 or older will increase

to about 33 million from about 18 million, the

report said.

<P>Consequently, the ratio of workers to retirees will plunge to 1.7 in 2050 from 4.8 in

1995, the report said.

<P>To maintain the ratio at the 1995 level, Japan requires 10 million immigrants a year. This means that 90 percent of the population would be immigrants or descendants by 2050, according to the report.

<P>Without immigration, people would have work

to the age of 77 to maintain the 1995 workforce

level, the report said.

<P>According to Labor Ministry estimates, the

working population will decrease to about 67 million in 2010 from about 68 million in 1998

after peaking at 69 million in 2005. The ministry defines the working population as people aged between 15 and 64 who are currently

employed or are looking for employment.

<P>Workers aged between 15 and 29 will decrease

by 4 million by 2010 while workers aged 55 or

older will increase by 3.8 million.<!-- docend

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<TD><FONT size=4><B><FONT color=#0000ff>OECD
official says joint fund difficult</FONT>
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<P>Mami Tsukahara Daily Yomiuri Staff Writer,

3/23/2000
<P>It may be difficult for donor countries to

set up a common fund for development aid in the

near future, due to divisions in the donor
community, a top official from the Organization

for Economic Cooperation and Development said

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Wednesday.

<P>"In some cases, it would be very useful

to revise the financing system and for all donors to pool their resources and act together

in joint programs...(However) it may be difficult for some donor countries to do that,

because they have their own rules and policies," Jean-Claude Faure, chairman of

the OECD's Development Assistance Committee (DAC), said during an interview with The Daily

Yomiuri.

<P>While stressing that it would be efficient

for donor countries to integrate their aid programs, Faure admitted: "Harmonization

has its own limits. We have national interests,

national conditions and numerous rules. So it's

not easy to move in that direction."

<P>Faure also stressed that it is important for

the donors to continue discussion on the subject.

<P>"I understand it is important for the

sake of coordination for closer harmonization

and simplification," he said.

<P>Japan has been cautious over the idea of a

common fund or harmonization, in which donor countries would work together on aid projects,

an issue being discussed by the DAC.

<P>As for the growing presence of social democratic forces in the DAC, which are trying

to strengthen the organization's humanitarian

role, Faure said poverty reduction is the top

priority.

<P>"If developed and developing countries

are not able to decisively tackle the problems

and reduce poverty together, it will be very

difficult to imagine that globalization will benefit everyone," he said. "Poverty

reduction is a very central element."

<P>To reduce poverty, Faure pointed out that th

international community should tackle social problems, such as education, health and gender

discrimination, as well as economic development

<P>"Poverty reduction depends very much on

economic growth...However, we know that growth

sometimes bring inequalities. So I think that

social sectors are important," he said.

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<H3>/ Can U.S. economy land softly?

</H3>

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<P>Yomiuri Shimbun, 3/23/2000

<P>The U.S. Federal Reserve Board has raised key
short-term interest rates--the federal funds rate and

the official discount rate--by 0.25 percentage point each, repeating the move it made in February.
<P>In June last year, the Fed tightened its monetary policy, believing the U.S. economy had overheated as a

result of overinflated stock prices, which in turn were

increasing inflationary pressures.

<P>The latest interest rate hike is the fifth since then, but, with Wall Street shrugging off the Fed's announcement and pushing stock prices higher Tuesday,

the hikes appear to have had little effect.

<P>The more the economic overheats as the excessive stock market surge continues, the greater the impact of

any economic downturn will be. A downturn under these

circumstances would deal a massive blow to the global

economy, which is being pulled along by the locomotive

force of the United States.

<P>This year, the New York Stock Exchange has frequentl

yo-yoed, showing that, while market players on the one

hand have been bullish, they also have grown increasingly jittery over the economy's immediate prospects.

<H3>U.S. govt, Fed must act </H3>It is hoped the U.S.

government and the Fed will cool the market down and guide that country's economy to a slower, stable growth

phase through flexible policies based on sound economic

analysis.

<P>The U.S. economy last month marked a record-long period of expansion--eight years and 11 months--with high-tech companies riding the wave of the information

technology revolution and other firms restructuring.

<P>The potential growth rate suitable for achieving stable growth is said to be about 3 percent. However, u

until 1999, the United States' real growth rate had stood at about 4 percent for three years. The growth rate for last year's October-December quarter reached a

annualized 6.9 percent.

<P>The currently overheated U.S. economy is being buoye

by rising stock prices. Individual investors' joy at seeing their assets rise as a result of surging stock

prices has bolstered their consumption--a phenomenon known as the assets effect--which in turn has pushed up

overall personal consumption and produced further economic expansion. Going full cycle, that has lifted

stock prices still further.

<P>However, with the 30-issue Dow Jones industrial average having broken through the 10,000 barrier, stock

prices are too high given current corporate earnings and

interest rates, and, according to an estimate by one major bank, need to be modified downward by more than 3

percent. If the current growth without inflation that is

supporting bullish sentiment founders, stock prices may

plummet.

<P>Another problem with the U.S. economy is the sudden

expansion in the current-account deficit. Last year's

deficit reached the 300 billion dollars level, surpassing the previous record set two years ago by more

than 50 percent. The deficit has reached that level due

to an increase in imports on the back of strong domestic

consumption and the rise in the price of crude oil.

<P>Flow of funds must be diversified

<P>Until now, global funds have been intensively concentrated in the United States, which has been able

to balance its books by offsetting its current-account

deficit with them. However, a reversal in the flow of

funds might accelerate a plunge in the U.S. stock market.

<P>The speeding U.S. economy must be slowed to keep import levels under control and correct the current-account deficit. Doing so would also ensure the

stability of the global economy.

<P>It is important for Japan and Europe to put their economies onto a recovery track and bring about a system

under which they and the United States are the driving

force behind the global economy.
<P>While increasing imports from the United States to
help correct the U.S. deficit, Japan and Europe must tr
to make the flow of global funds better balanced, to
include three key areas--Japan, the United States and
Europe--as well as the rest of Asia and Latin America,
instead of concentrating the flow on the United States.

Such efforts are also indispensable if the global
economy is to achieve stable growth.

<P>(From March 23 Yomiuri Shimbun)

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<H3>Miyazawa reminds IMF chief Asia needs more voting
power</H3>

<BLOCKQUOTE>Japan Times,
3/22/2000</BLOCKQUOTE>

<BLOCKQUOTE>Finance Minister Kiichi Miyazawa on Wednesday reminded the next
head of the International Monetary Fund of the need to give Asian countries

more voting power at the IMF.

The reminder was addressed to Horst
Koehler, head of the European Bank for Reconstruction and Development,
during the German's meeting with Miyazawa in Tokyo.

But in a news
conference after the meeting, Miyazawa declined to reveal Koehler's respons

because his appointment as IMF managing director has not yet been made
official.

When the United States expressed support earlier this mont

for Koehler, Europe's second candidate for the IMF's top position, Japan
followed suit and withdrew its nomination of Eisuke Sakakibara, former vice

finance minister for international affairs.

In a telephone
conversation Wednesday with German Finance Minister Hans Eichel, Miyazawa

said he told Eichel that Asia's voting share at the IMF remains unreasonabl

low.

Haruhiko Kuroda, Sakakibara's successor, pointed out the same

problem Monday during a speech in Hong Kong before finance officials from

Asia.

"Despite the fact that many Asian countries have emerged

as important economic powers, the voting share and (the IMF board's)
representation of Asian countries have been extremely limited," Kuroda

said. "We believe that the member countries of the IMF urgently need t

consider the redistribution of quotas."

Domestic slump cuts Brazil's chances of gaining funds

By HISANE MASAKI
Staff writer, Japan Times,
3/22/2000
Brazil is turning to Japan to raise badly needed funds for

a new four-year development program that went into effect this year.
Martus Tavares, the Brazilian budget and planning minister, will visit Tokyo in late April to brief executives of the Japan Bank for International Cooperation on the PPA, as the development program, worth som

1.1 trillion Brazilian reais, or \$630 billion, is commonly called, accordin

to sources familiar with the deal.
The sources say that in June, fou

other Brazilian ministers, including the finance minister, plan to visit Tokyo for a seminar aimed at selling the PPA to private-sector Japanese corporate executives and at luring Japanese investments in infrastructure

and other projects to be covered by the PPA.
The JBIC was created in

October through a merger between the Overseas Economic Cooperation Fund and

the Export-Import Bank of Japan -- the two major government-affiliated foreign lending agencies.
But it is doubtful whether the planned PPA-promotion campaign by the Brazilian officials will bear fruit, as most

Japanese companies are more cautious than ever before about investing abroa

amid the prolonged economic slump at home.
Brazil is the world's fourth most-populous developing country -- after China, India and Indonesia

-- with some 160 million people. The country also has the world's eighth largest economy in terms of gross domestic product.
Japanese government officials say Japan should strengthen economic ties with Brazil

through increased investment, not only for purely economic reasons but also

to ensure its "food security" in the long term. Japan is the world's largest food-importing country, while Brazil is a major agricultura

products exporter.
But this view does not seem to be shared by many

private-sector Japanese corporate executives, who still have a negative perception of Latin America as a whole.
Foreign direct investment in

Brazil is rising sharply, totaling some \$29 billion last year. In stark

contrast with their American and European counterparts, however, Japanese

companies remain shy about investing in the potentially lucrative Latin American market.

Although Japan accounted for 9 percent of the cumulative foreign direct investment in Brazil in terms of value in 1990,

that share is believed to have dropped below 1 percent last year.

In

the 1990s, Latin America emerged with East Asia as one of the world's two

most dynamic regions despite suffering through the "lost 1980s,"

a period during which Latin American countries suffered a foreign debt crisis

, a prolonged economic slump and other dire economic hardships.

Since

the end of the 1980s, Latin American countries -- with the sole exception o

f Cuba -- have established democratic political systems after years of military dictatorships.

They have also pushed ahead with free-market

reforms, economic liberalization and fiscal reforms, including privatization

n of inefficient and unprofitable state-owned enterprises.

These efforts have produced noticeable results. Despite such hiccups as the Mexican peso crisis that erupted at the end of 1994 and the Asian financial

and economic crisis that began in the summer of 1997, Latin America remains

d on a relatively sound growth path in the 1990s, helped by strong domestic

consumption and investment and a smooth inflow of foreign investment.

In many countries, the scourge of hyperinflation is now

a thing of the past as sharp price rises have been tamed or brought down to

controllable levels.

"Japanese private companies are just like

burned children who dread fire," one senior government official quipped.</BLOCKQUOTE>

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<DIV>TOKYO, March 23, Kyodo

<H3> 3rd new runway in operation at Tokyo's Haneda airport</H3> The third and last new runway for Tokyo's Haneda airport began

operations on Thursday, accelerating a plan to relocate the facility closer to Tokyo Bay. Two new runways

have already begun operations as part of the relocation plan, which has been ongoing since 1984 to deal with noise

pollution disturbing nearby residents and to increase the number of flights arriving at or departing from Haneda.<FONT face=Arial

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vAlign=top width=420><DIV><FONT face=Arial size=3><!-- #BeginEditable "photo" -
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ficiency ratio, measured in caloric terms, has declined from 73 percent in 1965
to 40 percent in 1998. </FONT></DIV><DIV><FONT face=Arial size=3></FONT>
</DIV><FONT class=text face="Times New Roman, Times, serif" size=3><P><FONT fac
e=Arial size=3>Today, Japan has the lowest food self-sufficiency ratio among th
e advanced industrialized nations and is the world's largest net importer of ag
ricultural products. </FONT><P><FONT face=Arial size=3></FONT> </P><P><FON
T face=Arial size=3>By some estimates, 17 million hectares of arable land are n
eeded to grow the food consumed by the population, so the nation is forced to r
ely on 12 million hectares of arable land in foreign countries. </FONT><P><FONT
face=Arial size=3></FONT> </P><P><FONT face=Arial size=3>Since 800 millio
n people from around the world suffer from malnutrition, it is unlikely that th
is country will be able to remain so highly dependent on foreign producers for
its food supply. The nation's low food self-sufficiency ratio raises pressing f
ood security concerns. </FONT><P><FONT face=Arial size=3></FONT> </P><P><F
ONT face=Arial size=3>These concerns led to the insertion of a clause into an a

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agricultural bill that was enacted last July calling for the establishment of food self-sufficiency targets.

An agriculture panel that advises Prime Minister Keizo Obuchi responded with a report establishing a food self-sufficiency target of 45 percent by the year 2010 and also set a long-term target of above 50 percent. It is the panel's desire to raise the ratio to as high a level as possible.

If we extrapolate from current consumption and production trends, however, the self-sufficiency ratio will decline to 38 percent by 2010. To boost the current ratio by 5 points, we will have to not only reverse the present trends but also take additional measures to boost domestic production.

Two-thirds of the decline in the food self-sufficiency ratio can be attributed to the Westernization of the Japanese diet. Today, consumers eat less rice and more meat, oil and fat.

Changes in eating habits have contributed to increased imports of feed grains and plants which are used to produce oil and fat products. The failure of domestic producers to keep up with changes in the marketplace accounts for one-third of the decline.

A concerted effort by producers, consumers and policymakers will be necessary to achieve the target of 45 percent. Producers will have to increase domestic production of wheat, soybeans and feed grains, most of which are now imported.

The panel hopes to achieve a 3-point increase in the wheat self-sufficiency ratio to 12 percent over the next 10 years.

Consumers will need to develop healthier eating habits.

Our fondness for Western-style dishes has led to unbalanced diets and excessive consumption of fatty foods, many of which are made from imported ingredients.

And households, restaurants, and food retailers will have to find ways to save some of the nearly 7 million tons of food that are discarded every year from trash bins.

The government will have to consider new programs to utilize land that now lies fallow due to rice-paddy acreage reduction policies. But subsidies would have to be kept to a bare minimum, however, to avoid a backlash from critics at home and abroad.

#0000ff> </DIV><DIV>Big U.S. Auditing Firms Expand Services In Japan<!--EH1--><!--SBT--> </DIV><DIV>
 </DIV><P>TOKYO (Nikkei)--The Big Five U.S. auditing firms are expanding their consulting services in Japan in a bid to take advantage of preparations by Japanese companies to shift accounting priorities to consolidated results and also to support the growth of electronic commerce.</P><P></P><P>Consulting services offered by the auditors are based on U.S. management models making the most of the Internet and information technology. Specifically, they help Japanese clients by making their computer systems and business models suitable for e-commerce and consolidated accounting rules by using enterprise resource planning (ERP) and other software.</P><P> sp;</P><P>To expand its presence in the Japanese market, PricewaterhouseCoopers Consultants Co. will increase its number of consultants from the current 1,200 to 1,600 this year.</P><P></P><P>KPMG Global Solution KK will integrate its various consulting services under KPMG Consulting on April 1 and triple its consulting staff to 400 a year later.</P><P></P><P>Asahi Arthur Andersen Ltd. plans to double the number of consultants to 1,000 in two years, while Ernst & Young Consulting Japan Co. plans to create a consulting force of 500 in three years.</P><P></P><P>Apart from the expansion of consulting forces, Deloitte Tohmatsu Consulting Co. will shortly set up a wholly owned subsidiary to break into the application service provider (ASP) business, which leases software to smaller and venture businesses online.</P><P></P><P>Deloitte Tohmatsu will form two more subsidiaries to accept outsourcing orders and provide technical support. The three new units combined are planned to have 400 to 500 staff members and chalk up 10 billion yen in annual sales.</P><P></P><P>Japanese companies recognized the importance of IT consulting services since late last year, although they were cautious about actual investment out of concern about possible Y2K computer glitches.</P><P></P><P>The entrance by the Big Five auditing firms into Japan reflects their strategy to spin off consulting operations so as to minimize regulatory effects on auditing services, enabling them to raise funds and tie up with clients more flexibly.</P><P></P><P>But it is not easy to recruit consulting staff. The difficulty of hiring competent manpower was demonstrated by Microsoft Co., the Japanese unit of the U.S. software giant, which kicked off a campaign in late October last year to triple the number of consultants from 100 by offering 3 million yen to each recruit as a signing bonus.</P><P></P><P>Although the campaign lasted throughout the rest of the year, Microsoft secured only 70 consultants because of a shortage of engineers well versed in both business models and information technology.</P><P></P><P>Consulting services bring relatively high profits to hardware and software companies in Japan where the consulting market is not fully developed. With the five big U.S. auditing firms entering the market in a big way, competition, including recruitment of competent consultants, is expected to intensify.</P><P></P><P>(The Nihon Keizai Shimbun Thursday morning edition)</P><!--EBT--><!-- Corporate Profiles None --></TD><TD width=77><SPACER TYPE = block WIDTH = 77></TD></TR></TBODY></TABLE> ; <TABLE border=0 cellPadding=0 cellSpacing=0 width=670><TBODY><TR><TD align=middle rowSpan=2 vAlign=top>
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ial size=2>Thursday, March 23, 2000
<!--SH1--></DIV><DIV> </DIV><DIV>Free-Wheeling Cash Outflanks Monetary Policy<!--EH1--> <!--SBT-->
</DIV><P> </P><P>TOKYO (Nikkei)--Stock prices worldwide continue to surge ahead even as Western central banks lean toward tightening credit, and warnings over rising equity investment risks stream from regulators in a variety of markets.</P><P> </P><P>Traditional monetary policy, which targeted commercial banks as intermediaries of credit supply, appears blunted in an age when direct financing through the capital markets, has taken center stage in the global financial system.</P><P> </P><P>At the core of the phenomenon is a mutually feeding cycle of the wealth effect of buoyant shares and powerful flows of money into stock markets. In the U.S., mutual stock funds are posting net inflows exceeding 40 billion dollars monthly, and outstanding purchases of stock on margin hit an all-time high at over 260 billion dollars in February.</P><P> </P><P>Europeans are now net buyers of American shares to the tune of more than 10 billion dollars a month, while U.S. investors are increasing exposure in Asian equities. </P><P> </P><P>High-tech-oriented growth funds are taking the lion's share of investor interest in Japan, the U.S. and Europe. Wall Street-style IT booms are reproduced in markets as different as those of Hong Kong and Scandinavia.</P><P> </P><P>Not to miss out on the bonanza, major U.S. bank holding companies have set up venture-capital subsidiaries focused on businesses yet to be publicly traded. In the meantime, bank lending in America has shown no notable growth.</P><P> </P><P>The problem for the U.S. Federal Reserve Board is that its traditional policy tightening tool of raising rates in 0.25% increments is being upstaged by widespread euphoria over stocks multiplying several-fold in value within a short space of time. Moreover, investor money can simply shrug off Fed policy intentions by hopping untrammelled across national boundaries.</P><P> </P><P>There are growing arguments in the U.S. and Canada that tightened restrictions on trading on margin are necessary to quell speculative fever. </P><P>There are also emerging demands that capital adequacy requirements for banks be lifted in view of the high risks pertaining to bank-led venture capital activities. But the danger is that such direct market intervention could spark the kind of hard landing Japan experienced in the early 1990s after curbs on property lending were introduced.</P><P> </P><P>Besides, speculation is not necessarily the only force behind the global market upswing, with some analysts defending current stock valuations on grounds of expected economic growth. Credit Suisse First Boston estimates real growth in 2000 at 4.6% for the U.S. and 3.7% for the euro bloc of the European Union. A Japanese gain of 1% or so would complete a best-case scenario for balanced growth across the world.</P><P> </P><P>Still, there is no denying that global money supplies have swelled out of proportion to the expansion of the real economy. Economic policy management worldwide may be battered by torrents of footloose money until there is convincing evidence that U.S.-European credit tightening is finally getting the upper hand, guiding the global economy onto the orbit of stable growth.</P><P> </P><P>(The Nihon Keizai Shimbun Thursday morning edition)</P><!--EBT--><!-- Corporate Profiles N one --></TD><TD width=77><SPACER TYPE = block WIDTH = 77></TD></TR></TBODY></TABLE><TABLE border=0 cellPadding=0 cellSpacing=0 width=670><TBODY><TR><TD width=125><SPACER TYPE = block WIDTH = 125></TD><TD width=15><SPACER TYPE = block WIDTH = 15></TD><TD align=middle colSpan=2 vAlign=top width=530></PRE><CENTER>
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<!--SH1--></DIV><DIV> </DIV><DIV>Japan, U.S. Fail To Reach Accord In NTT Access Fee Talks<!--EH1--><!--SBT--> </DIV><DIV>
 </DIV><P>TOKYO (Nikkei)--Japan and the U.S. ended Thursday working-level talks on lowering the interconnection fees charged by Nippon Telegraph and Telephone Corp. (9432) without any compromise being reached. The talks were part of three-day bilateral negotiations on deregulation.</P><P> </P><P>The breakdown resulted from Tokyo's refusal to budge from its position to carry out a phased reduction of the fees by 22.5% from their fiscal 1998 level over four years, starting at the end of this year.</P><P> </P><P>The U.S. urged Japan to come up with a compromise plan to slash the charges by 22.5% within two years, and by more than 40% sometime in the future.</P><P> </P><P>The Ministry of Posts and Telecommunications rejected Washington's demand since "accepting the proposal will lead to a rise in basic telephone charges to ordinary users and seriously damage the management of the two NTT companies that provide regional telephone services."</P><P> </P><P>NTT levies the fees on long-distance carriers who hook up to its local lines. Both Japanese and overseas telecom firms say the charges are too high and a barrier to industry newcomers.</P><P> </P><P>A solution to the issue will now have to be found in talks by higher-ranking officials, including ministers. </P><P> </P><P>(The Nihon Keizai Shimbun Thursday evening edition)</P><!--EBT--><P>
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<!--SH1--></DIV><DIV> </DIV><DIV>E-TRADE TAXATION: Levying Downloads<!--EH1--><!--SBT--> </DIV><DIV>
 </DIV><P>TOKYO (Nikkei)--Japan's legal, tax and regulatory systems lag behind the swift progress of information technology, which has been driving the economy and offers the potential to improve corporate productivity and consumer purchasing power.</P><P> </P><P>Music downloaded via the Internet is of as high a quality as that on CD. But imported CDs of value exceeding a certain amount are subject to the consumption tax at the customs clearance, while music downloaded from abroad is not.</P><P> </P><P>"Like any domestic transaction or import, in theory downloaded content ought to be taxed. But this is not done, however, because there's no way to collect taxes from foreign companies," said a Ministry of Finance source. The MOF has begun discu

ssing ways to tax online transactions, while companies are forced to develop ne
 w business on a field riddled with land mines -- tax regulations.

Sony Computer Entertainment Inc., which just launched PlayStation2, plans
 to deliver visual and game software via the Internet starting in 2001. Securit
 ies analysts worry about SCE's planned network of servers independently located
 in Japan, the U.S. and Europe.

If the company uses a high-speed, high-ca
 pacity network, a single server could suffice, with higher efficiency and less
 investment.

A server's location is all important for tax pur
 poses. Even a company headquartered in Japan "would not have to pay consum
 ption tax" on Internet-delivered content if the server was located abroad,
 said a MOF source.

"It's best to pay taxes in each cou
 ntry," said SCE President Ken Kutaragi. An executive at Sony Corp. (6758)
 admitted that "If a multinational concentrates its servers in one location
 , it will provoke tax authorities."

Sega Enterprises Lt
 d. (7964) is moving in the opposite direction, concentrating all its servers in
 the U.S. for international delivery of the interactive games it began offering
 this month to Dreamcast users worldwide.

The service is still free, but
 "the tax savings will be enormous when they start drawing profit from pai
 d services," said a tax strategist.

Last month, the Eur
 opean Commission, announcing an Internet taxation plan, said an estimated 10 bi
 llion euro (about 1 trillion yen) worth of tax was being avoided through intern
 ational Internet transactions.

The OECD is also considering
 whether taxing online transactions is the right path to follow, and if so, how
 to go about it. But differences among the economic scale and Internet developme
 nt of OECD member nations is complicating things.

"A fa
 ir taxation system may be needed when Internet revenues grow large. But in the
 start-up stages, the government will do better to set policies that encourage i
 nfrastructure-building and investment," said Sega President Shoichiro Irim
 ajiri.

"A tax-free system should be considered to nurtu
 re these new growth markets," said a MITI executive. That opinion is gaini
 ng currency within the government.

An executive at a start-u
 p firm agreed, "When an Internet business is profitable, we only have to m
 ove the server to a country where taxes are low." (The
 Nihon Keizai Shimbun Thursday morning edition)

EBT

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Id:headline-->DaimlerChrysler Closes In On 33% Stake in Mitsubishi
> </DIV><DIV> </DIV><P><!--plsfield:byline--><I>By Akiko Kas
hiwagi</I>
<!--plsfield:credit-->Special to The Washing
ton Post
<!--plsfield:disp_date-->Thursday, March 23, 2
000; Page E03 <P> </P><P><!--plsfield:descript
ion-->TOKYO, March 22—DaimlerChrysler AG is close to acquiring a major st

ake in Japan's fourth-largest carmaker, Mitsubishi Motors Corp., a move that wo
uld create the world's third-largest auto group. <P> </P><P>Mitsubishi Mot
ors said today that its board has granted President Katsuhiko Kawasoe the autho
rity to make a final decision on a proposed alliance with Western auto companie
s. <P>Mitsubishi officials declined, however, to confirm Japanese media reports
that directors have agreed to allow DaimlerChrysler to buy a 33.4 percent stake
in the ailing Japanese carmaker. <P> </P><P>The deal with Mitsubishi, if
it goes through, would give DaimlerChrysler a strategic foothold in Asia. Daim
lerChrysler Chairman Juergen Schrempp has repeatedly said he hopes Asia will ev
entually account for a quarter of his company's sales.<P> </P><P>For Mitsui
bishi, the alliance would provide ready cash. The company is struggling under d
ebt of nearly \$18 billion even as sales are slipping. Notably, that benefit can
not be provided by follow members of Mitsubishi's keiretsu, or industrial group
. <P>Mitsubishi's need to seek financial support from foreign rivals demonstrat
es how severely a decade of recession has weakened institutions at the core of
Japan's postwar economic model. <P> </P><P>But with their own financial di
fficulties to worry about, Mitsubishi group companies have come to view outside
ownership in a different light. Under Japanese corporate law, a 33.4 percent s
take would give DaimlerChrysler veto power over all Mitsubishi management decis
ions, and thus considerable leverage over corporate strategy. <P> </P><P>J
apan's leading business daily, Nihon Keizai Shimbun, reported that under terms
of the proposed alliance, the Japanese carmaker would keep the Mitsubishi brand
and be spared the need for mass layoffs in exchange for ceding management cont
rol to DaimlerChrysler. <P> </P><P>Analysts said a union would allow the t
wo companies to offset each other's weaknesses in both regional presence and ty
pes of cars produced. But some cautioned that a 33.4 percent stake might not gi
ve DaimlerChrysler enough control over Mitsubishi Motors. <P> </P><P>Mitsu
bishi has produced several vehicles with Chrysler in the past 20 years. <P>&nbs
p;</P><P>Mitsubishi shares have risen nearly 20 percent since reports of the po
ssible deal first appeared in the Japanese press in early March. <P> </P><
P>A DaimlerChrysler stake in Mitsubishi would be the latest in a series of majo
r realignments in the global auto industry. In the past week, General Motors Co
rp. announced that would buy a stake in Fiat SpA's auto unit, and on Thursday t
he German carmaker BMW AG announced it would sell its Britain-based Rover subsi
diary to an investment company, Alchemy Partners Ltd. <P> </P><P>In additi
on, South Korea's finance minister said today that Renault SA will probably tak
e over Korea's troubled automaker, Samsung Motors Inc. In Japan, the auto indus
try has been reduced to two viable independent manufacturers--Toyota Motor Corp
. and Honda Motor Co.<!--Text end--> <P><BR clear=all> </P><CENTER><P>&cop
y; Copyright 2000 The Washington Post Company <P></CENTER><!--END PUSH ARTICLE-
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ND OF STORY TEXT. Ensure it includes a COPYRIGHT notice. *--><!--*****

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Start a Conversation
(Requires Yahoo! Messenger</TD></TR></TBODY></TABLE></P><P>(go to http://dailynews.yahoo.com/h/nm/20000323/bs/telecoms_japan_3.html to access this box)</P><P><P><!-- ConvS lot --> ``We are at an impasse," Fisher said. ``The government of Japan is proposing a policy that would reduce the costs by too little over too long a period." <P></P><P>An adviser to Japanese Prime Minister Keizo Obuchi said he had passed on a message to Obuchi from Fisher that President Clinton was closely watching the issue and may raise it at the July Group of Eight summit in Japan. <P></P><P>Disagreement On Fee Cuts<P></P><P>NTT, still 59 percent government-owned, is under intense U.S. pressure to slash interconnection fees for carriers using it

s networks. <P> </P><P>Washington is pressing for an immediate 41 percent reduction in the charges, saying this would not only benefit U.S. firms seeking access to the Japanese telecoms market but would provide a much-needed lift for Japan's fragile economy. <P> </P><P>Tokyo has offered a 22.5 percent cut implemented over four years, arguing that bigger cuts would jeopardise NTT's profits and threaten its workers with unemployment. <P> </P><P>''We do not accept the fact that jobs will be destroyed," said Fisher, noting that the breakup of similar monopolies in both the United States and Britain actually worked to produce jobs.<P> </P><P>''The inefficiencies of NTT are being borne by consumers and by their competitors, and they are a significant drag on the economy," he added. <P> </P><P>A Japanese official told reporters earlier Thursday that the world's two biggest economic powers would try to resolve the issue by the end of March. <P> </P><P>''We will make our utmost efforts to settle the issue by the end of this month... But we cannot predict how it will be settled," the official said. <P> </P><P>Japanese officials blamed the U.S. side for the blockage on Wednesday, accusing Washington of raising extreme demands. <P> </P><P>NTT controls more than 90 percent of local lines connecting Japanese homes, giving it an iron grip on the huge Japanese telecoms market. <P> </P><P>The United States says Japan's connection costs are triple what they would be under open competition. Analysts agree the rates are higher than in the United States but many question U.S. methods of calculation.<P>&nb sp;</P><P>While Tokyo has adamantly refused U.S. demands so far, such a stance may not bode well for Obuchi, who has called for an "information technology revolution" as a means to give the recession-mired economy a badly needed boost. <P> </P><P>Several domestic firms, including Sony Corp, have also complained about the costs and called for more competition.<!-- TextEnd --><!-- TL --><P><CENTER> </CENTER><CENTER> </CENTER><DIV><!-- /TL --><!-- MTF SID 0:2718085:7645365:7663536:7663545:27169057 -->

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</NYT_DATE><NYT_HEADLINE version = 1.0 type = " "><!--ELEMENT HEADLINE--><H2>Japan Remains at Odds With U.S. on Telephone Deregulation</H2><H2> </H2></NYT_HEADLINE><NYT_BYLINE version = 1.0 type = " "><!--ELEMENT BYLINE--><H5>By STEPHANIE STROM</H5></NYT_BYLINE>OKYO, March 22 -- After two days of meetings, the United States and Japan failed to reach any agreement today on further deregulation of the telecommunications market here and extended their talks to a third day. <P>Other areas of the Japanese economy are also under discussion -- drugs, medical equipment and construction, among others -- but it is the telecommunications debate that has become heated because its outcome has important implications for future economic growth here. <P>The United States contends that Japan is hurting itself economically by not creating the basis for more competition in its telecommunications market, the most expensive such market for users in the industrial nations. The Americans have successfully framed the debate as multilateral, affecting not only United States companies but their European and Japanese competitors. <P>Even the Keidanren, Japan's traditional business lobby, has sided with the United States, not to mention blue-chip Japanese companies like Sony. <P>"Persistence in the old ways threatens to transform Japan into a fading giant," Richard W. Fisher, a deputy United States trade representative, told journalists here on Tuesday. <P>Washington is demanding an immediate 41 percent reduction in the fees that telecommunications companies pay to hook up to the network owned by Nippon Telegraph and Telephone, the former government-owned telephone monopoly that is a member of the NTT Group. NTT controls more than 99 percent of local phone traffic. <P>The fees, according to the Japanese government, eat up as much as 40 percent of the revenue of NTT's competitors. <P>But the government says it can cut the fees only by 22.5 percent over a four-year period, contending that a more aggressive move would deal a crushing blow to NTT. The election year presents a further complication because the ruling party's popularity is waning, and NTT and its subsidiaries employ 224,000 voters directly and probably as many indirectly. <P>The United States is threatening to take the matter to the World Trade Organization if some agreement is not reached by the end of the month, an escalation of the dispute that the Japanese want to avoid in advance of a meeting of the leading industrial nations in Okinawa in July. <P>"There is a wide gap between the two sides on the so-called reduction rate," said Akitaka Saiki, a spokesman for Prime Minister Keizo Obuchi, referring to the interconnection fees. "I think the Japanese negotiators are trying to persuade their American counterparts of the difficult domestic circumstances surrounding NTT." <P>Mr. Saiki said the reductions demanded by the United States could force NTT to reduce employment and increase management turmoil at a company where opinions are divided over strategy. NTT has already begun an overhaul aimed at reducing the work force by 21,000 and curtailing investment over three years, but the job cuts are regarded by many as cosmetic since they will be achieved through attrition. <P>The Japanese government is having trouble making its case, however, because NTT is an extraordinarily rich company, owning controlling stakes in the NTT Mobile Communications Network, or NTT DoCoMo, Japan's largest mobile phone company, and the NTT Data Corporation. <P>The regulators are further hampered by their own efforts to make a case to politicians for supporting sharply reduced interconnection fees. Having convinced politicians that any further reduction in the fees would hurt NTT and its callers, the regulators are now unable to easily change their stance.<!--plsfield:NYT_FOOTER--><NYT_FOOTER version = 1.0> </P></BLOCKQUOTE>

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CREATOR: Khalid.Azim@exim.gov (Khalid.Azim@exim.gov [UNKNOWN])

CREATION DATE/TIME:23-MAR-2000 11:11:46.00

SUBJECT: RE: Africa Committee Meeting

TO: John B. Buxton (CN=John B. Buxton/OU=OPD/O=EOP [OPD])
READ:UNKNOWN

TO: Jacqueline F. Lain (CN=Jacqueline F. Lain/OU=WHO/O=EOP [WHO])
READ:UNKNOWN

TO: Sonny Garg (CN=Sonny Garg/OU=OMB/O=EOP [OMB])
READ:UNKNOWN

TO: Daniel F. Feldman (CN=Daniel F. Feldman/OU=NSC/O=EOP [NSC])
READ:UNKNOWN

TO: blprice@opm.gov (blprice@opm.gov [UNKNOWN])
READ:UNKNOWN

TO: 'esther benjamin' <benjamin-esther@dol.gov> ('esther benjamin' <benjamin-esther@dol.gov> [UNKNOWN])
READ:UNKNOWN

TEXT:

Lance asked me to forward this to the committee.

Khalid

can you forward my response to the rest of the committee?

----- Forwarded by Khalid Azim/BD/EXIMBANK on 03/23/00 09:21 AM -----

"Wyatt, Lance"

<lance.wyatt@ma il.va.gov> To: "'Khalid.Azim@exim.gov'"
<Khalid.Azim@exim.gov>

cc:

03/22/00 07:35 Subject: RE: Africa

Committee Meeting
PM

Khalid,

What a well-written letter! I am very curious about the questions you raised and I hope you receive a thoughtful reply.

I would like to comment on several issues.

Susan and Gayle believe that Nigeria deserves consideration for relief of debt as a democracy dividend. It appears that you believe that nations moving towards certain paths consistent with our ideas should be rewarded in some sort of way, but not debt relief, for the reasons listed.

The central theme then is that the U.S., its allies and instruments (IMF, WORLD BANK, ETC.), should reward others for doing as we believe.

What right do we have to reward any nation for what we feel is an appropriate way to govern its people? This issue raises the specter that we use economics in ways that we wish, to reward others as we see fit.

The issue of debt begs questions: under what circumstances was money borrowed, who borrowed it, who benefitted, who did not, who owes, and who is accountable?

The IMF's 'RESCUE PACKAGE' for Indonesia approximates the wealth of the Suharto family.

Most citizens of countries now in debt had nothing to do with borrowing money - it was not borrowed by the mass of populations. One Indonesian economist estimates that 95% of the country's \$80 billion foreign debt is owed by 50 individuals, not the 200 million who are now burdened by it. Where did the money go? Who was overseeing all of this?

Is it possible that global banks made bad loans to corrupt leaders, dictators, military elites, and other wealth members of states who then took the \$, and ran, i.e. flight capital? Economists believe that debt in Latin America that reached crisis levels in the early '80s would have been sharply reduced by return of flight capital...the World Bank estimates that Venezuela's flight capital exceeded its foreign debt by some 40%.

Some feel IMF and WORLD BANK policies have forced poor countries to make debt service a higher priority than basic human needs. The UN estimates that if Mozambique were allowed to spend half of the money on health care and education that it now spends on debt, the country would save 100,000 children lives ...each year. Have past loans been a subsidiary to the policies of those who control the banks? Is debt even credible?

Finally, in the past, debt has been cancelled. Per the Wall Street Journal, Britain, France, and Italy defaulted on debts to the US in the 1930s, and the US "forgave or forgot". There are other historical examples.

With these considerations, debt is a political instrument, a psychological construct, not an economic issue.

I am beginning to believe that democracy is not on our agenda. We loan and involve ourselves in other countries, not at all for "moral and social obligations", but for perceived self-interest. This may explain why we are

so involved in China while democratic India begs for respect.

On the issue of "why Africa", i believe that our initial committee of 4 laid out a compelling set of answers, so I wonder what Susan and Gayle will add.

LW

-----Original Message-----

From: Khalid.Azim@exim.gov [mailto:Khalid.Azim@exim.gov]
Sent: Wednesday, March 22, 2000 4:46 PM
To: John_B._Buxton@opd.eop.gov
Cc: benjamin-esther@dol.gov; blprice@opm.gov;
christopher.m.moore@usdoj.gov; Daniel_F._Feldman@nsc.eop.gov;
Jacqueline_F._Lain@who.eop.gov; John_B._Buxton@opd.eop.gov; Wyatt,
Lance; Sonny_Garg@omb.eop.gov
Subject: Re: Africa Committee Meeting

To the Africa Team,

FYI, this is the letter I am sending to Gayle and Susan in regards to Africa. Would welcome any comments or suggestions.

Khalid

March 21, 2000

Gayle Smith
Senior Director for African Affairs
National Security Council
Old Executive Office Building
Washington, DC 20504

Dear Gayle and Susan:

Thank you for an educational and engaging session on Africa. We as a class are very excited about our trip to Africa and felt very fortunate that you would spend time with us to further our learning. I for one am greatly impressed by your accomplishments on Africa in this administration and I certainly hope that the next administration have people with the same passion and desire to engage American foreign policy in Africa.

For what little it is worth, I'd like to humbly pass on a few areas where I differ slightly with you both on Africa. The first is on debt relief for Nigeria. Like you, I am desirous of finding a way to reward the bold path Nigeria is charting on the path towards democracy. However, I believe debt relief is not the way because it will discourage private capital from coming into the country, it will diminish the credibility of debt relief for HIPC countries, it will require global comparative review with other countries in similar circumstance (such as Venezuela) and beg for equal

consideration (especially in the context of other nation's Paris and London club agreements), it will be based on a transition to a very new government in which Nigerian history has shown might not last, finally debt relief for Nigeria with the price of oil at about \$30 per barrel would be difficult to validate.

Secondly, though I agree with you that the importance of Africa in the post cold war can not be made solely on national security concerns, which the establishment might prefer; however I do believe a stronger argument has to be made to the American people about the importance of Africa besides that of a moral or social obligation. Why should America's foreign policy matter to a farmer in the Kansas, a factory worker in Michigan or a wealthy dot-com millionaire in California? We didn't really give you a chance to address this fully, however I have for one did not get an understanding of this.

Finally, though I believe in a democracy dividend as you refer to in Nigeria, I am more interested in a dividend for a functional common law, a commercial code, creditor rights, transparency, and international accounting standards. Though I understand you were speaking in broader terms, I think democracy unto itself will not generate wealth, establish institutions to govern or provide for a fair and equitable society. On the contrary, I would argue that authoritarian regimes such as China, Singapore, Malaysia, Morocco, Chile and even Indonesia have had remarkable transformation in their societies, economies and public policy. Though democracy is desirous from a human rights and philosophical standpoint, it did not play a role in the transformation of the countries named above. Even the great Indian democracy still must beg for respect while the focus of American policy makers continues to rest first and foremost on socialist and authoritarian China.

I hope after this trip, you might the opportunity to talk again to our class. I look forward to continue watching the work you will be doing in terms of America's engagement with Africa. Thanks again for a wonderful session.

Respectfully Yours,

Khalid Azim

ARMS Email SystemRECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:28-MAR-2000 10:43:43.00

SUBJECT: World Bank/IMF Spring Meetings

TO: David Tseng (CN=David Tseng/OU=OPD/O=EOP@EOP [OPD])

READ:UNKNOWN

TEXT:

David,

Only additional point I was going to make is that while the formal meetings run from April 15-17, the overall process goes on for about a week--from say 14th-20th, with piggyback meetings, informal regional get-togethers of say, finance ministers from Latin America, central bank presidents from Eastern Europe, meeting to discuss matters--that sort of thing. Plus the Institute for International Finance holds a 2-day conference on the margins of the WB meetings, Fred Bergsten's IIE always has a day-long conference at the hotel where the main meetings take place, etc. And the Merrill Lynch's, the Deutschebanks, and the Goldman, Sachs of the world hold little private meetings with their clients and some invited international big-wigs in hotels around town in the day or two before or after. Plus finance ministers and central bankers hold little meetings around town with IMF officials, Treasury officials, etc. to chat about things. On the Friday before the meetings, the IMF will have a big press conference to unveil its new World Economic Outlook (which I used to prepare) and the international press always comes in for that and then just stays for the 5-7 days.

Rob