Monday, October 26, 1998

BusinessWeek

SPECIAL REPORT ON BUSINESS ENTERPRISE
BEGINS OPPOSITE PAGE 86

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Will the growth machine keep going?

Working at Home
Telecommuting's

GLOBAL RISK

How to reshape the **WORLD FINANCIAL SYSTEM**
PAGE 112

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PAGE 34

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William J Clinton
President of the United States
The White House
1600 Pennsylvania Ave. NW
Washington DC 20500

THE PRESIDENT HAS SEEN
10-26-98

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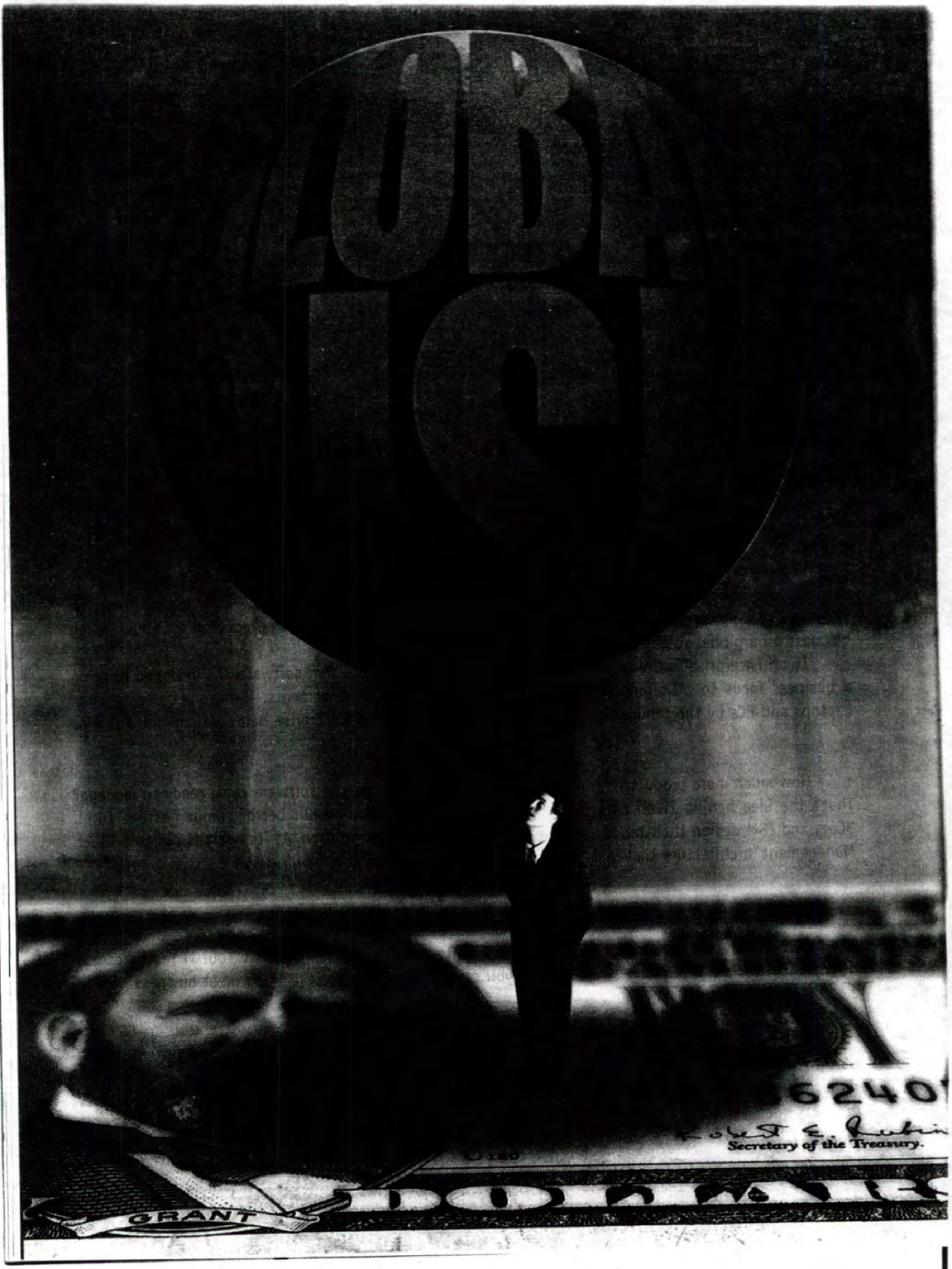
Secretary of the Treasury.
GRANT

Special Report

How to Reshape the World Financial System

"Sound management of fiscal and monetary policies provides no guarantee against major economic crises."

—International Monetary Fund, September, 1998

The first and biggest task is to tame the anarchy of markets that globalization has unleashed

It once was comforting to believe that the international financial system was a just and fair god. Countries that ran big budget deficits and borrowed from overseas to finance consumption, rather than investment, would be punished by capital flight and depreciating currencies. Nations pursuing prudent policies would be rewarded by strong growth and a steady stream of money from global investors.

But when the world's top finance ministers and bankers gather at the beginning of October in Washington for the annual meetings of the International Monetary Fund and the World Bank, they face a different reality. Despite being held up for years by the IMF as models of development for the rest of the world, countries such as South Korea, Thailand, Malaysia, and Indonesia have been ravaged by capital flight.

To date, the IMF-led rescue plans for these nations do not appear to have worked. Unemployment and interest rates have soared, the value of their currencies has plummeted, and prosperity has turned into social dislocation and riots. The flow of private funds into these countries has screeched to a halt. Even Thailand, which has made impressive progress in modernizing its financial and legal systems, will not see a full recovery for years (page 120). Overall, the stricken Asian economies will shrink by more than 5% this year, according to forecasts by Standard & Poor's DRI, vs. 5.8% average growth in 1996 and 1997.

What's more, the rescue effort does not appear to have halted the rolling crisis, which has hit other emerging markets such as Russia and Latin America. The latest victim: Brazil, whose stock market has dropped by almost 40% since mid-July as it battles the perception that its financial situation, too, is becoming unsustainable (charts, page 114). The fear now is that a series of defaults would cause an unraveling of the global financial system, bringing international lending and borrowing to a halt. The tremors have even reached the U.S., with the collapse of giant hedge fund Long-Term Capital Management.

There is little argument that today's global financial system needs to be rebuilt. The goals are obvious: Reducing the likelihood of future financial crises, preventing today's problems from spinning out of control, and restarting battered economies. At the same time, any fix needs to preserve and even strengthen the global flows of trade and foreign direct investment. These flows, which helped fuel the Asian miracle of the past 20 years, are the foundation for restoring growth in the future.

There is no perfect solution to the global mess—but BUSINESS WEEK believes there are ways to make things better. Some steps are easy: Everyone agrees that there needs to be better information and heightened regulation, both in developing and industrialized countries. But the far bigger task is to tame the anarchic nature of the global financial markets.

THE IMF OPTION. International finance is no longer the province of a relatively small number of large financial institutions. With the growth of rapid communications, investment banks, mutual funds, hedge funds, and multinational corporations all can jump in and out of markets at the click of a mouse. At the same time, financial wizards are creating swarms of new types of securities—ranging from derivatives to emerging-market debt—where the risks are hard to assess and price correctly.

Indeed, the current crisis stems, in part, from the breakdown of pricing discipline in global markets. Capital poured into emerging economies with little attention to the creditworthiness of the borrowers. As a result, countries like Thailand and Indonesia were able to borrow in dollars at far lower interest rates than they would be required to pay at home, encouraging them to take on far more

CONTENTS

TYPE DESIGN BY JAMES LEBBAD; PHOTO IMAGING BY DAVID RUDES/BW, MODEL: SCOTT BOOKHEIMER foreign debt than they could handle.

When problems arose, everyone tried to get their money out as quickly as possible, making the crisis even worse. Complicating matters still more, there were no clear guidelines for which private-sector lenders had to share the cost of cleaning up the financial mess.

Not surprisingly, the road to restoring stability is not so clear. Economists and policymakers see three main alternatives for getting the global financial system under

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GLOBAL RISK

control. The first option would pump a lot more funds into the IMF—giving it enough resources to bail out troubled countries and get them back on their feet again. In effect, the IMF would be turned into a real lender of last resort for the world economy, much as the Federal Reserve serves as the last line of defense against the collapse of the U.S. financial system.

The danger of counting on the IMF, though, is the "moral hazard" problem. Assuming that they would be bailed out, investors would be encouraged to take bigger and bigger risks in emerging markets, leading to the possibility of even deeper financial crises in the future. Eventually, the crises would get so large that even a souped-up IMF could not handle them. Moreover, the IMF can never function as a true lender of last resort, since it will never have the Fed's most potent weapon—the ability to print money.

FLOW VALVES. An alternative being given increasing consideration is the imposition of controls on international capital movements. The goal would be to damp down the tidal surges of "hot money" that helped overwhelm the emerging economies of Asia and Latin America. The notion is attractive to government leaders faced with a sinking economy. In Malaysia, for example, Prime Minister Mahathir Mohamad imposed an indefinite moratorium on capital outflows. But the idea of limited capital controls is picking up support among top economists as well. World Bank Chief Economist Joseph E. Stiglitz argues, for example, that it's time to consider "some form of taxes, regulations, or restraints on international capital flows."

Indeed, there is some evidence that capital controls can be effective in protecting an economy from the global markets. In 1991, for example, Chile imposed a 30% tax on incoming portfolio investments, refundable after a year, in an effort to slow money coursing in so fast it was creating an inflationary bubble. From 1991 to 1997, inflation declined from 22% to 6.1%, while the country averaged more than 8% annual growth.

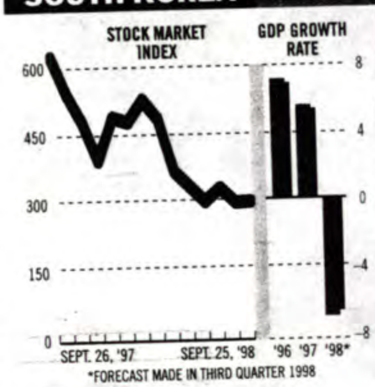
Nevertheless, the Chilean example cannot be counted a complete success. Chilean businesses that needed funds went offshore in such great numbers that three-quarters of all trading in Chilean equities now occurs on the New York Stock Exchange. And many businesses have tried to circumvent the capital controls by smuggling, bribery, and false invoices. Indeed, Chile recently dismantled its beloved controls in an effort to help the private sector get financing during the global market turmoil. "It's paradoxical that so many are advocating a [Chilean-style] system that has been repudiated by its very developers," says Sebastian Edwards,

A YEAR TO FORGET *Over the past 12 months, the gl*

INDONESIA *Indonesian shoppers stock up as the rupiah tanks*

MALAYSIA *Crisis-induced riots result in arrests in Kuala Lumpur*

SOUTH KOREA *A bank employee readies for the cash crunch*



(CLOCKWISE FROM TOP LEFT) PHOTOGRAPHS BY JOHN STANMEYER/SABA, RICARDO AZOURY/SABA, ROBERT BURROUGHS; ROBERT WALLIS/SABA, PAUL BARKER/REUTERS, ED WRAY/AP/WIDE WORLD. CHARTS BY RAY VELLA/BW ast 12 months, the global financial crisis has depressed stock markets and growth worldwide

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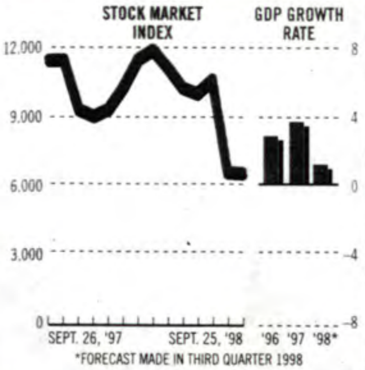
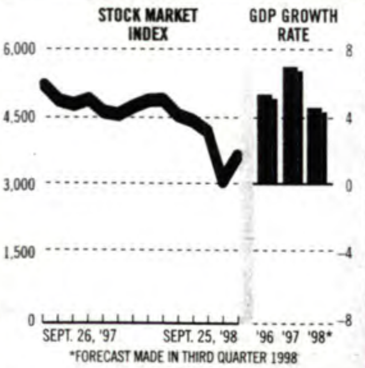
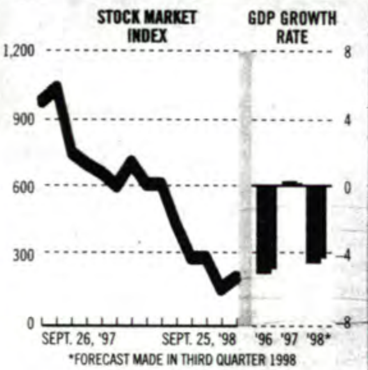
BRAZIL *A trader watches stock values plummet in São Paulo*



MEXICO *Samsung workers in Tijuana: The shock waves get closer*



RUSSIA *In a Moscow market, a woman relies on traditional currency*



the World Bank's former chief economist for Latin America.

Indeed, because of the acknowledged limitations to capital controls, economists and policymakers are searching for another way to tame risk that won't require countries to take a step back from open capital markets. A big part of the problem is that there are no explicit rules for quickly resolving a financial crisis. The ad hoc approach worked in the past, when a debt crisis consisted of a handful of money-center banks lending to a government. Today, however, such crises can involve thousands of banks, mutual funds, and hedge funds, all lending to a slew of public and private debtors.

Without a formal workout process, precisely the wrong investors—those people who provide long-term money—take the bath. Equity and bond investors get hit hard, but perversely, when the IMF comes in with a bailout package, much of the currency infusion actually goes to pay off the short-term foreign lenders who helped cause the problem. "If you had a bond in an Indonesian company, you got wiped out," says Robert Litan, an economist at the Brookings Institution. "But if you made a foreign-currency loan to an Indonesian bank, you got off scot-free."

What's needed is gradually to change the rules to make all private-sector investors bear their fair share of the cost of a rescue effort, and not to favor providers of hot money. One proposal under consideration is a debt-restructuring plan akin to a Chapter 11 bankruptcy proceeding. Such a system, as outlined by proponents such as Harvard University professor Jeffrey D. Sachs, would allow a country in trouble to enjoy a temporary standstill on debt payments, with the approval of the IMF. Creditors and debtors would come to an agreement in an orderly manner on whether the debt should be marked down or exchanged for equity.

An approach like this could help revive moribund economies by providing what is in effect "debtor-in-possession" financing, giving special rights to those who provide credit after the original bankruptcy is declared. This would allow countries to tap new private capital, just as Chapter 11 in the U.S. allows bankrupt companies to get the credit they need to keep operating. The global equivalent would allow countries to get enough foreign exchange loans, guaranteed for a limited amount of time by the IMF, to allow exporters to keep functioning.

INCENTIVES. Formally bringing the private sector into the rescue process would cut the likelihood of future financial crises. Because lenders know they would not be bailed out by the IMF, they would have an incentive to pay closer attention to the quality of their investments. They would also likely want higher returns on money invested in emerging countries. As a result, the existence of a bankruptcy option could moderate flows of destabilizing hot money to emerging markets.

When a financial crisis does occur, a borrowing country would be less likely to be crushed under the weight of its bad debts. Instead, the losses would be shared with institutions that made the loans originally, with the goal of getting the country back to economic health as soon as possible. This would reduce the chances of a spillover to other emerging countries. Moreover, if existing debt can be marked down or rolled over quickly, it becomes easier for a country

DATA: STANDARD & POOR'S/DRI; BLOOMBERG FINANCIAL MARKETS

Rescue Plans: Weighing Some Options

There are some ideas on which just about everyone can agree. Emerging countries should supervise banks more closely and adopt more rigorous accounting standards. Better information should be gathered and disseminated about emerging-market debt. And Congress should provide the IMF funding that the Administration has requested. But there's a debate over more far-reaching efforts. Here are three proposals, with arguments pro and con.

BATTEN THE HATCHES *Put controls on the flow of foreign capital to insulate emerging economies from global financial markets.*

PROS Action may be focused on short-term capital flows rather than beneficial long-term investments. Controls can't be reversed if they are no longer needed.

CONS Government intervention can choke off investment and growth. Government control of foreign exchange can encourage inefficiency and corruption.

MAN THE LIFEBOATS *Strengthen the IMF's hand by pumping billions more into the Fund and turning it into a true lender of last resort.*

PROS Resources would be available to defend embattled currencies. Troubled countries could get enough funds to get back on their feet again.

CONS Lining up funding would be difficult. The "moral hazard" problem, in which private lenders count on public bailouts, might create bigger future problems.

START OVER *Codify debt rescheduling by allowing countries to petition the IMF to file for a debt-standstill agreement. This global Chapter 11 should spread risk and encourage more prudence.*

PROS Borrowers are more likely to receive trade financing and could recover more quickly. Creditors would be more cautious, reducing the odds of future financial crises.

CONS The legal framework for a global Chapter 11 does not yet exist. Countries might petition the IMF for debt relief too readily.

DATA: BUSINESS WEEK

that hit the skids to tap private capital markets again.

Of course, a global system modeled on Chapter 11 might not help every country with financial woes. Russia, for one, suffers from such severe internal problems that no fixes to the international system are likely to help. Japan, the linchpin of the Asian economy, is stuck in recession, unable to address its own enormous debt problems because of political paralysis.

Beyond that, some bankers object that allowing debtor countries to get out from under some of their obligations is a recipe for disaster. A Chapter 11 for nations is "the worst idea I've heard in my life," says Paulo Ferraz, CEO of Banco Bozano Simonsen, one of Brazil's premier investment banks. "It would be the end of the global financial system."

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"GET REAL." Moreover, many people are profoundly skeptical that such a proposal is anything more than an academic exercise. For one, unlike the U. S., the legal framework to compel creditors to accept a Chapter 11-type workout does not now exist on a global scale. In addition, some of the mechanisms that make Chapter 11 work in the U. S., such as the ability of creditors to shut down firms that are not economically viable, may not apply when the borrower is a sovereign nation. Even Treasury Secretary Robert E. Rubin, who thinks the notion is "a conceptually sound idea," admits to having doubts (page 126). "How you actually implement such a thing in an international regime where there is no Chapter 11 is a challenge," he says.

Nevertheless, the broad notion of moving toward a formal debt-restructuring system for the global economy is getting a great deal of attention these days. On Sept. 14, for example, President Clinton called for measures "to lift the weight of private-sector debt that has frozen the Asian economies." His urging followed the Bank for International Settlements' June suggestion that "the private sector [needs] to take some responsibility for the ongoing provision of credit to customers to whom they had previously lent all too freely." The Group of 22—consisting of the G-7 industrial countries plus 15 emerging economies—is also discussing new ways of dealing with private-sector debt.

In fact, history suggests that in times of crisis, demanding full repayment of debt can be an enormous mistake. After World War I, the victors' moves to collect war debts from each other and reparations from Germany helped create the conditions that bred the Great Depression and World War II. In the 1980s, Latin America struggled for years under debt problems until a deal was struck allowing capital to flow in and growth to resume. By contrast, the U. S. system doesn't require companies or people who fall on hard times to spend the rest of their life paying debts back. "Once your old mistakes get big enough, they drown your future," says Elizabeth Warren, a bankruptcy expert at the Harvard Law School. "Bankruptcy is a way to say to creditors, 'Get real. The money's not there.'"

Perhaps the hardest problem is how to decide when a debt standstill is appropriate. Clearly, it's important that a country not be able to unilaterally declare a debt moratorium—that's a sure route to chaos. Instead, the IMF should take the lead role in certifying when a country is in deep enough trouble to trigger the restructuring mechanism.

Both capital controls and a Chapter 11-type system have pluses and minuses. In the short run, capital controls are clearly an easier policy to adopt. Countries can implement them unilaterally, and they do not require new financing. By contrast, a formal debt-rescheduling scheme would be much harder to actually put into practice.

But capital controls do not solve the underlying problems of the world financial system. Rather, they are a temporary stopgap. A set of rules for global financial markets that codifies the now messy process of debt rescheduling may be difficult to achieve any time soon. But in the long run, moving in the direction of a system that prices risk appropriately and keeps capital markets open is the right thing to do.

By Michael J. Mandel in New York and Dean Foust in Washington, with bureau reports

Economic Trends

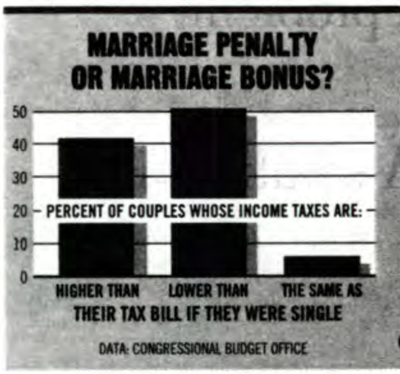
BY GENE KORETZ

CONGRESS' IFFY WEDDING GIFT

The pros and cons of a tax break

Few ideas are more popular among Washington legislators in this political season than reducing the federal income tax code's so-called marriage penalty. Republicans have made it a major feature of the tax-cut bill just passed by the House of Representatives. Democrats have weighed in with several rival plans. The betting is that any tax cut plan that finally flies will take at least a modest step in that direction.

What's often passed over in the public debate, however, is that the current tax system is more biased in favor of marriage than against it. That is, for every four couples who pony up more in



income taxes than they would if each partner were single, five couples actually pay less. And those who benefit the most are "traditional" families in which one spouse is the main provider and the other's main energies are devoted to child-rearing and homemaking tasks.

A recent Congressional Budget Office study estimates that some 51% of couples filing joint returns wind up with marriage bonuses, compared with 42% who lose out because of their marriage status (the rest aren't affected). On a net basis, married couples paid some $4.1 billion less in taxes in 1996 than they would if they had filed individual returns, with $2 billion of the net bonus going to couples with adjusted incomes over $50,000.

This pattern exists because past legislators wanted married couples with equal incomes to be taxed equally regardless of how much each partner earns, but they also wanted to hold down the gap between taxes levied on single people and the taxes paid by workers with similar earnings who happen to be married. The upshot is that couples with relatively equal individual earnings now pay higher taxes than they would if they were single, but couples with relatively unequal earnings come out ahead.

Needless to say, it's the couples who pay higher taxes because of their marital status that have been griping. The challenge Congress faces in providing them with relief is to do so in a cost-efficient way without increasing the relative tax bite on single taxpayers. (Already, a single worker earning $64,000 pays 42% more in income taxes than a married co-worker with the same pay and a nonworking spouse).

By that standard, the House-passed Republican tax bill falls short of the mark, says analyst Iris Lav of the Center on Budget & Policy Priorities, a liberal Washington-based think tank. By increasing the standard deduction for joint filers, the bill would provide relief to many middle-income couples, she notes, but it still wouldn't lessen the stiff marriage penalty facing some low-income working families who qualify for the Earned Income Tax Credit.

More important, the bill would actually increase the marriage bonus for many couples who already benefit significantly from the tax code. In the process, it would widen the already large gap between what single people pay and the taxes levied on married couples with nonworking spouses. A similar proposal targeted only at couples facing marriage penalties could avoid this effect and cut the estimated $6-billion annual cost in half, Lav says.

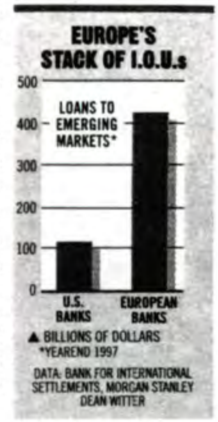
While singles have yet to be heard from, she adds, their numbers aren't small. About a fourth of adult Americans live alone, and single taxpayers file 58% of all returns.

A TRANSATLANTIC CREDIT CRUNCH

Is Europe blind to danger signs?

Europe may be far more vulnerable to the widening world financial crisis than it believes, contends economist Stephen Roach of Morgan Stanley Dean Witter. The news that Switzerland's UBS bank just took a $686 million charge to reflect losses on its exposure to Long Term Capital Management's hedge fund may be only the tip of the iceberg.

Roach estimates that European banks had $426 billion worth of debt exposure to emerging markets at the end of last year, equivalent to approximately 7% of the Euro region's gross domestic product. By contrast, U.S. banks' exposure came to $117 billion, or just 1.5% or so of American GDP. Even in Latin America, Europe's exposure was double that of U.S. banks: $133.6 billion, vs. $64.3 billion.



The bottom line, says Roach, is that Europe may well experience a credit crunch as its banks write down their emerging market assets. What's really worrisome, he adds, is that European policymakers seem to be totally oblivious to such a possibility. And with economic growth in Europe running 2.5% on a year-over-year basis, compared with 3.5% in the U.S., it has a far smaller growth cushion should credit scarcity foster a slowdown.

THE WIDENING HEALTH-CARE GAP

Small-business cuts can't help

A sharp decline in health insurance provided by small businesses to their employees may be a major factor behind the rising number of Americans who lack such coverage (page 144).

According to a Dun & Bradstreet Corp. survey of owners and senior executives of small businesses around the nation, only 39% of such businesses in the U.S. offer health-care benefits to their employees—compared with 46% only two years ago. Since small businesses account for close to half of private-sector employment, the D&B survey appears to shed light on a recent Census Bureau report that the share of the U.S. population with no health insurance rose from 15.6% in 1996 to 16.1% last year, an increase of 1.7 million Americans.

D&B indicates that small businesses are cutting back on other employee benefits. Only 19% of firms surveyed said they offer retirement benefits, for example, compared with 28% in 1996. And only half of small businesses provide paid vacations for full-time workers.

ERIC HOFFMANN/BW

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LATEST DRAFT: 13 October 1998 :

STILL INCORPORATING CHANGES

1. The financial problems which began in Asia last year have exposed weaknesses in emerging market countries and in the international financial system in mechanisms for crisis prevention and resolution. In these circumstances it is essential that the major industrialized economies show both leadership and the willingness to embrace necessary reform. Following detailed discussions we, the Ministers and Governors of the G7 countries, are now agreed on the following specific reforms to strengthen the international financial system. We have agreed to implement these reforms in our own countries and to use our voice and votes to implement them within the International financial institutions. We now call upon other countries to take similar action.

2. We believe these measures will strengthen the fundamentals of the international financial system and assist crisis-affected countries to find a route out of their current difficulties.

1. CRISIS PREVENTION

Transparency and policy making procedures

3. We agree on the need for greater transparency and openness in the financial operations of the public sector and of financial and corporate institutions. This must be based an internationally agreed standards and codes of best practice.

4. We agree in the public sector to deliver greater transparency in economic policy making and in disclosure of economic statistics and key indicators. We therefore commit ourselves to:

   (i) comply with the IMF's Code on Transparency in Fiscal Policy;

   (ii) comply with an internationally agreed Code of Conduct on Monetary and Financial Policy. We urge the IMF quickly to complete its work on this Code;

   (iii) disseminate regular and timely information about the foreign exchange liquidity position of our public and financial sectors.

5. Similar standards of transparency are required in the private sector. We call upon:

(i) the OECD, in conjunction with the World Bank and IMF, quickly to complete its work on a Code of Corporate Governance;

(ii) the IASC quickly to develop a proposal for a full range of internationally agreed accounting standards;

(iii) the Basle Committee, in conjunction with other relevant private and public sector bodies, quickly to develop internationally agreed standards of transparency and disclosure in relation to private sector financial institutions involved in international capital flows. There should be internationally agreed standards of disclosure by which market participants can judge hedge funds and related investment institutions.

6. We commit ourselves to take the necessary steps to ensure that private sector institutions in our countries comply with these codes.

7. We call upon:

(i) all countries which participate in the global capital markets similarly to commit to comply with these internationally agreed codes and standards;

(ii) the IMF to monitor, in close co-operation with the standard-setting bodies, the implementation of these codes and standards as part of its regular surveillance under Article IV;

(iii) the IMF to publish in a timely and systematic way the results of its surveillance of the implementation of the Codes as part of a regular Transparency Report assessing the level of transparency in each of its member countries;

(iv) the Fund and the World Bank to work closely together to provide advice and, where necessary, assistance to its member countries to help them meet these internationally agreed codes and standards.

(v) the IMF to include in its programmes: trade liberalization measures consistent with trade agreements which countries have already signed; prescriptions against directed lending by governments to industry; and support for the creation of legal frameworks for non-discriminatory insolvency procedures.

8. We agree on the need for more openness and greater transparency at the IFIs themselves. We call upon:

(i) all IFIs to adopt a presumption in favour of release of information, except where this might compromise confidentiality;

(ii) the IMF to establish a mechanism for systematic evaluation, involving external input, of its operations and policies

Stability of the International Financial System

9. We agree that better processes are needed for monitoring and promoting stability in the international financial system and for the international financial institutions to conduct surveillance

of national regulatory and supervisory regimes with all relevant information accessible to them.

10. We agree therefore that we will:

(i) establish a process for surveillance which will draw on national and international regulatory and supervisory expertise to provide an input into the IMF's regular surveillance of its member countries under Article IV;

(ii) to this end bring together the key international institutions and key national authorities involved in financial sector stability to monitor capital flows and liquidity in the international financial system more systematically;

(iii) develop better sharing of information between private sector and the relevant international bodies on the global pattern of risks and exposures.

11. We call upon other countries which participate in the global capital market to give their support to the establishment and operation of the process.

How do we increase margin requirements from [illegible] speculators? have to be focused + everyone even more clear [illegible] to adopt no bailout [illegible] for funds that go offshore to avoid?

12. We commit ourselves to strengthen, in our own countries, the regulatory focus on risk management systems and prudential standards in financial sector institutions: in particular, examining the implications arising from the operation of international institutional investors including hedge funds.

13. We call upon other countries which participate in the global capital markets to take similar action.

14. We recognise that the opening of capital markets in emerging economies must be carried out in a careful and well sequenced manner if countries are to benefit from closer integration into the global economy. In particular, sound financial sectors and robust regulatory and supervisory regimes must first be in place. We therefore call upon:

(i) the IMF and World Bank jointly to develop a "roadmap" for capital account liberalization in each emerging market country, providing advice and assistance to prepare countries for full liberalization.

2. CRISIS RESOLUTION

15. We agree that improved mechanisms are needed for dealing with crises when they do occur, particularly in the coordination of the relevant international bodies, regulators, national authorities and the private sector.

16. Better ways are needed to stabilize the system quickly in times of crisis without bailing out the private sector or creating moral hazard. We therefore welcome the agreement on the IMF quota increase and the New Arrangements to Borrow. At the G7 meeting in Washington in October we agreed to explore a strengthened capacity, based in the IMF and with the general increase of IMF quotas and establishment of the New Arrangements to Borrow, to provide more effectively contingent finance to help countries pursuing sound policies to maintain stability in the face of difficult global financial conditions. We therefore now:

(i) resolve to involve the private sector, in a consultative way, in crisis resolution, and to create both principles and procedures by which the private sector plays its part in sharing of responsibility;

(ii) call upon the IMF as a matter of urgency to develop its facilities with a greater emphasis on precaution;

(iii) commit ourselves to supplement the Fund's resources where necessary through the activation in consultation with our partners of the New Agreement to Borrow and the General Agreement to Borrow;

(iv) agree to consider urgently ways of using the SDRs allocated to industrial countries in the prospective equity allocation of SDRs to create an additional reserve working on the principle of conditionality to be used in conjunction with the IMF's SRF and precautionary facilities;

Good! If you go this route don't you have to have some sort of [illegible] link [illegible] or other workouts w/ [illegible] swaps, debt extensions to avoid moral hazard.

(v) increase the resources available to the IMF by committing ourselves not to draw on the IMF reserve tranche of our IMF quotas so as to counter systemic risk;

(vi) it is for each country to consider further bilateral financing in support of IMF programmes.

17. We agree that more attention must be given in times of crisis to the effect of economic adjustment on the most vulnerable groups in society. We therefore call upon the World Bank to develop as a matter of urgency:

(i) general principles of good practice in social policy, in consultation with other relevant institutions. These should be drawn upon in developing adjustment programmes in response to crises;

(ii) a new emergency facility focused on support for the most vulnerable groups in society and for restructuring the financial sector.

What about debt forgiveness for poorest countries? Good tagline. Offering to [illegible] in exchange for Brown speech,

3. NEXT STEPS

18. We agree to take immediately the actions to which we have committed ourselves.

19. We commit ourselves also to consult widely throughout the whole of the international community to encourage others to take

similar action and to build a broad consensus in support of this declaration. We will therefore:

(i) ask the relevant international institutions and organizations to carry forward the proposals above and report back to us by (insert date);

(ii) develop quickly, in consultation with the wider international community, detailed proposals for ways to strengthen the international architecture including strengthening and broadening the Interim and Development Committees of the IMF and World Bank.

(iii) meet by [insert date] to review progress and consider the next steps.

AGENDA

MEETING ON INTERNATIONAL FINANCIAL ISSUES

October 14, 1998

9:00 to 10:00 p.m.

I. POSSIBLE INITIATIVES

<u>Short-term Crisis Response:</u>

- Precautionary Finance Facility
- Brazil Financial Package
- Special Drawing Rights
- Progress on Japan

Asia: Priv. Debt Rest
Debt → Equity
Russia

<u>Long-term Architecture:</u>

- G-22 Recommendations:
  - Transparency
  - Surveillance and Regulation
  - Crisis Resolution

<u>Other Steps</u>

- UK Proposal

II. OPTIONS FOR LEADERS MEETING

- Venue/Host
- Timing
- Participation
- Virtual Meeting

October 26, 1998

TO: Jim Steinberg

FR: Phil Caplan

I wanted you to have copies of the attached material.

As you can see by my note of Oct 19 to the President, he complained because he thought I was keeping a couple of memos from him. In fact, I was following my normal routine in trying to manage his paper flow.

This is not a big deal, but I wanted to let you know because of the Bill Richardson/Climate Change issue. After my Oct 19 note (in which, with Todd's help, I told him what was happening with the Richardson proposal), the President somehow got a copy of Richardson's memo (he didn't get it from me). As you can see, he wrote, "John P, I think we should do this."

Phil

THE PRESIDENT HAS SEEN
10-20-97

Phil— I understand but on hot topics like Economics or memos from Cabinet secretaries, I'd like to see when they come in, w/ comments more appropriately in process
BC

THE WHITE HOUSE
WASHINGTON

October 19, 1997

MR. PRESIDENT:

A word of apology....I heard from Maria (then I saw your note to me) that you were upset about getting some paperwork late, specifically the Japanese banking memo from the Brookings Institution via Sandy and the Bill Richardson Climate Change proposal that the VP mentioned to you.

On the banking memo, you should know that although Sandy's note to you is dated Friday, Oct 10, I did not receive it from his office until Tuesday evening the 13th. In trying to manage your paperflow each day, I make a judgement about what I might be able to package up for you in "weekend reading" so that you're not loaded down with individual blue folders during the week. I thought this memo fit this category though I understand that in light of recent developments regarding the Japanese economy, you may have preferred seeing it earlier.

I'd like him to do this

On the Richardson memo, I've been handling it like all decision memos. I circulated it to senior staff for their input before sending it to you. Todd has talked to Jim Steinberg, who wanted to discuss this with the Secretary of State's office before the memo is forwarded to you. In essence, Richardson is interested in leading the effort to persuade developing countries to participate meaningfully in the Kyoto Protocol. My understanding is that there is interest in Secretary Richardson playing an important role on developing countries, provided that the role is structured so that State and NSC still have the lead on diplomatic strategy.

Phil Caplan Phil

cc: Maria Echaveste

THE PRESIDENT HAS SEEN
10-22-98

'98 OCT 6 PM6:09

The Secretary of Energy
Washington, DC 20585

October 5, 1998

MEMORANDUM TO THE PRESIDENT

FROM: BILL RICHARDSON

SUBJECT: WINNING DEVELOPING COUNTRY COOPERATION ON CLIMATE CHANGE

copied
Podesta
Stern
COS
Steinberg

Our collective efforts to persuade key developing countries to adopt binding emissions targets have not yet been fruitful. Only with Argentina are we beginning to see real progress. These developing countries have managed to characterize this disagreement as a North-South issue and have maintained remarkable group discipline. With a concerted effort I believe we can divide and conquer this group, persuade at least a few key countries to adopt voluntary or binding targets for the 2008-2012 time period, followed by binding targets beginning in 2013. It will require an interagency effort, a willingness to link some forms of cooperation to progress on climate change and some cabinet level pressure on our friends and partners. I am willing to lead this effort with your support, the support of the Vice President and cooperation from Treasury, State, EPA and USAID.

The key argument we must make is that it is in the economic interest of developing countries to adopt binding emissions targets. While we can make our case on environmental and political grounds, these arguments are not compelling to countries struggling for development and fearful of the current economic turmoil. We must shift our diplomatic focus away from the Foreign Ministries, which make their trade in G-77 cooperation, and towards the Trade and Finance ministries, which are looking for any lifeline they can get. We must also make a concerted effort to wage a public diplomacy campaign in the media of the countries we are targeting. We must make the case that cooperation on climate change is the key to technological cooperation and the generation of cash from the international emissions trading regime.

You made this argument in your meetings with President Jiang Zemin and President Kim Dae Jung. The high level working groups you offered to create have met and are beginning to make some progress. I would like to expand on your idea and target additional countries that are in more dire economic straits or with whom we have the greatest leverage. We will have to work with them to develop their own analyses indicating the economic benefits of entering the emissions trading

Printed on recycled paper

system. We must provide them with the analysis that shows them the international capital flows that could accompany the adoption of an emissions target. My Department has the analytical firepower and resources to develop this analysis and present it with credibility abroad.

While access to capital is the carrot, ultimately each country's decision to cooperate with us will be a political decision. We need a more political strategy to win their cooperation. We need to begin by targeting the countries that we have the best chance of splitting away from the G-77. These can be Allies like Israel and friends like Singapore, who are well off and have low emissions levels now. We should work on Mexico and continue to push South Korea -- countries in need of a capital boost and likely to see the benefits from emissions trading. We can also target those countries over which we have, for a variety of reasons, great leverage.

With your support I will use my travel abroad to press our case and gain agreement to create a series of these multi-agency working groups. I can begin this month when I visit Mexico and Venezuela and continue with the Caspian nations, South Korea and the Gulf States later this Fall.

What I need is your support to let me lead these bilateral efforts. My counterparts in other countries need to know that we will meet at ministerial level when their Presidents come to town or when we host major binational events. I will work hand in glove with the Vice President, Todd Stern and my colleagues at State, Treasury, EPA and USAID. But if we want to break the current logjam and persuade the Congress that we are making a serious effort to win "meaningful developing country participation" we need to start fresh, work as a team and start now.

You have set a new course for our efforts with China and South Korea, one which has shown some promise. I think we need to turn this into a concerted campaign. I'm ready to hit the trail.

THE PRESIDENT HAS SEEN
10-26-98

Guns

Do any of these ideas have merit?

BC

1. cc Sperling Jones
2. Froman

THE PRESIDENT HAS SEEN
10-26-98

BC

cc Gene S | Laura Summers

Sounds on n. will very good - BC

copied Sperling COS

FROM THE DESK OF
AMBASSADOR DEREK N. SHEARER

FACSIMILE TRANSMITTAL SHEET

TO: President Clinton	FROM: Ambassador Shearer
COMPANY:	DATE: Oct 4
FAX NUMBER:	TOTAL NO. OF PAGES INCLUDING COVER:
PHONE NUMBER:	SENDER'S REFERENCE NUMBER:
RE: Global Econ. Crisis	YOUR REFERENCE NUMBER:

☒ URGENT ☐ FOR REVIEW ☐ PLEASE COMMENT ☐ PLEASE REPLY ☐ PLEASE RECYCLE

NOTES/COMMENTS:

Bill,

Bill Greider's piece - attached - merits your attention. While Greider is not right in all his policy Rx, he is correct about the need for bold action - and you are the only one who can lead in this crisis. Things will get worse - in Russia, Brazil, etc. Japan will not act quickly. It will be up to us.

We are now in residence in our new house. When your schedule permits, I'd like a chance to see you - and if I can be of service on international matters, let me know.

Ruth joins me in sending our regards

- Derek

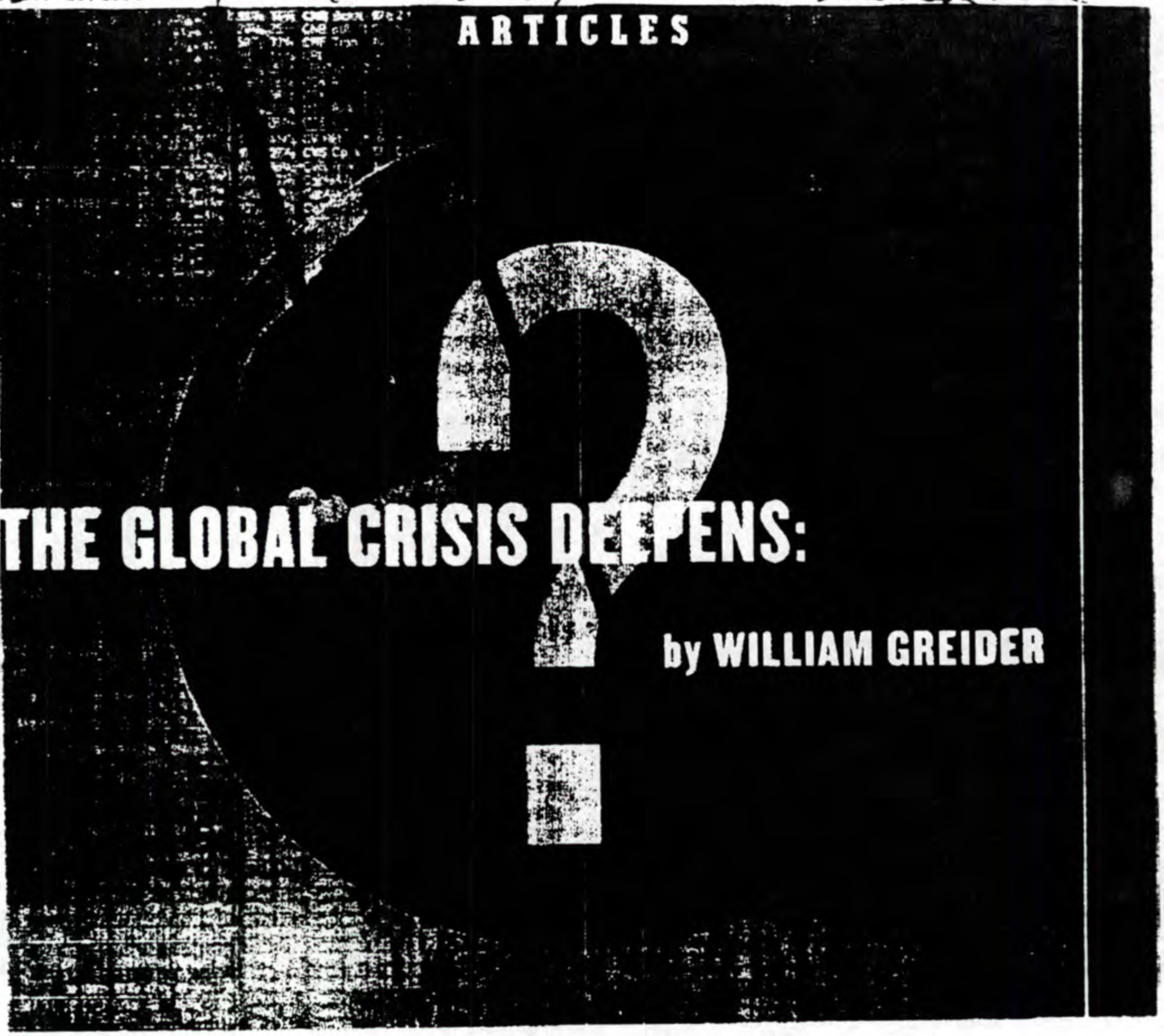
She is enjoying the Postal Rate Commission.

2101 Yorktown Rd NW Wash DC 20012
Tel. 202-829-7476 ~~633 ASHLAND AVENUE SANTA MONICA, CA 90405~~ FAX: 202-829-7478
~~TEL 310-396-4914, FAX 310-396-6060~~

cc: Sully D.
2. Pres

FOR: The President From: Amb Derek Shearer

ARTICLES



THE GLOBAL CRISIS DEEPENS:

by WILLIAM GREIDER

As the crisis deepens, the crumbling self-confidence of the US establishment is reflected in the poignant headline over a *Washington Post* editorial: "Don't Quit on Capitalism Yet." The newspaper is pleading with nations like Malaysia and Russia not to abandon the free-market principles that brought them to ruin.

Business Week, meanwhile, offers a brisk action plan for halting the economic destruction. Half of its proposals—economic stimulus from cutting interest rates and taxes—seemed farfetched to conventional wisdom when they were first elaborated ten months ago. The financial press was then celebrating the triumph of the American way over those defunct "tigers" in Asia.

And the *Wall Street Journal* runs a front-page article on the merits of capital controls that reads like a lengthy correction. For many months, the *Journal* reassured its readers that the US economy had entered a "new paradigm" of recession-free prosperity. It led cheers for the mantra of US policy-makers: The collapsed economies could save themselves only by adopting the Washington model of freewheeling, unfettered markets. Now the idea of controlling cross-border capital flows no longer seems so heretical, since the *Journal* has found that controls are protecting some developing nations from the "hot money" panic that has torn up so many other economies.

Even the disabled President makes a timid start at acknowledging the new reality. Bill Clinton, in a speech in September to the Council on Foreign Relations, calls for an international conference of finance ministers to discuss the crisis and asks major central banks to consider reducing interest rates jointly. In these terrible times, one longs to have a Democratic President (the old kind, not the new variety).

This creeping self-doubt among the government elites is progress, of course, but it mainly mirrors the bearish confusion in financial markets. Respectable opinion did not admit the ominous nature of global events until that icon of US hegemony—the Dow Jones average—started unraveling too. Leaders of US government, business and finance are still behind the curve—dangerously so—because they still assume that, with a few deft policy adjustments, the global economy can be restored to "normal."

There will be no return to normal, not in the terms that financiers and economists envision. The global system will either be reformed in fundamental ways or we will watch passively as the destabilizing dynamics of unregulated markets continue to deliver random destruction around the world, compounding the loss and misery for innocent bystanders. As the political turmoil accumulates, so will the conflict among trading nations. For better or worse, the global system is going to be profoundly altered by these events (if not utterly smashed).

What the world needs now is a "bank holiday"—a global equivalent of the shocking intervention that Franklin Roosevelt delivered during the first days of his presidency in early 1933. Close everything for one day—banks, brokerages, financial markets worldwide—while, overnight, major governments announce new operating terms for the global financial system and simultaneously launch a vigorous reflation of currencies, prices and economies. A contemporary version would require stimulative economic measures on many fronts and emergency suspension of the usual standards for orderly finance and commerce.

> ***No one has been more wrong than the IMF about the nature of this crisis—except perhaps the Treasury officials who tell it what to do.***

The urgent objective is to pull the global economy out of this muck—before everything gets stuck. A deflationary spiral is far more difficult to reverse, once under way, than it is to avoid with timely ameliorative action.

The symbolism matters. Governments must declare a holiday from the bankers—a political escape from the smug conservative orthodoxy that has ruled public life for twenty years, the hard-money ethic that trampled competing values like equity or social stability and effectively shifted governing power from elected politicians to the unelected technocrats at central banks and in private corporations and finance. The current crisis is the logical consequence of blind faith in the marketplace as the most efficient governor of society. Recovery requires heretics in high places.

Here's a short list of what major governments can do quickly to reverse the unraveling if they can find the courage to assert their power over the markets:

§ Cut interest rates right now. Mobilize emergency tax cuts, skewed in a very progressive manner so that the money is put swiftly in the hands of wage earners who will spend it. Accelerate public works and other spending projects. Accept the unorthodox reality that running significant budget deficits, at least for a few years, is now the therapy, not the disease.

§ Dismiss the failed leadership at the International Monetary Fund and install a group of pro-growth business executives to run the place, empowered to reverse course. No one has been more wrong than the IMF about the nature of this crisis or how to stop it—except perhaps those leaders at the US Treasury who tell the IMF what to do. A new IMF team would scrap the austerity plans and instead lend to struggling nations only if they devote the capital to stimulating recovery in their real economies of production and consumption (some Koreans or Brazilians should be included on the team to win credibility among the scared and skeptical developing nations).

§ Central banks and bank regulatory agencies (the Fed is both) should temporarily relax balance-sheet rules for commercial banks—that is, reduce the global capital standards for banks or even reserve requirements—so bankers will have plenty of breathing space to restart international lending. If nervous bankers still hesitate, regulators should muscle them into line.

§ The G-7 industrialized nations must accept the necessity of developing countries' adopting emergency controls on capital flows—a temporary insulation that will allow nations to recover from the storm without being overwhelmed by the panicky flights of manic capital. The same regulatory authorities leaning on the bankers should broadly warn the capital markets that speculators may get whacked with increased margin requirements (drying up the borrowing leverage that fuels their "hot money") if they do not exercise more self-restraint in these dicey times. They should also hint that the offshore banking havens where global financiers park their capital are suspect institutions and perhaps ought to be shut down.

§ A global "reconstruction finance corporation," roughly like the one in FDR's New Deal, should be established to supervise friendly workouts between creditors and failing corporations, with substantial capital posted by major industrial nations to help in the process of repackaging the mountain of bad debts and reliquefying credit-starved enterprises, until the time when private financial systems are able and willing to resume that role. With new leadership, the IMF might fulfill this function.

§ There should be a general debt forgiveness by the IMF and World Bank for the forty poorest nations. This will have only a mild stimulative impact, but it sends an important statement of good intentions to the entire world. When the global system gets out of this mess, it will not simply return to the old rapacious forms of creditor conquest.

§ In the case of these transactions and some other measures, the United States and other industrial leaders should demand a crucial codicil: If the wealthier, healthier economies are going to lead and finance global recovery, then every borrowing nation and corporation must sign on for fundamental reforms in the aftermath. If the global system's leaders try to restore the status quo ante without moderating the unstable dynamics, then the systemic contradictions will lead us yet again to crisis and breakdown.

The debate among peoples and nations begins now. A new Bretton Woods understanding, one that serves both rich and poor nations, must wait until we get out of this ditch.

My melodramatic proposition sounds extreme, of course, or at least absurdly premature. After all, when FDR launched the blizzard of eclectic initiatives that began the New Deal, the United States—and the world economy—was already in depression. During the four years of inaction following the stock market crash of 1929, recurring waves of contraction and bankruptcy swept through the US economy, pushing unemployment toward 25 percent and wiping out nearly half of America's commercial banks. Why should anyone regard

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William Greider, the author of One World, Ready or Not: The Manic Logic of Global Capitalism, *now available in paperback from Touchstone, writes regularly for* Rolling Stone.

the present moment of full employment in such desperate terms?

Because Roosevelt's New Deal recovery plan was already too late—four years too late—to avoid the massive dislocations and suffering of the Great Depression, to avert the utter breakdown of the international trading system. That is the core point of our current dilemma—the fateful question of timing. Governments and politicians (as well as central bankers) are naturally hesitant to take extreme measures in the absence of desperate conditions. Yet if they wait to act until the malignant consequences are fully visible for all to see, then it may be too late again. The challenge for leaders is to have the guts to mobilize convincing economic cures *before* everyone can recognize the nature of the sickness.

To grasp the potential dimensions of the crisis, it helps to understand that three negative currents are loose in the world, each delivering damaging shocks and surprises in one region after another, with interacting feedback on one another. The first strand is a collapsing financial bubble—the failed investments and bad bank loans, inflated expectations and stock prices. This began in Asian financial markets, but its origins were always global—financial delusions fostered in New York City as much as Jakarta or Tokyo. Thanks to rising income inequalities (the wealthy accumulating larger shares of the economic returns), the world actually has a surplus of capital—and that encouraged giddy investors to take more wishful risks and plunges, investments increasingly detached from real-world prospects.

When illusions were shattered, it created the second negative current—the contractionary forces spreading now through the real economies. A huge, vital source of global demand was suddenly lost when Asian economies stalled out. The damage spread unseen to other nations in the form of glutted supply and falling prices—too much oil being produced for the shrinking market, too many computers or cars being manufactured for the available demand. So the shock wave suddenly turns up in Russia or Mexico, even Silicon Valley, because producers must cut prices to sell their output or shut down production and send the workers home (or often do both). Those defensive measures add to the downdraft—including a relentless decline in profits.

The abrupt loss in global demand compounds the fundamental problem of overcapacity that already exists worldwide—too many factories chasing scarce buyers. In nearly every major sector, the era of over-investment produced far more productive capacity than the global base of consumption can possibly absorb (a reality directly aggravated when companies shift high-wage production to cheap labor markets). The meaning is harsh and inescapable for the global system: Somebody somewhere must close lots of factories. As nations struggle to protect their own production base the competitive devaluation of currencies can become a defensive weapon—artificially cheapening their exported goods so they can grab market share from others. That contest—desperately pushing the deflationary pressures off on some other nation—can become a deadly spiral, once it gets started.

The third negative current—the psychology of fear—is potentially the most explosive, but also the most impossible to track. When people are subjected to repeated shocks—economic setbacks the authorities did not foresee—at some point they may decide to hunker down in a defensive crouch, that is, stop buying and borrowing, stop investing and lending, stop building and producing. Whether they are consumers, corporate managers or bankers, the pessimism of not knowing from where to expect the next bad news can become a powerful depressant itself—the one that is most difficult for a struggling economy to shake off.

That gloomy condition roughly describes Japan's current predicament. Prices are falling, but nobody wants to buy; interest rates are near zero, yet nobody borrows. It is not that Japan hasn't tried major pump-priming and other measures, but whatever it tried was too late or too little to reverse the paralysis. A prosperous people, profoundly anxious, are sitting on their savings and waiting for the storm to pass—their economy caught in the "liquidity trap" that John Maynard Keynes warned about sixty years ago. In a broad sense, that is the ultimate threat facing everyone, even the United States. When governments do get around to reversing the downdraft, will it be too little, too late? When they promise recovery, will people believe them?

Right now, US policy seems dangerously at odds with itself. Obsessed with yesterday's demon (inflation), the Federal Reserve deliberately set out to slow down the robust American economy and it succeeded. The Treasury Secretary, on the other hand, urged Japan to revive its own economy with more Keynesian stimulus so it would pull the rest of Asia out of depression. The strategy smacked of US opportunism, since the Clinton Administration put the onus for reform and recovery on everyone but Washington.

Amid all these negative currents, was it really a good idea to slow down the largest, most vibrant economy in the world? The Federal Reserve actually added to the recessionary pressures. It has now finally started to cut short-term rates, when only a few weeks ago it was still claiming that inflation and a dangerously robust economy was the problem. The Fed's sudden change of heart is suspect: What might have caused it was the collapse of a high-flying hedge fund, Long-Term Capital Management, and the dangers that posed for the Federal Reserve's core constituencies—the major US banks and brokerages.

Is the central bank already too late? Those who think Fed chairman Alan Greenspan is an infallible economic manager should recall that the 1990 recession was inadvertently induced by him when he kept short-term rates too high for too long. Greenspan didn't see a contraction coming until it had been under way for three or four months.

Monetary policy aside, falling corporate profits may produce the same outcome. David A. Levy, an unorthodox economic forecaster who tracks profit rates as the key leading indicator, has been warning that the US economy faces a 75 percent probability of recession in the next two or three quarters.

If that does occur, the global economy may soon arrive at the fateful juncture where we find out whether this deflationary storm is turning into something far worse. A US recession would seriously quicken the negative currents because much of the world, led by Japan, is counting on the American market for their own recovery. They expect the United States to be the "buyer of last resort" that absorbs their cheapened exports and provides the demand stimulus that will reinvigorate their economies. If the United States is unable to play that role because its economy is contracting too, then all the desperate options are intensified for struggling nations—both protective measures to shut out foreign goods and more currency devaluations to keep their export prices cheaper than competing producers.

At that point, the deadly spiral beckons: Each player may do what seems necessary to save itself—nations, banks and companies—but such self-protective measures simply amplify negative currents for the whole. Governments will act, one assumes, but not necessarily in convergence. Some countries are already opting out of the unregulated global financial market, and more are sure to follow if the leaders of the global system do not offer them something more than old sermons on the virtues of the Washington model. The major central banks will reduce interest rates sooner or later—and substantially—but, as with Japan, their timing matters. If gloom has already swallowed up optimism, the stimulative impact may be disappointing. Central bankers will find themselves staring at the fact that they cannot cut interest rates below zero. Paralysis in crisis is what disgraced the Federal Reserve seventy years ago and persuaded many politicians and economists to belittle the power of monetary policy as "pushing on a string."

The basic policy question is: Which economic risks are you willing to accept in order to avoid another risk that seems more harmful? If the most dire consequences do not unfold, we may experience a painful global recession but nothing worse. In that case, if governments act too soon and aggressively to stimulate growth, it could complicate recovery or even produce an episode of price inflation, the old nemesis of the reigning orthodoxy. But the other risk is that, by blindly sticking to their orthodoxy, the governors of the global system may be ratifying a slide into the big swamp—historic losses that would be very difficult to overcome and that could even wreck the global trading system in the process. Put in those terms, the choice does not seem so difficult: Take the risks on the upside.

While the first challenge is avoiding catastrophe, that task cannot be separated from the long-term need to reform the global system so that its dynamic expansion will be more stable and equitable. In other words, if Washington expects to keep leading this system, it has to acknowledge what other nations are beginning to figure out for themselves: The present regime that Washington has long sponsored generates recurring crises and bloody surprises, especially for the poorer aspirants struggling to industrialize. Treasury Secretary Robert Rubin offers a vague assurance that "new architecture" is needed in the future, but a process of redesign is already under way, country by country, for better or for worse.

The cold war ended, but US elites have not yet grasped that this change loosens the bindings on its alliances and undercuts the supervisory power that the United States exercised for two generations. Renewing its position as global premier will not be accomplished by bombing a factory in the Sudan or terrorist camps in Afghanistan. It might be enhanced, however, if the United States opened the way for a new Bretton Woods compact that set more realistic rules for governing the global economy.

The priorities for reform are all bound to be extremely difficult, but the first test is whether US elites really do believe in a progressive global system or merely in their own opportunism. One stunning revelation in this crisis is how quickly US leaders in politics, finance and multinational corporations abandoned their own longstanding sermons on the inevitability of globalization, pretending instead that this crisis does not involve us. They seem to have gotten over that illusion.

But the hubris with which US business and banking leaders prescribe hard reforms for others and bargain-basement scavenging for themselves is sowing deep suspicions of US purposes elsewhere in the world. If the United States expects to lead, it must first restate, convincingly, its own commitment to fashioning a global system that is not based on neocolonial capitalism but truly is intended to be in everyone's long-term interest.

What's needed is a new system that will moderate investors' manic qualities without blocking creative international lending.

The fundamental problems a new Bretton Woods agreement must tackle involve finance, commerce and social relations—a much broader global understanding than the one fashioned from the rubble of World War II. Everyone, not just bankers and economists, should be at the table contributing to the "new architecture," everyone from labor and environmentalists to poor nations to social activists and religious leaders.

Finance. Given the instabilities and random destructions caused by unregulated global finance, what's needed is a new system of acceptable capital controls that will moderate—that is, slow down and perhaps channel—the manic qualities of investors without blocking the creative energies of international lending. Tony Blair has been brave enough to endorse the idea.

There are lots of ways to do this, including taxes on foreign exchange that would recapture some of the billions lost to societies through global tax avoidance. At a minimum, developing countries are entitled to some sovereign self-protection as they seek a maturing share in the industrialized prosperity.

Moreover, Milton Friedman's grand experiment—the harrowing roller coaster of floating exchange rates among national currencies—has to be abandoned as too costly, though this is a much more difficult problem. If the euro succeeds rapidly (surviving its own predictable crises), the basis will soon exist for establishing some sort of stable concordant among the three major values—dollar, yen and euro. That would give the world a framework for re-establishing more reliable relationships among all currencies. Such a system would exert its own discipline on nations and their economic policies, but that would be more rational and just than the folly-flight of manic capital.

Commerce and Trade. The core problem is the dynamics for expansion that yield persistent overcapacity in productive output, thus always forcing a race to the bottom for cheaper labor and political deals in which multinationals trade away jobs at home for market access abroad. Mature economies (not just that of the United States) will continue to experience recurring waves of deindustrialization, and political pressures to protect domestic industries are sure to intensify.

The terms of trade must be reformed to confront this continuing imbalance between supply and demand that depresses wages at both ends of the system. Acknowledging that labor rights are not different in law from property rights will begin the process of bringing up the bottom, rebalancing wage incomes with capital incomes everywhere and thus helping the demand side of consumers to catch up with the supply side of available output. Income inequality is an economic issue, after all, as well as the right thing to do.

At the same time, the trading system must confront the export-led model for growth that worked so well for Japan and some other Asian nations but that also guarantees the persistent overcapacity. The issue is not whether aspiring countries will have a national industrial policy guiding their development—of course they will, and why not? That is how the United States first built its industrial system in the nineteenth century.

The real issue is whether those fast-developing economies are permitted to prosper by riding free at the expense of others—exporting robustly while refusing to accept a reasonable share of imports. There is a legitimate remedy for this, but it involves the taboo issue of tariffs. The United States, as buyer of last resort, absorbs the heaviest costs of this unbalanced trading system through its persistent trade deficits (so do displaced US workers). But even wealthy America cannot pile up indebtedness forever.

Once the smoke from this present crisis has cleared, the United States should announce that either the trading system will work out some new rules requiring more balanced trade and compelling developing nations to focus more capital on domestic industrial development, not just exports, or the United States will act in its self-interest, invoking legal trade sanctions (including an emergency tariff) to correct its own financial imbalances. I believe it would take only a serious announcement of potential tariffs by Washington to convince everyone, including Japan, that trading relations have to change.

Social Relations. Banishing random inhumanities, from sweatshops to child labor to abusive and unsafe working conditions in the "dark satanic mills," is fast gaining political momentum as people grasp how this global system treats the weak and voiceless. No one expects utopian changes, but political leaders have to get serious about accepting the universality of basic human rights—free speech, for starters—and devising new rules that are enforceable elements in trade agreements. Otherwise, the political conflicts in the streets on these matters of human decency will swell until they become a market force of their own. Consider how, after years of arrogant corporate denial, a concerted campaign of progressives—plus falling sales—persuaded Nike to promise new respect for its own workers.

These and other propositions are not beyond the range of human invention, though they are now blocked by political inertia and stalemate, especially in the United States. If authentic reforms are ignored by stubborn orthodoxy, the global system may well evolve anyway in directions that undermine the status quo. One can imagine a balkanized collection of blocs emerging from the present turmoil—regional groupings that work out their own understandings of production and capital, no longer deferring to the direction of Washington or Wall Street. If the present turmoil deepens, one can also imagine much worse. ■

Editorial and Op-Ed pages, 14-15

10-26-98

The New York Times

Education Advertising
Careers in Education and
Health Care Employment

Week in Revi

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Blueprint

Sunday

Filling In Peace's Details Is the Painful Part

By ETHAN BRONNER

THE images were arresting. There they were, Ariel Sharon, who once sent the Israeli military to Beirut for Yasir Arafat's head, and Benjamin Netanyahu, who long avoided shaking the man's hand, sitting together in Maryland agreeing with the Palestinian leader on land and airports and prisoner releases.

It is often said that the weakness of the 1993 Israeli-Palestinian peace accord worked out in Oslo, Norway, was that it was embraced by only half of Israel, the secular liberals of European origin, and had never been sold to religious Israelis, the poor and those of Middle Eastern origin.

Now, three years after an Orthodox, Yemenite Israeli student sought to end the peace deal by assassinating Prime Minister Yitzhak Rabin, here were the representatives of that other Israel coming to terms with the reality that Oslo had created.

Yes, they were making it hard with their near walkouts and last-minute demands. But that was the way toward real peace: you relinquish holy land with a tear in your eye and an ache in your gut, not with the detachment of the previous Government. Here were negotiators who understood the fears as well as the hopes of their people, who could build an agreement that might survive those fears. Prime Minister Rabin, the messenger of peace, may have died, but his message has survived.

Perhaps. But the past five years — since Mr. Rabin and Mr. Arafat shook hands on the White House lawn — have offered sobering lessons on why optimism has rarely held sway in this process since.

In contrast to the intimate and personal Oslo negotiations, at the Wye Plantation it took the President of the United States and the King of Jordan days and nights of prodding to produce this next interim step. And its implementation is highly complex. Of course, details and implementation posed formidable barriers to peace from the start. What is different this time is that the Wye agreement comes in the context of difficult experience in making specific peace arrangements work.

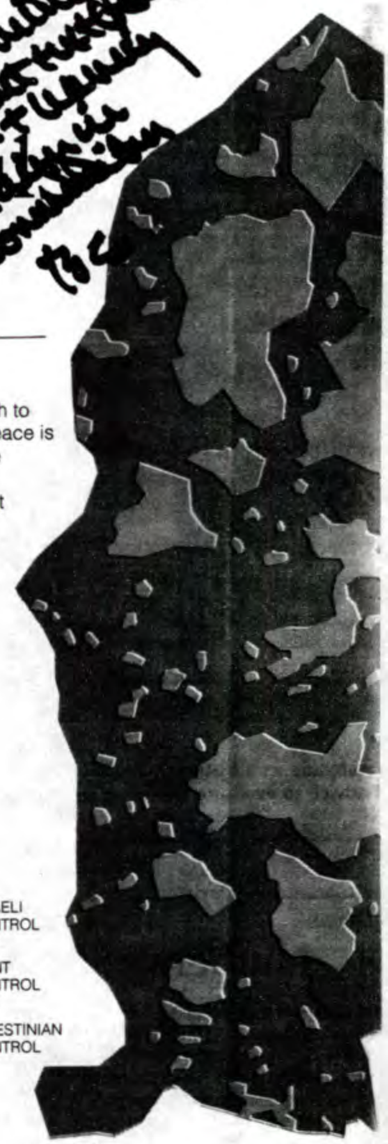
"Until Netanyahu's election more than two years ago, the message from the Government was that we have to begin a new life with the Palestinians; let's be neighbors," said Yoel Esteron, managing editor of the Israeli newspaper Haaretz. "But now there is no spirit of reconciliation. What we have is a deal among technocrats, a deal with no soul or spirit because there is so little good feeling left."

Shlomo Gazit, a former director of Israel's military intelligence, put it this way: "I am very doubtful that this is a new beginning. For the process to go on, there must be trust and understanding between the two sides and a joint will to move ahead to an overall agreement. What happened in recent months does not bring us any nearer to that."

The West Bank Jigsaw

Words like "land" and "peace" seem simple enough to understand, but not in the Middle East. Land-for-peace is an intricate design, based on efforts to balance the competing needs and ambitions of Israelis and Palestinians. Below, the numbers. At right, the West Bank before the Wye Plantation Agreement.

*Includes nature preserve under Israeli security control.



One reason is that the Palestinians and Israelis agreed to make peace five years ago but never did much to alter the sense they had of each other. Schools on both sides have virtually no lessons in the other's history. Maps in Palestinian schools still show only the names of Palestinian villages destroyed by Israel, not the new Israeli cities. Israeli maps and textbooks make no reference to the destroyed Palestinian towns or to the life and culture of Palestinians before Zionist immigration in the late 19th century.

An official 8th-grade textbook from the Palestinian Authority was recently shown to include the sentence, "The prime examples

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Painful Details

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of racial discrimination are Zionism and Nazism." Last August, Palestinian television was showing footage of a summer camp with youngsters training with automatic weapons and chanting, "I foresee my death and I rush toward it!" and, "A hero's death, the death of a suicide warrior!"

Mr. Esteron of Haaretz said that even the largely liberal, educated Israeli readers of his newspaper seem unmoved by the difficulties that Palestinians suffer as a result of Israeli rules and regulations — checkpoints, bans on home building, severe restrictions on trade, industry and movement.

"People look at it as if it were somewhere in the Philippines, not right next door," he said.

Each side has tended to consider the Oslo accord a kind of apology from the other, an acknowledgment that it had done wrong. But each side sees only the other's misdeeds, not its own.

And the problem that has overwhelmed all others is the enormous imbalance — military, geopolitical and economic — between Israel and the Palestinians. For many Palestinians, Israel is simply a neighborhood outpost of the American-dominated global economy.

Since the new global system has little place in it for land, clan and honor, values upon which Palestinian society has long been built, and can be so unforgiving to those not part of it, Israel is seen as a threat in the most fundamental way to the values of many in the West Bank and Gaza. To many there, Israel stands for sexual permissiveness and godlessness, and so the battle against it goes beyond a fight over land and sovereignty.

The picture is, of course, still more complicated. A battle over values exists within Israel itself, where a religious-secular divide threatens internal politics. Mr. Rabin's assassin, Yigal Amir, like many Sephardi and religious Israelis, felt that peace was draining the nation of its biblical mission and spirit.

Now, with Mr. Netanyahu and Mr. Sharon the advocates of peace, the opponents of peace within Israel may feel more and more marginalized. But that does not necessarily mean Israelis will see Palestinians in a more generous light. Israelis feel that what they are giving up is not fully appreciated — as Mr. Netanyahu has said, 1 percent of the West Bank is the size of Tel Aviv.

But even if the end of this process includes something that bears the name "State of Palestine," as the Palestinians so fervently hope and the majority of Israelis now accept, many doubt it will end the century-old Jewish-Arab conflict.

"This deal does not change the basic rules of the game," asserted Meron Benvenisti, a former deputy mayor of Jerusalem and advocate of greater Israeli concessions. "Let's say the Palestinians get even 50 percent of the West Bank.

"Think about water resources, land development, sewage. Israelis use five times the water of Palestinians. What happens when the Palestinians want more? Where will it come from?

"The Israelis will say: 'We gave all we could. No more. The rest is ours.' So what the Palestinians will get is exactly what the Israelis can live with, peace without any real price. That's why they don't care if there is a Palestinian state. That's why even Sharon and Netanyahu can accept a state, because of the way they will define it."

At the End of the Track

Ali Jarbawi, a Palestinian political scientist at Bir Zeit University in the West Bank, said he was equally pessimistic. "I think that for Netanyahu this week's deal is the end of the track altogether," he said. "He won't give up much more land. And what kind of state will we get? There will be cantons with no direct links. It is a gloomy prospect for us."

Daniel Ben-Simon, a political analyst for Haaretz, said he believes the new accord will reshape Israeli politics because the issue that has defined left and right for so long — territorial concession and a Palestinian state — will no longer be there. In addition, he says that because of the Palestinian question, other Israeli problems, like the religious and ethnic divides, have festered. Now they can be dealt with, and that process will produce an entirely new set of parties and coalitions.

But General Gazit, the former military intelligence chief, is less hopeful. He believes that Mr. Sharon and Mr. Netanyahu have no long-term vision for the Palestinian question.

"There is huge writing on the wall," he said. "It shows us that without a comprehensive agreement with our neighbors we are doomed ultimately to war. I think the politicians see it. But they don't have the courage to act on it."

Word for Word
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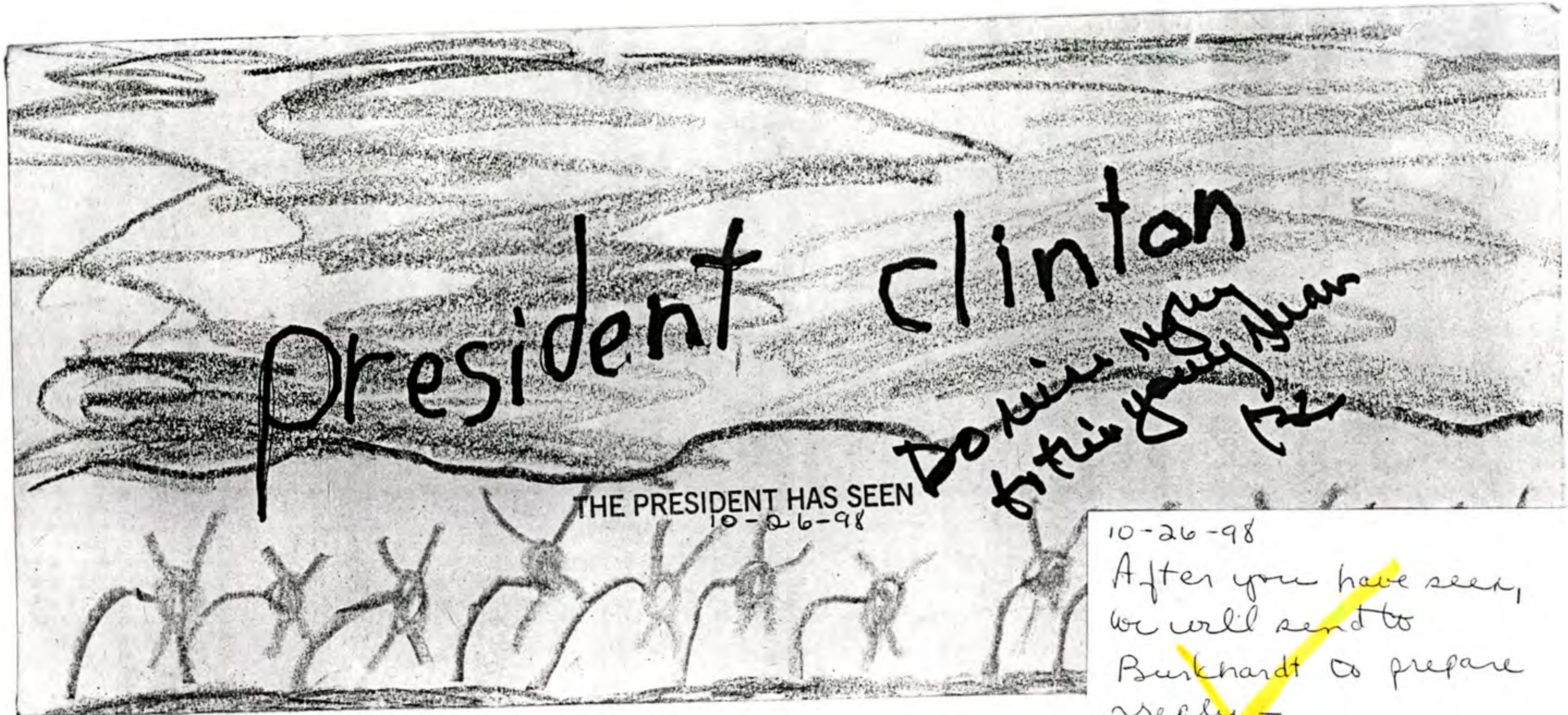


THE PRESIDENT HAS SEEN
10-26-98

Do nice reply to this young man

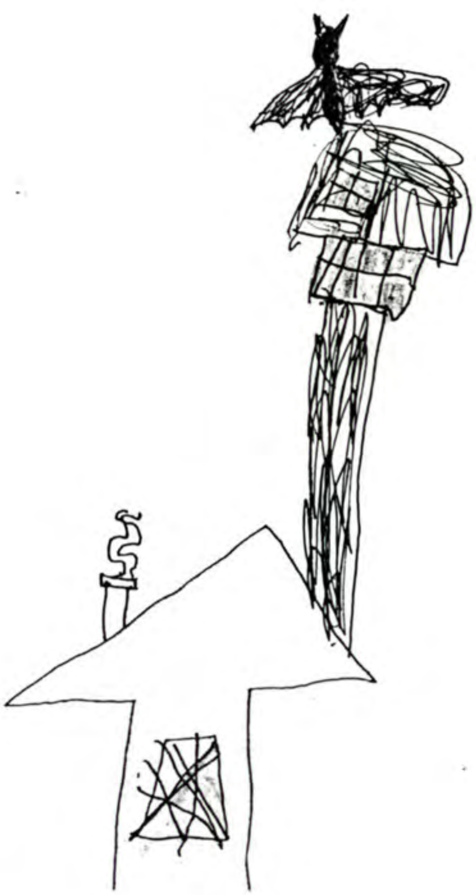
10-26-98
After you have seen, we will send to Burkhardt to prepare reply –

Carol

THE PRESIDENT HAS SEEN
10-26-98

Happy Halloween

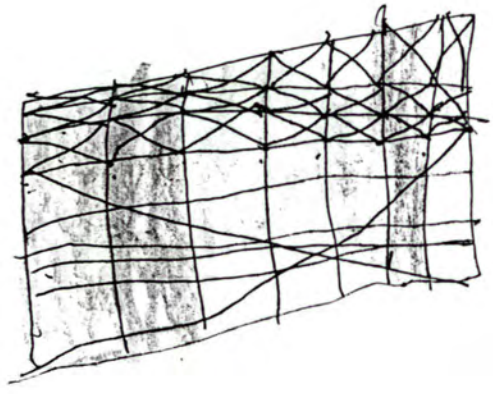
Mr. President



thank you for letting
me see your AirPlane.
I hope you are President for
A long Time

your Friend
Nate

from Nate Grossman



Nate GROSSMAN
2558 BURSON RD
TOPAnga Ca
90290

10/26/98

After you have seen,
we will send to
Burkhardt to prepare
reply –

OK

Carl

Mr President

Do nice
reply - further
w suggestions

BC

THE PRESIDENT HAS SEEN
10-26-98

THE PRESIDENT HAS SEEN
10-26-98

10/24/98

Brittney Zipperman
34508 Goldridge Lane
Acton CA 93510

Dear Mr Clinton,

My name is Brittney Zipperman and I am ten years old. I go to Wiley Cyn school in Valencia.

I was happy when my Dad said he was going to meet the President of the United States. I wish it was me meeting you, but its not. Maybe when Im a hundred years old I can meet you.

Sincerly
Brittney Zipperman