THE WHITE HOUSE

WASHINGTON

Date 1/4

To: Sally Katzen
Cynthia Rice

From: The Staff Secretary

I had this NSC letter rewritten to better respond to Sen. Conrad's ag concerns.

Does it meet with your approval? ... especially 3rd paragraph. Can you let me know by the end of the day?

Thanks, Phil

THE WHITE HOUSE

WASHINGTON

'98 DEC 18 PM5:14

December 18, 1998

ACTION

'99 JAN 4 AM9:26

MEMORANDUM FOR THE PRESIDENT

FROM: SAMUEL BERGER (K) Fer
LARRY STEIN LJS

SUBJECT: Response to Senator Kent Conrad

'98 DEC 31 PM2:04

Purpose

Respond to a letter from Senator Conrad requesting that you explore exchanging surplus food for Russian tactical nuclear weapons.

Background

Senator Conrad suggests that a food for nuclear weapons exchange would be a win-win transaction because of Russia's need for Western food and assistance and the lack of an arms control treaty to reduce tactical nuclear weapons. The Senator offers to introduce legislation to initiate the exchange.

Your response thanks the Senator for his suggestion, describes key aspects of our recent food aid package for Russia, and explains our intention to address further reductions of tactical nuclear weapons in the context of START III negotiations.

RECOMMENDATION

That you sign the letter at Tab A.

Attachments
Tab A Letter to Senator Conrad
Tab B Incoming Correspondence

cc: Vice President
Chief of Staff

TAB A

THE WHITE HOUSE

WASHINGTON

Dear Kent:

Thank you for your letter on the food situation in Russia. We are responding quickly to help mitigate the impact of Russia's worst harvest in forty years. Our food aid package will help lessen the impact of Russia's economic crisis on average people and the most vulnerable groups within Russian society. We are working hard to institute proper monitoring and oversight for the program to ensure that our assistance reaches the intended beneficiaries. In addition, monetized proceeds from the program will be used for pensions or other social purposes.

In your letter, you suggested drawing a direct connection between this type of engagement and our security agenda with Moscow. I believe strongly that our food aid program advances U.S. national security interests by promoting stability inside Russia and furthers our important humanitarian goals. While I do not believe we should tie the aid to progress on arms control, I do agree that we need to tackle the problem posed by Russia's considerable arsenal of tactical nuclear weapons. Russian President Yeltsin and I have agreed to take this up in the context of START III negotiations.

I share your concern regarding low commodity prices and the strain this places on America's family farms. As you know, last year's final budget agreement includes $6 billion in emergency assistance to farmers and ranchers -- an additional $1.8 billion in aid as compared to the bill I vetoed, H.R. 4101. The final budget increases the funds for crop loss compensation by $228 million and the funds for economic loss compensation by $1.4 billion -- bringing the totals for these programs to $2.6 billion and $3 billion, respectively. In the year ahead, solving the agricultural crisis here at home will continue to be one of my top priorities.

Again, thank you for writing. I appreciate your creative ideas and look forward to future exchanges with you on Russia and other key issues.

Sincerely,

The Honorable Kent Conrad
United States Senate
Washington, D.C. 20510-3403

TAB B

NORTH DAKOTA
202-224-2043

AGRICULTURE, NUTRITION, AND FORESTRY
FINANCE
BUDGET
INDIAN AFFAIRS

United States Senate

WASHINGTON, DC 20510-3403

October 19, 1998

The Honorable William Clinton
President of the United States
The White House
Washington, DC 20500

Dear Mr. President,

I believe it is time to explore exchanging surplus food for Russian tactical nuclear weapons.

As you know, Russia is in serious financial difficulty and will likely experience food shortages without additional supplies from other countries.

At the same time Russia maintains up to 12-thousand tactical nuclear weapons, we retain only 16-hundred. We have treaties between our two countries on strategic and conventional weapons systems, but no treaty to reduce tactical nuclear weapons.

I believe now is the time to propose to the Soviets a swap of our surplus food for their tactical nuclear weapons.

It would be a win-win transaction, with them receiving the food they need, and with us reducing the nuclear threat to ourselves and the rest of the world.

Such a transaction would have the additional benefit of strengthening agricultural prices, at a time commodity prices are at a 52-year low in real terms.

I would be pleased to introduce legislation that is necessary to accomplish such a swap.

I look forward to hearing from you on this important initiative.

Sincerely,

Kent Conrad

Kent Conrad
United States Senate

KC:apw

THE WHITE HOUSE

WASHINGTON

October 28, 1998

MEMORANDUM FOR GLYN DAVIES
NSC Executive Secretariat

FROM: JANET MURGUIA
Legislative Affairs

SUBJECT: PRESIDENTIAL CORRESPONDENCE

Attached are copies of letters sent to the President by various Members of Congress. Since these letters address national security issues, we would appreciate your assistance in drafting the responses.

Thank you very much for your assistance. If you have any questions, please call Eli Joseph at x67500.

The following is a brief description of the letters:

1) Sen. Kent Conrad (D-ND), suggesting the United States establish an exchange of food for tactical nuclear weapons with Russia;

2) Sen. Alfonse M. D'Amato (R-NY), expressing concern over the future of several Israeli POWs;

3) Sen. Trent Lott (R-MS) and Rep. Newt Gingrich (R-GA), concerning the creation of a national missle defense system.

4) Sen. William V. Roth Jr. (R-DE) and four other Members of Congress, regarding the North Atlantic Treaty Organization's Washington Summit;

5) Rep. Bob Barr (R-GA), regarding the release of Mr. Jonathan Pollard;

6) Rep. Elton Gallegly (R-CA), regarding the release of Mr. Jonathan Pollard;

7) Rep. Benjamin A. Gilman (R-NY) and Rep. Douglas K. Bereuter (R-NE), regarding the November Asia Pacific Economic Cooperation forum in Malaysia;

8) Rep. Cynthia A. McKinney (D-GA, regarding the policy of the United States on democratization in Uganda;

OCT 28 19:15

9) Rep. Joseph R. Pitts (R-PA), regarding the President of Colombia's visit to the White House in regards to three Americans being held hostage by the guerilla group Fuerzas Armadas Revolucionarias de Colombia;

10) Rep. Charles B. Rangel (D-NY), regarding a proposed National Bipartisan Commission on Cuba; and,

11) Rep, James A. Traficant, Jr. (D-OH), regarding the future of former General Augusto Pinochet of Chile.

Enclosures

1-4-99

THE WHITE HOUSE
WASHINGTON

Back to Sperling

December 11, 1998

MR. PRESIDENT:

Attached is a memo and a number of discussion papers from Secretary Rubin on the future of the international financial architecture. He is circulating the material among members of your economic team for comment in preparation for the Cologne Summit next summer, but wanted you to see it concurrently.

I've spoken to Gene about this; he is fully aware of it and involved in the process. Normally I would ask him to draft a cover memo for these sort of documents, but given your level of interest in these issues Gene and I thought it was fine for the material to go from Bob to you directly.

There is no specific deadline here, so you can read this at your leisure. Bob and Gene will keep you updated as work progresses.

Phil Caplan Phil

copied
Sperling
Podesta

'98 DEC 10 PM 6:09

1-4-99

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

December 10, 1998

MEMORANDUM FOR THE PRESIDENT

FROM: Robert E. Rubin R.E.R.

RE: International Financial Architecture

Treasury, with the Federal Reserve and many colleagues around the world, has done a tremendous amount of work on the future of the international financial architecture. The enclosed memo encompasses some of our current thinking on the subject, which we thought would be of interest to you, and which we are circulating to other interested agencies. We will keep you posted as the work progresses and look forward to discussing this with you at an appropriate time.

CC: Madeleine K. Albright
Samuel R. Berger
Stuart E. Eizenstat
Gene B. Sperling
Janet L. Yellen

'98 DEC 10 PM6:09

1-4-99

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

December 10, 1998

MEMORANDUM FOR THE PRESIDENT

FROM: Robert E. Rubin R.E.R.

SUBJECT: A New International Financial Architecture

At Treasury we have been giving a great deal of thought to the question of the new financial architecture. We have consulted closely with the Federal Reserve, market practitioners, leading academics, and our colleagues from other countries – most recently at a G-7 Deputies retreat. This note and the attached paper summarize our thinking to date.

Events in Asia, Russia and Brazil, coming on top of the Mexican problem of a few years ago, point to the need for substantial steps to enhance stability. It is also true that the sense of urgency created by these problems may make it possible to accomplish changes that have been desirable for a long time. As important as strengthening the system is, it is clear to us that very little will happen without American leadership.

The Challenge

As you stressed at the Council on Foreign Relations and in your speech in Tokyo, the central challenge of international economic policy is insuring that global integration does not mean local disintegration. That is, we need to manage the greater global integration made possible by technology, economic development, and the spread of the market system so as to enjoy its benefits while minimizing the disruptions of people's lives that can come in its wake.

As recent events in Asia, Russia and Brazil point out very clearly, this challenge is especially pressing in the financial sphere. It is the global financial system that makes trade and exchange possible, and the flow of capital can have enormous benefits in creating opportunities for growth. At the same time, we have seen recently that the breakdown in the functioning of that system can have great economic, social and political costs.

That is why increasing the robustness and stability of the international financial system has to be a critical priority. Finding the right approaches here – as in other areas of managing international integration – means finding the right balance among three sometimes conflicting objectives: integration, regulation, and national sovereignty.

1-4-99

Giving great weight to any two of these objectives is easy. Pat Buchanan's policies sacrifice integration in order to be able maintain our sovereignty and regulate our markets. Milton Friedman and other conservative economists welcome integration and respect national sovereignty because they approve of the pressure on regulation and taxation caused by competition between jurisdictions. Many idealists, though few practical policymakers, favor much greater global governance and erosion of national sovereignty so as to allow regulation and integration to coexist.

The challenge is properly to balance all three objectives so as to realize the benefits of capital flows, without either giving up nations' ability to set their own course, or setting off a race to the bottom in regulation and taxation as jurisdictions compete to attract capital. Through the first 150 years of our history, similar challenges faced American policymakers as economic integration among the states increased.

Inevitably, the need for balance means a need to find solutions that are flexible and can evolve. Integration cannot and should not be stopped. But it will have to be managed. A smaller world will have to be a world of more common standards, and more international concern and leverage over what would once have been considered domestic policies. But there are limits on the global interference that nations will tolerate. This may in turn limit the pace at which integration can safely increase.

While it is important to avoid blaming the victims of international financial turmoil excessively, it is equally important to recognize that the recent turmoil has had relatively little to do with hedge funds or other large financial institutions shorting currencies or countries, although these institutions may have an effect from time to time. It has had much more to do with countries' own citizens fleeing with their capital, and governments choosing to borrow heavily short term in order to support their currencies or pursue other objectives. It is important, but not easy, to encourage prudent financing practices. Most countries will not welcome our efforts to restrict efforts to lend to them or their companies *ex ante*, even if *ex post* they wish that there had been more regulation. Moreover, we should remember for every bad borrower, there is a bad lender and central to dealing with this problem is improving the inducements to discipline the latter.

What Can be Done?

We believe that it is necessary to work to and through the Cologne Summit on the new financial architecture at three levels.

(i) *Improving the stability of capital flows*. This will require:

- Stronger incentives for emerging market economies to adopt policies that will improve their ability to capture the benefits of the global capital market, while withstanding its risks;

- Incentives in industrial countries to encourage more disciplined investment and credit decisions, and to reduce leverage and limit systemic risk;
- A more effective regime for crisis management that aims to minimize the severity of crises while maintaining incentives for prudent private credit and investment decisions.

(ii) *Refinement of the existing institutional structure*. If one were to redesign the two global financial institutions today, it is doubtful that one would replicate their current governance structures, division of labor, or modes of raising capital. However, it is also doubtful today that one would be able to obtain political support for the creation of two institutions as ambitious in their conception as the Bank and the Fund. This is something we need to bear in mind as we proceed with institutional reform.

(iii) *Consideration of reforms to the existing governance structure*. At present the G-7 functions as a kind of steering committee for the international financial system. But the advent of EMU and the increasing importance of emerging markets raise questions about the G-7's composition and its near monopoly over the system. We need to create a process that balances effective leadership, which the G-7 can provide, with the inclusion of other countries which have a stake in systemic stability.

Getting From Here to There

A rough timetable of key steps – past, present and future – to bring about architectural changes along these three dimensions is attached. Obviously, developments will depend on how the current crisis evolves. As the focus broadens from the technical financial side to the more political questions of institutional mandate and governance arrangements, it will be particularly important to have interaction at the Head of State level.

Getting From Here to There

Recent "Architecture" Events

Winter 1998. U.S. calls for a meeting of industrialized and developing country finance ministers (G-22).
Spring 1998. April meeting of Finance Ministers and Central Bank Governors followed by agreement to create working groups on transparency, strengthening national financial systems, and managing international financial crises with increased private creditor involvement.

Summer 1998. Birmingham Summit Communique calls for proposals in five key areas. G-7 Finance Ministers agree to report on progress to Heads by end of year.

Fall 1998. President participates in the second G-22 Ministerial. Recommendations from the G-22 working groups, along with the U.S. proposal for a contingent facility, form the basis for G-7 Heads Statement.

APEC calls for a task force to examine proposals to strengthen prudential regulation of financial institutions, including examination of questions related to highly-leveraged and off-shore institutions.

G-7 Deputies, at a recent retreat, discuss various ways to carry forward ongoing work on architecture, as well as substantive elements on the architecture agenda.

Forthcoming Events

Winter 1998-99. Heads receive report of Finance Ministers detailing procedures for taking G-22 and other work forward.

First G-7 Finance Ministers meeting following EMU takes place. May reach agreement on forum for strengthening cooperation on financial stability among international regulators, IMF, World Bank and national authorities in key industrial and emerging market economies.

Sherpa process likely to agree on "architecture" as a major theme of Cologne Summit.

In response to the APEC communique and the need to maintain the process of broader consultation started in the G-22, the G-7 Finance Ministers are likely to invite other countries to send representatives to a series of ad-hoc meetings on architectural issues.

Spring 1999. Spring IMF/ World Bank Meetings. Possible emerging markets/ industrial countries ministerial. APEC Finance ministerial.

Summer 1999. G7 Head of State Summit. Opportunity for pointing the way towards reform of the international governance arrangements, procedures for increasing regulatory collaboration, and, possibly, changes in the mandates of the IFIs.

Fall 1999. Annual IMF/ World Bank Meetings in Washington. Implementation of agreements on reform.

Improving the International Financial Architecture

Overview

More than $1 trillion in private capital has flowed from developed to developing countries since the start of the 1990s, bringing new expertise and new investment to the developing countries, as well as contributing to rising living standards. These flows have also helped to increase returns and diversify risks in the developed countries. Yet for all the opportunities that large-scale capital flows bring with them, recent events have reminded us that they also bring new risks. Financial crises such as those we have seen in Mexico in 1994-95 and, more recently, in Asia and Russia, have inflicted immense economic and social damage on the affected countries, imposed heavy direct and indirect costs on the international community as a whole, and threaten to undermine political support for closer global integration.

In the wake of these crises, we all have a responsibility to build a better world financial system, one more adept at avoiding crises and more effective in dealing with them when they strike. Key elements in such a system include:

- stronger incentives for emerging market economies to adopt policies that will improve their ability to capture the benefits of the global capital market, while withstanding its risks;

- incentives in industrial countries to encourage more disciplined investment and credit decisions, and to reduce leverage and limit systemic risk;

- a more effective regime for crisis management that aims to minimize the severity of crises while maintaining incentives for prudent private credit and investment decisions.

The following sets out how we see the main issues, and what steps should be considered going forward. In some cases, work is sufficiently advanced to press for specific actions. In other areas this note points more tentatively to ideas that should be considered, both in our internal discussions and internationally.

I. Improved policies in developing countries

Better policies in emerging markets are needed to promote their domestic stability and to limit their vulnerability to crises caused by shifts in global capital. We should press--bilaterally and through the international agencies--for the following:

A. *Sound macroeconomic policies.* Countries need consistent monetary and exchange rate policies as well as fiscal policies that avoid excessive accumulation of government debt.

B. *Prudent public debt management.* Borrowing short-term, and in foreign currencies, can be very appealing: it appears cheaper and may be easier in the short-run. But too much of this kind of borrowing makes governments and countries vulnerable to sudden shifts in investor confidence. In the long-run it can be very costly. Sound debt management is important to provide some "insurance" against the risk of temporary market disruptions.

C. *Stronger financial systems.* The following steps could all improve financial systems: adherence to the Basle Core Principles for Effective Banking Supervision (perhaps with higher capital standards to reflect the greater risks in less mature financial systems); adherence to other international standards now being developed, including for deposit insurance systems and financial sector safety nets; greater foreign participation in emerging markets, to spread better regulatory and risk management practices; the development of a better credit culture in the banking system; and prohibitions on directed lending and on "non-arm's length relationships" between lenders and borrowers.

D. *Stronger legal infrastructures.* The Asian crisis demonstrated that for private markets to work effectively, effective financial regulation must be supplemented by strong legal systems. There must, for example, also be clear and enforceable bankruptcy laws, so that a crisis in a single bank or company can be dealt with before it spreads; sound corporate governance, so that investors' and shareholders' rights are clear; and strong judicial systems, so that laws in these areas can be enforced and disputes settled fairly and expeditiously.

E. *Development of capital markets in emerging economies.* Greater reliance on equity and other financing that does not result in the build up of excessive debt burdens should limit vulnerability to crises. This could include efforts to develop local/regional capital markets.

F. *Other measures to strengthen governance and fight corruption.* Corruption can undercut economic performance as well as be corrosive politically. Inefficient economic structures also can contribute to corruption.

G. *Well-designed social safety nets.* Strong social policies alongside other measures are needed to protect the most vulnerable in society.

In section IV below, some direct steps that countries could consider to limit the buildup of excessive short-term debt are also discussed.

II. Measures to induce emerging market economies to undertake sound policies

Global, private capital markets should play a key role in encouraging emerging markets to strengthen their policy regimes, with investors less willing to lend where policies are poor, and insisting on higher returns to compensate for the greater risk when they do lend. But recent events have demonstrated that market discipline is often sporadic, with periods of easily available capital and little apparent attention to risks, followed by swift and sudden reversals. Official action is needed to strengthen incentives for creditors and investors to analyze and weigh risks with more discipline, and for emerging market countries to follow good policies.

A. *Developing a comprehensive set of codes and standards of good international practice, against which countries' policies can be judged.*

- We would support a major international effort to develop and agree on international codes and standards across the range of areas now understood to be critical for financial stability. Standards in some areas, such as disclosure of countries' foreign exchange reserves and how these measure up against short-term liabilities, are already close to being agreed and can soon be implemented. In other areas--ranging from bankruptcy regimes to corporate governance, to ways to deal effectively with weak banks before the entire banking system is crippled--much work is still needed before there is sufficient international consensus on standards that can effectively raise the bar.

As standards in these areas are developed and agreed, countries need to be encouraged to adopt and implement them. International agreement on an array of codes of good practice, perhaps with benchmarks for performance, provides a device for doing this. Making explicit which countries conform to which codes, and which fall short, could provide a vehicle for using the market to differentiate among those with stronger and weaker regimes.

There is a variety of ways to promote better practices in emerging economies:

B. *Giving a higher profile to countries' adherence to international standards*, with greater disclosure and transparency about how countries measure up against such standards. The G7 has proposed, for example, that the IMF publicly and regularly report on countries' compliance with the international data disclosure standards developed since the Mexican crisis. The G22 called for a transparency report to be prepared and published by the IMF on each country. We should press forward with these proposals.

C. *Stronger international surveillance*. Also key is a strengthening of international capacity to monitor financial systems. This could include a strengthened capacity in the IMF and the World Bank to review country performance, including compliance with new international standards as they are developed. As a complement, some form of new independent international accreditation process, perhaps involving the private sector, could also be explored.

D. *Financial market access*. We could also explore whether we should seek international agreement to link access to our markets, and those of other major financial centers, to emerging markets' adherence to appropriate international standards. While this could be a powerful tool, it may be difficult to achieve. Possible measures to consider could include:

- Linking the ability of foreign sovereign borrowers to issue bonds in U.S. and other capital markets to their meeting international standards, e.g. for disclosure.

- Linking the ability of financial institutions to do business in major financial centers to their meeting internationally-agreed minimum standards for disclosure and to adequate home-country bank regulation and supervision.

E. *Linking IMF and World Bank finance to adoption of better practices*. We could press for adherence to international codes to be part of IMF and World Bank conditionality when they lend money, with an explicit timetable for steps to conform to standards, and perhaps prior actions before a program begins.

F. *Technical assistance*. The G7 has asked the IMF and the World Bank to develop a strategy to provide technical assistance to help emerging markets improve their capacity to meet stronger international standards. Their work should be coordinated with that of bank supervisors and regulators of financial institutions.

G. *Exploring additional ways to create incentives for strong policies before, rather than only after, a crisis*. Conceptually, it could be attractive to link treatment of countries in crisis to how they had behaved beforehand, thereby encouraging countries to pursue better policies and avert crisis.

- Creating an on/off switch for favorable access to official financing to countries that have met certain key "qualification" criteria would not be workable. It would be difficult to avoid politicizing the process of qualification; bureaucrats in international institutions are not likely to be better than markets at judging in advance when a country is likely to run into crisis; and the international community will probably choose to help systemically important countries in a crisis even if they failed to "qualify." Moreover, creditors may be less prudent in their lending to countries that have "qualified," in expectations of a bailout.

- But it may be worth considering further work to develop a matrix that shows how countries perform across a range of economic and financial areas. We could explore whether this could be a guide to the terms of official finance provided in a crisis: better performers may, for example, be likely to need less conditionality. We could also explore the possibility of incentives (perhaps including differentiated capital charges, discussed below) for private creditors and investors to pay attention to countries' performance. This would add to the pressure for stronger policies. An obvious question mark over such ideas is why the official sector should be any better than private rating agencies at predicting a country's vulnerability or resilience to crisis.

III. Measures to induce creditors and investors in industrial counties to analyze and weigh risk appropriately

Measures to induce creditors and investors in industrial countries to act with greater discipline – i.e., to analyze and weigh risk appropriately in their lending and investment decisions – are also needed to dampen investors' tendency to underestimate certain risks during periods of market euphoria, and thus limit the build up of excessive debt during the upswing. Such measures are key if the market is to play its proper disciplining function. Industrial countries as well as emerging market economies should live up to the internationally-agreed standards and codes and be subject to an improved process for international financial sector surveillance.

There are two distinct issues in this area, both linked to measures to strengthen industrial country prudential regulation. The first concerns finance for emerging market economies. The second concerns the broader question of systemic risk in the system as a whole and in major financial centers, highlighted by the near-collapse of LTCM. An international task force to examine measures to promote safe and sustainable capital flows, including questions related to "hedge funds" and off-shore centers, should be set up to take forward work in these broad areas, as called for in the APEC and G7 communiques.

A. *Strengthened risk management systems.* There is a clear need for increased focus on the quality of risk management systems in financial institutions. These systems should also be systematically stress-tested to show the potential impact of unusual changes in financial markets. Regulators need to consider how best to foster the use of high quality risk management models.

B. *Greater differentiation in bank capital standards.* A review of the existing Basle Capital standards is already underway. This will consider greater differentiation in the capital charges on different assets and retuning the existing standards, e.g., to address current biases in favor of short-term interbank lending and riskier corporate borrowers. Higher regulatory charges on riskier assets should prompt lenders to demand higher returns and help focus management attention on risky lending. Some argue that if regulatory capital for particular categories of lending is set too high, it could encourage even riskier lending in order to justify the capital cost to banks.

- Consideration could be given, for example, to differentiating capital charges on the basis of a set of criteria related to risk, such as poorly-regulated or unsophisticated financial systems, or on loans to highly leveraged financial entities.

- The first would require the official community to make more judgements about the riskiness of different countries, which would be both politically and technically difficult. However, a more refined, if admittedly imperfect structure, would be better than the present crude distinction embedded in the Basle standards, which favor loans to OECD countries over loans to non-OECD countries. It could draw on a matrix (see II.G) that measures countries' performance against international codes and standards.

We could also explore whether to seek regulatory and disclosure changes aimed more broadly at reducing leverage and systemic risk in financial markets. The direct regulatory focus here, as in many other countries, is on the health of individual financial institutions. But at times what may be prudent for a single lending institution can turn out to be problematic for the system as a whole, if a very large borrower is able to obtain credit to build up exposures that could endanger broader financial stability. One aspect of this is to seek and publicize information about borrowers' total exposure. For sovereign borrowers, we are pressing for much better data in this area through the Bank for International Settlements (BIS).

Other possible changes would put greater regulatory focus on the systemic risk that can be created by a wide range of institutions, including institutions that are not currently regulated. For example, the regulatory net could be extended to cover all institutions above a certain size. But far-reaching changes would be politically difficult in the United States – indeed, more difficult in the U.S. than elsewhere given the diversity of our existing regulatory structure, and breadth and sophistication of our financial markets.

Measures that have been suggested include:

C. *Higher overall capital adequacy standards.* If financial institutions are made to hold more capital overall in relation to the total risks in their balance sheet, the total amount of risky lending activity that can be supported by the existing capital base would go down. (Higher capital standards in emerging markets may also be appropriate, even if we do not pursue this in major industrial countries.)

D. *Broader margin requirements.* Consideration could also be given to whether some existing gaps in the margin system should be closed, and more broadly, whether current margin requirements, e.g. on OTC and listed derivatives, are sufficient. Since in some cases margins can be borrowed, margin requirements may not by themselves decrease leverage.

E. *Disclosure standards.* Greater disclosure by industrial country banks and investors of their exposure to higher categories of risks could increase market discipline and discourage the buildup of imprudent exposures. Disclosure is not without its difficulties; open disclosure of actual positions could undermine financial markets.

- One potential approach is to demand additional disclosure from the banks and other financial institutions that lend to the highly-leveraged institutions ("hedge funds").

– The G7 has agreed to consider the questions raised by disclosure and transparency standards for highly leveraged institutions themselves. It may be more promising to explore whether to extend to other markets (and encourage in other countries) reporting to regulators of large positions in a particular market.

F. *Measures to limit the scope for off-shore regulatory and tax havens.* Strengthened regulation in major financial centers would be undercut if financial and capital market activity merely moved offshore. This is a very difficult area because effective action would need widespread international agreement. Some possible, but controversial, measures that have been suggested include:

– Preventing major financial institutions from establishing branches or subsidiaries in off-shore centers, so that the financial institutions in such centers have to borrow on the basis of the strength of their own balance sheets.

– Conditioning the access of unregulated foreign financial institutions and hedge funds to the major financial centers on their compliance with key regulatory and disclosure standards.

IV. Limitations on the flow of capital

The recent experience of a number of countries has underscored the risk of capital account liberalization that is not paced to the maturity and development of the domestic financial system and broader economy – and, in particular, the danger created when governments in emerging markets actively encourage risky short-term borrowing. We should consider the scope for developing principles to guide countries that are liberalizing and opening up their capital markets on how to reduce the vulnerability of their financial systems to sudden shifts in capital flows. These could include, for example, a focus on encouraging longer-term, equity financing with an open policy to foreign direct investment.

A. *Restraints on capital inflows.* A range of possible measures could be considered that may help to discourage imprudent foreign currency borrowing, while relying on market mechanisms to the extent possible. It is worth remembering that most countries that have recently experienced trouble have sought to encourage capital to flow in, rather than tried to deter it.

– Prudential bank standards, such as limits on a bank's open foreign currency positions, if enforced effectively, should reduce the riskier kinds of foreign borrowing by banks.

– Some countries have experimented with regulatory requirements that force their banking systems to maintain "liquidity buffers" to protect against the risk of a sudden shift in funds out of the banking system. Argentina, for example, has required banks to maintain large, liquid reserves against their short-term liabilities, including their short-term foreign liabilities.

– More controversially, some have suggested wider use of market-based, Chilean-style restraints on all capital inflows to deter short-term foreign borrowing by both banks and domestic corporations. The effectiveness of such controls has been questioned by some, in particular for countries with weaker economic policies than Chile.

B. *Limits on capital outflows.* Controls on capital outflows differ fundamentally from well-designed restraints on capital inflows, aimed to curb the borrowing that makes countries vulnerable to market shifts. Temporary controls on capital outflows introduced after a crisis has hit, in a general attempt to insulate an economy from the rest of the world, are likely to repel new investment, create inefficiencies, and prove difficult to sustain for long. They may also make more tempting policy errors that will worsen long-term prospects. Only in extreme circumstances, as part of the mechanism of a debt workout when the international community agrees that a country simply cannot afford to pay, is their consideration likely to be justified.

C. *Reducing the amount of trading activity.* In addition to considering whether measures to help restrain capital inflows make sense, we need to consider whether reducing the amount of trading activity – e.g. as a side effect of higher capital charges or stronger margin requirements, or even, as some have suggested, in response to a tax on trading activity (Tobin tax) – would make the international financial system more stable, or only less liquid.

– Some argue that reducing the overall volume of trading activity would make it easier for countries to adopt policies to respond effectively to crisis, maintain macroeconomic stability and avoid sharp surges in inflows or sudden outflows. Emerging market economies are particularly vulnerable to swings in capital markets.

– Others argue that limiting trading activity would make it more difficult for markets to allocate risk efficiently. It could reduce the benefits associated with the free domestic and international capital markets, without offsetting increases in stability. Liquid markets may be necessary for successful hedging – i.e., protecting yourself against certain risks. Moreover, a small tax on trading activity, even if feasible, would also be unlikely to deter the major swings in capital flows that occur in a financial crisis.

V. Exchange rate regimes

Devising appropriate exchange rate regimes, both for individual countries and for the system as a whole, is one of the central issues for the international system.

A. *Currency arrangements between the major industrial countries.* The major currencies in the system have floated against one another since the collapse of the Bretton Woods fixed exchange rates in the early 1970s. This has allowed the U.S. and other major industrial nations with floating rates to aim domestic monetary policy principally at domestic objectives, which is appropriate for large economies for whom trade is a relatively moderate share of the economy. But it has also produced large swings in the exchange rates of major currencies, which at times do not seem to have reflected changes in the underlying economic fundamentals.

- These large swings in the exchange rates among the currencies of major industrial countries have led to proposals to create target zones for the three major currencies to limit the size of fluctuations.

- However, we believe that the current system provides the best policy option for the United States and that a shift away from floating rates would likely involve an unacceptable loss of macroeconomic policy flexibility.

B. *Appropriate exchange rate regimes for smaller countries.* Given that large fluctuations between the currencies of major countries economies are likely to continue, that many emerging markets have extensive trading ties to a number of large industrial economies, and that the credibility of the policy environment in many emerging markets will take time to establish, the choice of an appropriate exchange rate for an emerging market economy is particularly difficult. Rigid exchange rates have been a common feature in recent crises, yet most emerging markets have been reluctant to accept the vagaries of a pure float.

- Exchange rate regimes are institutional choices that signal policies, priorities, and commitments. There is not a single exchange rate regime that is best for all countries: rather the choice must be based on a country's circumstances.

- No matter what exchange rate an emerging market economy chooses, it is critical that it be backed by a consistent policy regime. Macroeconomic stability is based on good policies, irrespective of the exchange rate regimes. Adjustable exchange rate regimes can be used to help absorb external shocks, but they cannot substitute for sensible policy making.

- Moving from one exchange rate regime to another, particularly in a crisis, can be particularly destabilizing. A key question is how to reduce the risks associated with such movements. Countries which have adopted fixed exchange rates to eliminate inflation have often held on to fixed exchange rates for too long.

- In some periods of crisis and financial chaos, experience shows that it may be better to select a regime that is at one or the other end of the exchange rate spectrum, either extremely flexible (a pure float) or extremely rigid, such as a currency board. Such clarity facilitates policy-making during difficult times.

C. Some have suggested that *more far reaching changes* in the international monetary system could be considered for the longer-term, such as the development of regional currency blocs and/or "dollarization."

- The experience of Europe has shown that both extensive economic integration to support a common monetary and exchange rate policy and a strong political commitment are needed for a successful currency union.

- Adopting the dollar or another international currency as the legal local currency provides more exchange rate stability than a currency board, but requires an explicit and transparent loss of monetary sovereignty.

VI. Crisis Response

There is a spectrum of crises, from those that stem primarily from poor policies to those that stem primarily from contagion. In practice, most fall somewhere in the middle. A regime for crisis response should provide for some combination of financial assistance and policy changes. The provision of large-scale official international finance raises difficult questions: what criteria should be used for access to large-scale assistance, and on what terms; how should such assistance be linked to private sector involvement; and where will the required resources come from.

A. *Provision of official finance.* Just as there is a role for the government to intervene to prevent a domestic financial crisis from destabilizing the domestic financial system, there is a role for the international community to intervene in an international financial crisis to help limit contagion and global instability.

- The proposed new IMF precautionary facility will allow large-scale international assistance in the form of a line of credit with appropriate conditionality rather than a traditional, highly-tranched package, so as to facilitate the rapid restoration of confidence for those cases where problems stem more from contagion than from poor policies.

- It may often make sense in today's world of large and sudden liquidity needs for more official money to be available up-front in return for more up-front policy change than has been traditional in IMF programs.

The current crisis has suggested that the official community may need, at times, to be able to provide large financing packages to quell potential contagion and instability. The increase in the IMF quota due to go into effect shortly will provide the IMF with an important pool of new, uncommitted funds. The World Bank currently has the capacity to provide additional resources, but its lending capacity is not unlimited. Still, the resources available to the International Financial Institutions in the foreseeable future are dwarfed by the scale of current cross-border capital flows. They are also smaller in relation to world GDP and trade than envisaged at the time of Bretton Woods.

- Some have argued for bolder and politically difficult measures to be put on the agenda, aimed at increasing sharply the available official resources.

  - One such suggestion has been to increase IMF quotas dramatically, perhaps also indexing them to growth of the world economy to assure their continued relevance, and increasing the amount that countries have to pay in and can use in crisis. Currently, countries have the automatic and unconditional right to use their "reserve tranche" or paid in capital, but today this is not a significant benefit in times of financial difficulty.

  - Another possible, but also politically difficult, idea that some have argued for would be to allow the IMF to issue additional SDRs (perhaps at a higher interest rate to discourage unnecessary use) to increase the amount of liquidity in the system.

B. *Private sector involvement.* Private sector involvement in the resolution of international financial crises is critical to the long-run health of the international financial system, both because of limits on the availability of official funds and of concerns about moral hazard – the risk that borrowers and private creditors will take decisions based on the expectation that official intervention will cushion the downside risk. The type of private sector involvement required by the official sector as a condition for its assistance should vary, depending on the nature of the countries' difficulties.

- The theoretical ideal towards which the international financial system should move over time is that private sector creditors and investors should bear as fully as possible the consequences of the risks that they voluntarily assume.

  - We could consider if there are ways to develop the system so that it is clear that investors who have made risky international investments, and earn large risk premiums in the best case, are not repaid in full if a country experiences a crisis that requires official intervention.

  - We need to examine how to avoid creating categories of debt that are treated as senior (paid even when other debts are not being paid) because of difficulties associated with their restructuring. Russia, for example, has defaulted on wide range of domestic and foreign debts, but Russian authorities currently want to continue to maintain payments on Russian Eurobonds, in part, by using funds obtained from the debt relief granted by other creditors.

  - In practice, finding appropriate ways to involve the full range of private creditors in the cooperative resolution of a crisis can be difficult. Concrete options for involving the private sector will continue to need to be explored. Already different models are being developed for different circumstances (Korea, Brazil, Ukraine).

- It can be difficult to convince the private sector to participate voluntarily – particularly if the relevant private creditors are numerous and diverse.

- More forceful means, including support for official lending into accumulated "arrears" on private debt payments, could be employed to generate stronger incentives for broad-based private sector participation. But coercive measures risk prompting additional contagion, so they must be used cautiously.

- The expanded use of "collective action clauses" in sovereign bonds issued in offshore offerings also could facilitate the orderly, cooperative restructuring of these bonds. The members of the G-7 have committed to examine whether to introduce such clauses into their own sovereign bonds that are issued in foreign currencies.

- It may also be useful to explore ways to encourage emerging markets to purchase more "insurance" against adverse developments, through contingent facilities and debt contracts that contain contractual arrangements that provide the borrowers with greater payments flexibility.

VII. Social Safety Nets

Possibilities for helping to minimize the social impact of financial crises include:

A. Granting the World Bank a larger role in the design of international economic policy programs, which would bring both the financial resources and social sector expertise of the World Bank to the table quickly in a crisis.

B. Development of a code of best practices in social policy, as called for in the G7 statement, which could be drawn upon in the design of IMF and MDB programs.

VIII. Institutional Reforms to Carry Forward the Agenda

It may be possible to obtain consensus for a set of institutional changes that would help both implement our architecture agenda and improve international monetary and financial coordination.

A. *A new financial stability policy forum to improve financial sector policy coordination.* We are proposing the creation of a Financial Stability Policy Forum that would meet semi-annually to discuss regulatory policy issues in an inclusive forum that would bring together financial regulators, the relevant international organizations and national authorities from both industrial countries and key emerging markets. It would create an informal, cooperative mechanism at the global level to discuss financial regulatory policy issues that affect the international system, replacing the series of ad hoc groups that have been set up over the last few years. We will be discussing this proposal with Hans Tietmeyer, who was asked by the G7 to look into this issue, and other G7 members.

B. *Ways to strengthen the interchange between industrialized and emerging market economies.* The G22 process worked well, as a way of promoting discussion between the G7 and other industrialized and emerging market economies. But some have raised questions about its legitimacy. We need to consider how best to retain the ad hoc and informal nature of the G7 process while including systemically significant emerging markets on a regular basis. Some favor strengthening the Interim Committee of the IMF, where all 182 countries are represented. However, the IMF mandate does not extend to all of the issues – the World Bank also would need to be represented for example – and the present Interim Committee constituencies are not well balanced (Asians are under-represented, Europeans are over-represented). We will need to work on these issues, as well as on how to bring together the IMF and the World Bank with the Basel-based groups.

C. *Redrawing the lines between the IMF and the World Bank.*

- One possible reorganization would transform the IMF into an "International Finance Organization," responsible for macroeconomic and financial policy surveillance and the provision of financing to systemically significant economies, and the World Bank into a "World Development Organization," centered around development advice and subsidized lending to the poorest countries. However, this would raise the question of how to draw a dividing line between different categories of countries, and how to avoid duplication of expertise.

- Another proposed reorganization that may be worth exploring would refocus IMF surveillance and program conditionality on exchange rate regimes, balance of payments, macroeconomic policy and the soundness of the financial sector. The IMF would get out of the business of structural reform and subsidized lending, while the World Bank would transfer all responsibility for financial sector surveillance and restructuring to the Fund.

D. *More dramatic institutional reforms.* Possibilities include merging the IMF and World Bank, or merging the IMF's Interim Committee and the World Bank's Development Committee. Merging the two institutions would create lots of chaos. Merging the Interim and Development Committees is one of the reforms being considered as part of our effort to find constructive fora for interchange between industrialized and emerging market economies.

United States Treasury Note Regarding
Meeting of G7 Deputies and Deputy Deputies
Lansdowne Conference Center, Virginia, November 21-22

The discussions covered a wide range of issues raised for the international community by the events of the past eighteen months. While not producing a clear consensus on future reforms, there were substantial areas of common ground on the causes of the crisis and on core issues that the review of the international financial architecture would need to address. This note summarizes the main points raised on an unattributed basis.

I. Lessons for Emerging Market Policies

1. Exchange Rate Regimes

There was broad agreement that problems with fixed but adjustable exchange rate regimes had been a central element in nearly all 1990s financial crises and should be a greater focus of international surveillance going forward. However, given the fallibility of judgments about "equilibrium" exchange rates and governments' deep reluctance to follow international advice in this area, there was a question about how this lesson could be translated in practice.

Main points:

- using the exchange rate as a device for disinflation tended to court overvaluation problems because of continued inflation differentials. Even adjustable pegs tended to harden into symbols of the authorities' overall credibility, making early adjustment extremely difficult politically. ("It is better to devalue sooner than later, but it is actually easier for politicians to devalue later, when there is no alternative.") Long experience with a fixed system also heightened the difficulties of establishing a credible alternative after devaluation; as, for example, in Indonesia.

- nearly all post-1992 crises had come from the combination of exchange rate misalignments, on the one hand, and on the other, a major weakness in the system -- such as a weak banking system -- that made investors doubt the government's credibility in defending the peg. This gave rise to the suggestion that countries relate the degree of fixedness of the exchange rate to the depth and maturity of the domestic financial system.

- one conclusion drawn was that countries should give up trying to import price stability through the exchange rate and instead seek to target the real exchange rate within a system of "controlled flexibility". The authorities would signal to the market that the exchange rate would depreciate in line with the inflation differential, and major misalignments resulting from nominal inertia would be avoided.

- on the other hand, it was pointed out that past attempts to target the real exchange rate had not been very successful (many of the recent crisis countries had in fact been on crawling peg regimes). In part this was because the "equilibrium exchange rate" was very difficult to calculate at any point in time and subject to significant real shocks. In addition, such a system did not provide a clear response to *upward* pressure on the exchange rate in periods of rising capital inflows.

- an alternative lesson from recent events was that -- in a world of relatively free capital flows -- countries would increasingly be driven away from the middle ground of fixed but adjustable exchange rates towards the extremes of "permanent fixing" (as with a currency board) or a pure float. All noted that currency board regimes had so far emerged unscathed in the crisis. However, it was considered striking how few emerging economies today opted for the vagaries of a pure float.

2. *Strengthening Financial Systems*

All agreed that the domestic financial system had been an important factor in the crises in emerging economies, and that greater efforts needed to be made to encourage countries to match the openness of their capital market to the robustness of their domestic financial system.

Main points:

- the crises had underscored the importance of countries pursuing a gradual, or paced approach to opening the capital account. In particular, it was argued that countries should begin with those liberalization measures that strengthen the domestic system, such as opening the system to foreign participation. Far from pursuing such a paced approach, it was noted that many of the crisis countries had actively sought out short-term, risky foreign borrowing while neglecting the development of the domestic financial infrastructure.

- counter-cyclical "taxes" on inflows or prudential standards, to help check excessive short term inflows in the boom years, were also supported by several participants.

- there was agreement that the international community's efforts to encourage improved regulatory and supervisory systems in the emerging economies had not been very successful. This pointed to a need for more "muscular" forms of encouragement, perhaps making use of international "rating" of national supervisory and regulatory systems. However, several voiced scepticism about the capacity to put such a scheme in place very quickly.

- conditioning access to major financial centers on the quality of home regimes was suggested as a more readily available incentive mechanism. However, it was thought that the authorities already did this informally in several countries, and there was a question whether it was important enough to emerging market economies to make a difference.

II. Promoting Safe and Sustainable Capital Flows and Constraints on Suppliers of Capital

1. Private Sector Contribution to the Crises

There was some agreement that the suppliers of capital in developed markets shared some of the blame for the crisis, both in their excessive risk-taking in boom times, and excessive panic afterwards. While curbing the excesses of international credit cycles was clearly desirable, there was some uncertainty as to how this might be achieved.

Main points:

- there had clearly been an element of "innocent" contagion in recent events, notably in the market pressure on Latin America following the Russian collapse, although opinions differed on the relative distribution of responsibility. The point was made that the markets still "attacked countries in the right order"(i.e., with reference to relative policy imbalances).

- while exchange rate misalignments had played an important role in several crises, it was said that countries could now be forced to devalue, even where the rate was not clearly out of line with competitiveness. The international community should insist on countries addressing genuine currency misalignments. But it should also help countries without fundamental imbalances from being forced to devalue by the markets.

- the point was made that the emerging market crises should be considered part of a longer run problem of a "global outburst of liquidity" into emerging market asset markets that had now gone dramatically into reverse. During this period, investors were thought by some to have exercised less prudence in their international lending than in their domestic.

- to reduce the scope for such behavior, there was considerable support for changing the Basel risk-weighting system, both to reverse existing biases and to begin to develop greater differentiation in the treatment of emerging market and developed market investments. Possibly, these could be made counter-cyclical, rising in times of times of heavy lending on the grounds that this was when lending tended to be less prudent.

- there was also a desire to impose greater transparency and disclosure requirements on offshore operations and other nonregulated entities, including hedge funds.

- in addition, the question was raised whether formal rules -- imposed *ex ante* -- requiring creditors to bear some of the burden of adjustments in the event of crisis might also discourage excessive risk-taking by the suppliers of capital. However, this raised a range of concerns, discussed below (Section III, Part 3).

III. The International Response to Crises

1. Content of Adjustment Programs and the Scope of Conditionality

Debate focused on the perceived flaws in the IMF and World Bank's support for troubled economies and on the inherent conflicts in designing adjustment programs -- in particular, balancing the desire to address the structural causes of crises against the need to respect national sovereignty.

Main points:

- some believed that the IMF had focused too much on tightening monetary policy in the Asian programs, particularly Indonesia, and not enough on providing liquidity to restore confidence in domestic financial systems. However, against this had to be considered the hyperinflationary risks of failing to rebuild confidence in domestic assets and the possible need for drastic steps to achieve this in an environment of panic.

- there was some agreement that IFI programs needed to be broader if they were to address the kinds of structural and governance problems that were thought to have contributed to the recent crises. In Russia, in particular, it was noted that the relative allocation of international funds to "macro-stabilization" and "micro-structural" programs had been excessively skewed toward macro measures, in part because of the World Bank's apparent difficulty in finding worthwhile projects to pursue.

- on the other hand, several felt that IMF programs -- particularly in Asia -- had intruded excessively on the choices of sovereign governments in imposing detailed structural and other reforms that were not directly relevant to the problem at hand. Many Asians, in particular, had felt that the IMF's conditionality had been ideological in imposing a "Washington Consensus" that was not universally accepted.

- in this context it was suggested that one might distinguish the scope of programs from the content. Where basic fiscal/ monetary imbalances were concerned, there were perhaps "not many ways to skin a cat". But in other areas -- for example the Indonesian clove monopoly -- there was a question whether it was appropriate for the international community to impose particular choices, however worthwhile these might be thought to be. It was accepted that this needed to be squared with the aforementioned desire to broaden the scope of programs to address governance and related issues.

- the point was made that the unpopularity of IFI programs was perhaps inherent in conditionality, and inevitable where governments had long followed the opposite policies.

By imposing such changes, the IMF could serve a valuable function for the G7 and provide cover for difficult but necessary reforms in the recipient countries. However, it was important that the World Bank and IMF maintain a united front and there was a widely-felt concern that the World Bank had not taken sufficient public ownership of joint IMF-Bank programs in Asia when these had come under criticism.

2. Precautionary Mechanisms

There was some agreement on the desirability of "precautionary" and other mechanisms, both to help restore confidence at times of generalized market panic and to provide an incentive for basically sound countries to adjust policy sooner.

Main points:

- recent events had highlighted the value of maintaining relatively high levels of foreign reserves (notably, in the case of Brazil). Several Asian economies were said to have concluded that they should build up very substantial reserve levels to protect themselves.

- given that it is costly for countries to hoard reserves -- and destabilizing for the world system for everyone to be trying to do it at the same time -- there was a question whether there ought to be a general increase in SDRs to provide additional, unconditional funds to fend off contagion.

- however, many felt that the international community was unlikely to support what would be perceived as a major expansion of IMF resources. No amount of reserves would prevent a crisis where monetary and exchange rate policies were unsustainable. And to the extent that countries made use of the new -- unconditional -- liquidity it might simply end up subsidizing bad policy.

- consideration was being given to the possibility of countries "pre-qualifying" for some form of contingent reserve facility from the IMF. However, this raised some of the same concerns about conditionality, not least given the international community's previous difficulties in identifying "model" countries. (It was noted that when a similar facility had been discussed in early 1994, Mexico was considered a prime candidate.)

3. The Scope for a Lender of Last Resort and Private Sector Involvement

There was a widely-held belief among participants that both the practical constraints on international official finance and a concern for moral hazard pointed strongly toward finding more effective ways to involve the private sector in resolving crises. But there was considerable disagreement about how, and whether, this should be determined ahead of time -- and the scope for a more effective international lender of last resort.

Main points:

- it was suggested that financial crises might be viewed as a continuum, with "pure" liquidity problems at one end, and "pure" insolvency problems at the other. Most crises tended to be somewhere in between, and it was impossible to draw clear lines around the different types But the international community needed to retain the capacity to respond to crises that are primarily seen as liquidity crises, even if using this capacity to respond to all crises would be highly undesirable.

- on the other hand, all agreed that moral hazard and basic ethical considerations called for a system that would punish reckless lending. Accordingly, several argued for *ex ante* rules to allow the imposition of temporary standstills and controls on outflows when crisis struck -- to enable orderly work-outs and prevent "irresponsible" creditors being rewarded at the expense of either other investors or the international community.

- however, it was noted that any such measures would bring a range of practical difficulties and also important risks. In particular, there was a risk that imposing any such rule would make crises more likely, by giving investors an incentive to remove their money earlier. In that sense, the problem of finding ways to penalize investors was less a technical problem than a problem of judging how other investors would react.

- against this, it was argued that most developed markets had systems in place for dealing effectively with each kind of problem at the domestic level and it was not obvious why the same two systems could not be constructed internationally. Also, it was said that to the extent that flows to the developing were already depressed, this might actually make it the perfect time to introduce new rules. Even if there were a long-term reduction in flows to the emerging economies, this would not necessarily be such a bad thing given their apparent incapacity to absorb these flows productively.

- moreover, as a practical -- and political -- matter, there was a widespread belief that the international community was unlikely to make available the kind of resources that would be required to have a truly global lender of last resort, especially where this was perceived to serve the interests of irreponsible investors.

- in light of these considerations, it was felt that the treatment of very high-yielding sovereign debt were worthy of particular attention going forward. Such debt played a key role in triggering crises in Russia and Brazil -- neither of which had especially high levels of public debt by international standards -- and could not be said to have been "innocently" taken on by investors.

- all were agreed that it was extremely undesirable for such investors to be fully paid off in countries that are presently, or soon likely to be, the recipients of substntial official finance. However, the extreme hesitance to force private sector rollovers of sovereign short-term debt in the case of Ukraine, a country in which there had been a widely accepted moral hazard element to past lending, was suggestive of the problems involved in applying this principle in practice.

TREASURY NEWS

FROM THE OFFICE OF PUBLIC AFFAIRS

FOR IMMEDIATE RELEASE
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"BUILDING AN INTERNATIONAL FINANCIAL ARCHITECTURE FOR THE 21ST CENTURY" DEPUTY TREASURY SECRETARY LAWRENCE H. SUMMERS REMARKS TO THE CATO INSTITUTE

Building a successful global financial architecture for the next century will involve a great many challenges -- for example, establishing the role of the Euro, and expanding the WTO. Today I want to focus on just one of these challenges: creating a safe and sustainable system for the flow of capital from the developed to developing countries.

This is not an easy problem. The most rose-tinted consideration of the record of investing in developing countries would admit that it has a checkered past. Ever since the South Sea Bubble there have been recurrent episodes where investors' initial enthusiasm turned to panic -- and boom turned to bust.

The postwar history of global capital flows can be summarized as several decades of little or no international capital flows, followed by a wave of petrodollar lending that halted in Mexico City in 1982, followed after a pause by the flood of capital to emerging economies in the 1990s -- a flood which we now see turned into reverse.

So the problem of how to establish the means for safe and sustainable capital flows to the less developed countries is not one to which the world was alerted with the collapse of the Thai baht -- or the Mexican peso. But we face this challenge today at a time when it has taken on unprecedented desirability and importance for the world's aging population.

The developed countries are now crossing the threshold into an era of increasing rates of retirement and a much lower rate of growth in the labor force. Negative population growth is already a fact in some European countries and the investment of retirement saving is becoming a critical concern. When all of the world's population growth over the next 25 years -- and the lion's share of its growth in productivity -- will take place in the developing countries we are heading into a period when there will be exceptional global benefits to the transfer of capital, expertise and know-how from the developed world to the developing world.

We have lately had a taste of the potential this offers. When history books are written 200 years from now about the last two decades of the 20th century, I am convinced that the end of the Cold War will be the second story. The first story will be about the appearance of emerging markets -- about the fact that developing countries where more than three billion people live have moved toward the market and seen rapid growth in incomes. For the first time in human history, living standards for huge populations have quadrupled or more in a single generation.

If the degree of convergence between developing and developed countries in recent years stands out in 20th century economic history it is hard to believe that it is not related to the very substantial increases in economic integration that have occurred, and that increases in foreign investment, trade finance, and portfolio investment are not an important aspect of integration.

I. Ongoing Reform of the International Financial Architecture

Building a more effective international financial architecture that can ensure that capital flows are sustainable as well as strong is of profound importance around the world. It matters for economic growth in the developing world and, as we saw in the 1980s in a very powerful way, it matters for the stability of our own financial system.

This has been a priority for the United States and the other industrial countries since President Clinton's call for reform at the Naples Summit. And there have been some significant results, including:

- the norm of transparency has come to be more widely accepted with the development and continued refinement of the IMF international data dissemination standards and international agreement, for example, on the need for better information on the true state of central banks' balance sheets.

- emerging countries have been brought into a broad-based initiative to raise the quality of banking supervision and regulation in emerging economies, with the development of the Basel core principles for effective banking supervision and similar international standards for securities firms and others.

- the Bretton Woods system has been recapitalized with an increase in IMF quotas and the creation of the New Arrangements to Borrow. And these institutions have made important innovations, with moves to become more transparent and accountable, with premium rate lending on large IMF loans and with a new recognition at the World Bank of the importance of issues such as good governance, social safety nets and the prevention of corruption.

These are important developments but we have seen too many financial crises in recent years to let matters rest there. President Clinton joined the meeting of finance ministers and central bank governors of key industrial and emerging nations held during the IMF and World Bank meetings in Washington two weeks ago. The reports presented there will carry work forward on transparency, financial stability and crisis resolution.

II. Major Questions Going Forward

Economists and historians will debate what caused the crises in Asia and Russia for many years to come. But it is fair to say that the debate has focused on four key problems:

- weak domestic financial systems;
- imprudent borrowing and lending;
- inconsistent macroeconomic and exchange rate policies;
- and, in face of difficulties, problems of confidence and lack of liquidity in markets.

Each of these factors point to areas that the international community will need to address going forward.

1. How to Build Sound Domestic Financial Systems in Emerging Economies

Empty office buildings in Houston, record levels of non-performing loans in Japan, and the need for nationalization of most banks in sober Scandinavia remind us that no one has figured out how to regulate financial systems soundly or is well positioned to offer definitive answers.

That said, if there is a common element in the emerging market financial crises we have seen, it is a large amount of short-term borrowing inefficiently intermediated into low-return investments because financial systems functioned poorly. This, in turn, was the precursor to major confidence problems later on.

Among other things, making these systems work better will involve:

- pressing for greater opening of domestic financial market to foreign providers of financial services -- and the experience and greater diversification that they afford. Hungary was a pioneer in moving to encourage foreign entry to its market in 1989 and has since reaped the benefits to build probably the deepest, most diversified financial system in Central Europe. Argentina's experience since 1995 holds similar lessons.

- following up on the agreement of the Basel Principles, with effective surveillance of national authorities' progress toward implementing these principles and building more effective systems. In improving surveillance and regulation going forward it may be that market-based approaches such as subordinated debt requirements need to be given consideration as potential supplements to traditional regulatory approaches.

- curtailment of domestic moral hazard in emerging economies, which in turn means the creation of more effective domestic deposit insurance systems, better domestic bankruptcy laws, and a much greater emphasis on arms-length transactions. Inflows in search of fairly valued economic opportunities is one thing. Inflows in search of government guarantees or undertaken in the belief that they are immune from the standard risks are quite another.

It is easier to say how emerging markets should improve their financial systems than it is for their governments to bring about change or to figure out how the surveillance of the IMF and other institutions can best be used to motivate change. These issues will require considerable thought going forward.

2. Reducing Imprudent Borrowing and Lending

Domestic financial systems can and must be improved. But the root cause of crises is not so much the weakness of financial systems as it is the inflow of capital that is excessive relative to the maturity of the system in which it must be absorbed. This raises a variety of more macroeconomic questions about the flow of international capital.

Countries need to calibrate their efforts to seek capital to the capacity of their domestic financial systems. It bears emphasis that where foreign capital has contributed in a measurable way to the onset of these crises it has not been a matter of countries swamped by unrequited foreign inflows -- but of countries positively digging a path to their own door:

- we saw this in Mexico, with the increasing resort to issuing dollar-denominated Tesobonos in the lead-up to the crisis in 1994;

- we saw it in Thailand, in the tax breaks on off-shore foreign borrowing which helped encourage Thai banks to take on excessive foreign debt;

- we saw it in Korea, where discriminatory controls kept long-term capital out, and ushered short-term capital in;

- we saw it in Russia, with the government's increasing efforts to attract foreign investors to the domestic market for GKOs.

While excessive efforts to attract hot money can clearly end in disaster it would be a mistake to infer that restrictions on securitization, illiquidity or the resistance of financial innovation necessarily promotes stability. Those with a tendency to blame problems on hot money and short-term speculation need to confront the observation that the largest financial sector crisis we have seen in the 1990s -- that of Japan -- has occurred in a system that has historically been most closed and "long-termist" in its approach. And they need to reckon with the fact that the most reliable source of major financial disturbances in the modern era has been the market for real estate -- one of the most illiquid and long-term assets around.

There are a variety of difficult issues that arise in relation to the proper pacing of capital account liberalization and effective prudential management. And there is no question that stronger prudential management will involve measures that will have the effect of preventing flows that might otherwise have occurred.

But we should all be able to agree on the danger of approaches to joining the global financial system which involve denying a country's own citizens the capacity to convert their own currency and invest abroad. Such measures represent substantial intrusions on freedom. They make unsustainable policy abroad. Such measures represent substantial intrusions on freedom. They make unsustainable policy errors more tempting. They repel new capital inflows. And in an age of the internet they are unlikely to be successful in the long run.

Of course it is important to recognize, in situations where more money is borrowed than can be well used, that every credit has both a lender and a borrower. And certainly the last few months have been chastening to developers of risk management systems everywhere. In this context I have wondered lately what advice a sophisticated value at risk analysis would offer based on past correlations about the need to anticipate two major league baseball players hitting more than 65 home runs in a single season.

As we consider how to build more effective international supervision systems and the continued evolution of risk-weighting within the Basel system of capital standards -- it will be important to think about how these tools can best be attuned to systemic stability. But at a time when international integration is so important -- it will be critical not to take steps that will dramatically raise the obstacles to international lending relative to similar-risk domestic investments.

Properly pacing capital inflows with the development of a country's financial system is important for stability. But the best outcomes will come with rapid strengthening of financial systems and substantial capital inflows over time. And with the right kinds of prudential regulation and risk management the volumes of capital we have seen in recent years can be sustainable. After all, as Alan Taylor's work as shown, as a share of both borrowers' and lenders' GDP, the flow of capital to developing countries was substantially greater a century ago than it is today.

3. The Right Kind of Exchange Rate Regimes

The kind of economists that migrate to the Cato institute are united on many tenets of economic theory and practice yet divided on the management of money in its international aspect. Some are with Milton Friedman in treating exchange rates as a price -- and a price that should be flexible for the same reasons that others are. For others, money and its exchange is a promise -- one that should be fixed and that should not be broken or devalued.

The choice between these two poses enormous difficulties. But we can all agree that where it is a promise, the promise should be maintained -- and that treating it as a promise, then breaking it, is probably the worst of all options. There is no single answer to exchange rate dilemmas. Indeed, the core proposition of monetary economics is a trilemma: that capital mobility, an independent monetary policy and the maintenance of a fixed exchange rate objective are mutually incompatible. I suspect this means that as capital market integration increases, countries will be forced increasingly to more pure floating or more purely fixed regimes.

To be sure, the grass is always greener elsewhere. Some fixed rates have built up pressure like a dam -- and wreaked devastation on the economic landscape on breaking. Yet the present enthusiasm in Mexico for the notion of dollarization underlines that floating rates are fine, except for where they float to.

In light of the difficulties we have seen in recent years the question facing the supporters of free floating rates going forward will be how to find a way for governments establish disciplined, clear policy framework without the clarity of an exchange rate signal -- particularly in a post-crisis environment. And the question for those who see no alternative in these settings must be how to reconcile that need for stability with the fact that all the work done by years of exchange rate commitments to markets can be undone by four days trading in exchange markets.

While there is no single answer I suspect that the European experiment with economic and monetary union will influence views and choices that are made in the future. What is important going forward will be the recognition that the contagion caused by discontinuities gives the international community an even larger stake in the right choices being made -- and that the approach that the international community takes will be very important to their success.

4. The Right Systems for Crisis Response

It is important always to remember that far and away the best response to a financial crisis is to prevent it. We should not hold out too much hope that any mechanism for crisis response will every offer anything approaching complete palliation of the adjustment costs of investors deciding that at current prices they wish to move 10 percent of GDP out of a country tomorrow.

Crisis response mechanisms have an ex post aspect, in that we want to respond well to crises, and an ex ante aspect because the decisions people make will be influenced by the fact that they exist.

In this context there is perhaps a useful analogy to be made between the dilemmas involved in responding to financial crises of countries and those involved in responding to the difficulties of individual institutions:

- on the one hand, the danger of bank runs, multiple equilibria, and self-fulfilling prophecies provides a case for providing liquidity where credit shortages are not fully justified by the fundamentals. That is why the Federal Reserve was established. And that is why deposit insurance of some kind is a feature of almost every national financial system.
- on the other, market discipline is the best means the world has found to ensure that capital is well used. And the inevitable byproduct of the confidence instilled by the availability of emergency capital -- indeed, in a sense the goal of mechanisms such as deposit insurance -- will be some blunting of investor discipline, and some greater preparedness to leave money invested when prudence might otherwise have dictated taking it out.

In a sense, moral hazard is the mirror image of contagion. When the availability of a supply of capital raises confidence and investment, it can either be called confidence that reduces contagion, or it can be called moral hazard.

Closely related to this is the notion that it is essential to distinguish problems of liquidity from problems of insolvency. When liquidity elements are dominant, it is the irony of financial crises that while the problem may have been caused by too much lending, the solution may lie in more lending taking place. Of course, where the solvency element is dominant, more lending is wrong and the challenge is to allocate burdens among creditors and write down debts accordingly.

In academic models the distinction between liquidity and solvency crises is clear. In the real world, the distinction is difficult to draw even in hindsight -- and even more difficult to draw in advance. It is not surprising, therefore, that the actual response to financial crises often involves a combination of subordination of old claims and their extension or reduction, and the provision of new finance.

How best this process should be managed in the future and how these elements should be combined is a central issue in thinking about how the IMF should function and what its scale should be. Even with the recent increase, it is striking to recall that if IMF quotas represented the same share of GDP today as when it was founded they would be five and a half times larger than they are.

Two recent developments have strengthened the IMF's capacity for responding to financial crisis problems: the Supplementary Reserve Facility providing that when large quantities of finance are provided to respond to pressure from capital inflows, a premium will be charged; and the recent agreement that in certain very specific circumstances the IMF could lend into arrears. And presently discussions are under way about the possibility of providing contingent finance to countries to help contain contagion.

Suggestions that the IMF should pre-commit to provide finance to countries that conform to various standards of macroeconomic conduct and financial prudence have lately attracted considerable attention. Among the many questions they raise are a problem akin to those raised by narrow banking proposals -- about the credibility of promises not to support important institutions or countries outside the system -- and important concerns about moral hazard.

In the real world it is perhaps inevitable that ex post conditionality will fill the gap between the promise not to reward imprudence and the realities of contagion. But in imposing conditions ex post there is the challenge of providing confidence to markets while at the same time providing a spur to necessary reforms. This will involve a difficult balance, both in the setting of conditions and the timing of disbursements.

Concluding Remarks

I have stressed the international financial architecture, which is obviously very important for the way the global economy functions. But no one should lose sight of the fact that the most important determinant of every country's fortunes is the policy choices of its people and its government. We can seek to create the best structure and best environment possible, and the international community can make a contribution when problems come. But none of this is a substitute for strong determined action of countries to maintain stability and to address instability when it comes.

I have touched on a number of the economic issues involved in thinking about the financial system of the future. But it may be that the most profound issue is a political one. Just as much greater integration in Europe has led to pressures for more pan-European decision-making, it is inevitable that at the global level tensions between integration and sovereignty will arise. But if recent events are a testament to the challenges which such tensions present -- they are no less a confirmation of the critical importance of their being overcome. Thank you.

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REFORMING WORLD FINANCE

Lessons from a Crisis

The Economist

October 3rd-9th, 1998

The IMF has been attacked for its handling of the world's economic and financial troubles. Here its deputy managing director, Stanley Fischer, responds

WHEN finance ministers and central-bank governors gather in Washington this weekend for the annual meetings of the IMF and the World Bank, the global economic crisis will dominate the agenda. The role of the IMF will come in for close examination. Three issues will feature prominently: the design of IMF-supported programmes in Asia and Russia, the international financial architecture, and how to respond to the immediate crisis without doing further damage to the international system. I consider these in turn.

The IMF programmes in Thailand, Indonesia and South Korea were designed to restore macroeconomic stability and growth, and to remedy structural weaknesses in each country. Early in each programme interest rates had to be raised temporarily to stabilise currencies. That was achieved in South Korea and Thailand, whose currencies are now stable in ranges about 35-40% below pre-crisis levels, with short-term interest rates of around 8-9%, also below pre-crisis levels.

Those who criticised temporary high interest rates fail to see that further depreciation caused by lower rates would have raised the burden of dollar-denominated debts. And while the burdens imposed by higher interest rates were temporary, those created by deeper devaluations would have been permanent.

Thailand embarked on its IMF programme with a current-account deficit of 8% of GDP. To shrink that, the programme included an increase in the budget surplus of 3% of GDP. Fiscal contractions suggested for Indonesia and South Korea were smaller, designed to cover only the expected interest costs of financial restructuring. Had we known, when the Thai programme was signed in August 1997, that Asia, including Japan, was heading for major economic slowdown, less fiscal contraction would have been recommended. As growth in South Korea, Thailand and Indonesia has slowed, the agreed fiscal deficit has increased; each country is running a sizeable deficit. More fiscal expansion, including additional social spending for the poor, would now make sense.

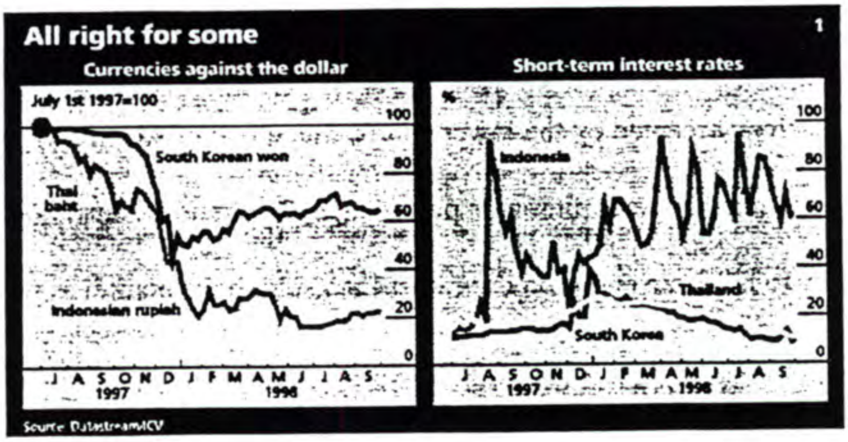
The inclusion of structural measures in these programmes has been criticised. But financial and corporate inefficiencies were at the epicentre of the economic crisis, and have to be dealt with to restore durable growth. Indeed, the priority now should be to accelerate restructuring. Some argue that because this will take a long time to have its effects, it was a mistake to try to move so rapidly. But delay does not make banking problems go away: as seen in Japan, it makes them worse.

Programme problems

If their design was right, why have the IMF programmes worked less well than hoped? There are two answers. First, governments were initially reluctant to implement them. In each of the three countries the programme began to take hold and the currency to stabilise only after a new government took office. And second, the external economic environment has worsened, due especially to the Japanese recession.

The consequences have been most visible in the three countries' exports. Rapid export growth to the United States helped bring Mexico out of its 1994-95 crisis. This time, the value of exports from Thailand, Indonesia and South Korea to both Europe and America did indeed rise in the year to the second quarter, but the value of their exports to Japan has declined sharply, by about 25%. So exports have not, so far, served as a source of growth.

Where do these countries stand today, a year after the start of their IMF programmes? Remember that the average American recession lasts about a year, and that a year into the Mexican crisis, there was a period of severe jitters. There are important signs of progress in both South Korea and Thailand, in the stabilisation of their currencies, the fall in interest rates and the start of bank and corporate-debt restructuring (see chart 1). Growth could still resume this year, though much depends on the external environment. A year from now each country is likely to be growing again and to have made more progress in structural reform than most of its neighbours - good basis for sustainable recovery.

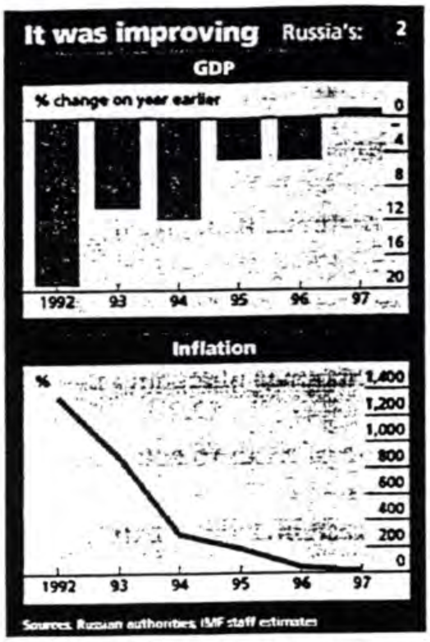


The problems in Indonesia are deeper, for the civil unrest that accompanied the end of the Suharto regime led to massive capital flight and a loss of investor confidence that will take time and careful political and economic management to repair. Critics blame the closing of 16 banks at the start of Indonesia's IMF programme for the collapse of the rupiah and investor confidence. But a careful look at the timing suggests the main culprits were President Suharto's illness in December, perceptions that the government would not carry out the programme, and excessive creation of liquidity by the central bank.

Indonesia has made some progress in recent months. The rupiah has strengthened, as foreign assistance has started flowing in. But attempts to keep food prices below world levels have failed and rice prices have risen. So the government, with the assistance of the World Bank, is removing general subsidies on food and switching to the provision of subsidised rice and other essentials for the poor. A start has been made in dealing with the linked problems of internal and external corporate debt and the banking sector, though more needs to be done.

Russia's dance

Ever since 1992 the IMF has been the world's main vehicle for assisting Russia and promoting economic reform. This was difficult from the start, for reformers never had full control over economic policy. Nevertheless, the world's stake in Russian reform was too critical not to make the effort.



Some progress was made: the rouble was stabilised and inflation cut to single figures, and positive growth was recorded in 1997 (see chart 2). On the structural side, privatisation took off. But little was done to restructure the military-industrial complex. And the government, unable to collect enough revenues, was often in arrears on wage and pension payments. The banking system was ill-regulated and heavily exposed to the risks of devaluation. And corruption was a huge problem for the economy and for foreign investors.

The extent of Russia's fiscal problem is hard to overstate. In 1997, federal tax receipts amounted to 9.7% of GDP, less than $4 billion a month. The budget deficit was 6.9% of GDP. Since 1996 the Russian government has been in a race between its need to collect more taxes and a rising interest bill on its growing debt. This year tax collection improved. In the second quarter, for the first time, federal revenues covered non-interest spending. But falling oil and commodity prices reduced export revenues, interest rates rose, and the government had to roll over $1 billion a week of GKOs, or short-term rouble-denominated debt.

In July the international community faced a hard choice: whether to help Russia try to prevent devaluation. The adverse effects of a devaluation were clear and the reformist Kiriyenko government was making progress on taxes and in other areas. So the decision was made to help, recognising that this was a calculated risk. An official package of $22 billion was assembled, on condition that the Russians undertake major tax reforms; and a voluntary debt restructuring scheme for GKO holders to switch to longer-term dollar obligations was introduced.

The take-up of this offer was, however, small. The programme could still have been viable if GKO holders had been ready to roll over their maturing holdings. But after the Duma rejected two tax measures (though it passed most of the legislation submitted to it), and with doubts about the ability of the government to deliver on policy commitments growing, this did not happen. So the government was faced with an unenviable choice between devaluation, debt restructuring or both. It chose both: the rouble was devalued, the GKO restructuring was imposed unilaterally and a temporary moratorium was put on private debt payments.

The contagion following Russia's actions has been serious. The realisation that Russia was, after all, not too big to fail shook investor confidence - although it is hard to credit that sophisticated investors who had earned an average of 50% a year on GKOs since 1994 really believed these investments were safe. Investors were concerned that other countries might follow suit and unilaterally restructure their debts, although almost all have rejected this.

Much of the contagion was caused by technical factors. Highly leveraged investors have had to realise assets to meet margin calls; investors seeking to move out of emerging markets have sold in the most liquid markets to raise cash. The shocks are now reaching rich-country markets too.

The new Russian government is in an extremely difficult situation. In the short run it may employ a mixture of money printing and more controls. But these approaches will not work; sooner or later a Russian government will have to return to the tasks of stabilising and reforming the economy. At that point the world may be able to re-engage financially. In the meantime we should encourage the authorities to try to agree with creditors how to restructure the GKOs and how to lift the 90-day moratorium on private debt payments.

What went wrong in Russia? Fundamentally, although progress was made over the years, successive governments have been too weak to implement their desired policies. The international community, through the IMF, was right to try to support reform in Russia. And the IMF was right from early on to stress the need to sort out the fiscal mess. Eventually, as a weak internal situation combined with external shocks, the crisis came. Its effects will take time to overcome, but the story of Russian reform is not yet over.

There is no shortage of suggestions for reshaping the international financial system. Amo: g the main ones are plans to strengthen national banking and financial systems; mechanisms to reduce contagion; capital controls; the need to minimise moral hazard; new exchange-rate regimes; and reform of the IMF itself.

Banking weaknesses have either caused or aggravated all the recent crises. Most of these weaknesses were identified in advance by the IMF, but efforts to get countries to take pre-emptive action were not successful. The development of international banking standards, the Basle core principles, is an advance. But although we are starting to strengthen surveillance of banking systems, enforcement mechanisms are lacking. One option among others might be to impose differential provisioning requirements against loans to different countries, depending on the standards met by their banking systems.

Containing contagion

The virulence of the recent contagion raises troubling questions about financial markets. Admittedly, contagion is rarely baseless: the markets treat countries in better shape more kindly than those in worse shape. Nonetheless, the technical factors contributing to contagion suggest it has been excessive - and that a way should be found to moderate it. That task will fall mainly to financial regulators, who should ensure greater transparency of positions being taken by investors, and consider when leverage can be excessive.

Fuller information should increase the efficiency of international capital flows. Through its special data dissemination standard, the IMF is prodding countries towards greater transparency. The standard needs strengthening, for instance by providing more timely data on foreign-exchange reserves and complete data on forward transactions by central banks. We also need better information on short-term debt, on which the Bank for International Settlements and others are working.

Malaysia's decision to impose controls on capital outflows - and support for the idea among some academics - raises the question of whether such controls will once again become widespread. The IMF's position has long been that capital-account liberalisation should proceed in an orderly way: countries should lift controls on outflows only gradually as the balance of payments strengthens; liberalisation of inflows should start at the long end and move to the short end only as banking and financial systems are strengthened. We have not opposed Chilean-style, market-based measures to regulate capital inflows at the short end, but they must be considered case-by-case (Chile has recently eased its controls).

Yet long experience shows that any short-term benefits that controls on outflows produce will be outweighed by their long-term disadvantages, as they encourage domestic evasion and capital flight, and discourage foreign investors. After Malaysia's imposition of controls, other Asian countries have firmly rejected them, as has Latin America. We should, even so, recognise that the lure of isolation from the international system will increase unless market turbulence settles.

Next is the issue of moral hazard. It is hard to see evidence of this on the part of policymakers. Most countries do their utmost to avoid going to the IMF. The thornier issues arise on the side of investors. Some point to investors who take excessively risky positions on the back of an IMF safety net. Others are concerned that investors who should have paid a penalty may be bailed out by IMF lending.

These worries should now be mitigated as most investors in Asian countries, and especially investors in Russia who bet on the "moral-hazard play", have taken very heavy losses. We need to balance concerns over moral hazard against the costs for the system of exacerbating instability by failing to assist countries in need. This issue is closely tied to the question of how to "bail in" the private sector (ie, get it to roll over its debts or provide new money rather than rushing for the exit). The IMF and other groups, including the G22, are working on this high-priority problem.

We also again need to appraise exchange-rate regimes for emerging market countries. The recent crises have all taken place in countries with fixed or semi-fixed exchange rates. Yet several countries, including Argentina, have benefited from a fixed rate; and currency crises also affect countries with flexible rates. The argument has been made that there are really only two stable exchange-rate systems: a freely floating rate, or the adoption (perhaps via a currency board) of another country's currency. With the expected success of EMU, more currency blocks may develop. But for now, we are in an uncomfortable in-between world in which floating rates are sometimes too volatile and fixed rates sometimes too vulnerable to attack.

Lastly there is the question of reforming the IMF. Many of the changes discussed above will affect its role. There is also general support - including from the management of the IMF - for greater transparency in IMF operations. There has been much progress in recent years, as a visit to our website (www.imf.org) can show. More can be done, but only with the full support of the membership.

It is sometimes argued that the IMF is not accountable. That is not true. It is fully accountable to its membership, through the 24-member executive board that represents the 182 member countries. No loan or other big decision is taken without the board's approval. Overall IMF policies are set by the 24-member interim committee, made up of finance ministers and central-bank governors, which meets twice a year. Most complaints about accountability are really about transparency. If more details of IMF operations were published, there would be more room for appraisal by outsiders - which would be to the good.

What to do now

While work on the international financial architecture moves ahead to prevent the next crisis, we need urgently to contain the present one. Four steps are needed.

First, as the balance of risks in the international economy has shifted, so should the stance of monetary policy in America and Europe. This week's cut in American interest rates is welcome news. It is also good that European central bankers have suggested that European rates should converge to the low levels in France and Germany rather than meet in the middle.

Second, Japan's continuing recession is a major problem, both for Japan and for the rest of the world. Rapid action to sort out its banks, and further fiscal stimulus, would go a long way to help Japan and the rest of Asia recover.

Third, the key to stopping the spread of the crisis is Latin America; and in Latin America it is Brazil. Latin American countries have made genuine progress in structural reforms this decade. They have reacted courageously to recent financial pressures by tightening monetary and fiscal policies. Brazil's President Cardoso has left no doubt that he will take more fiscal action after the election.

The international financial system, which has sustained the world economy through 50 years of growth and prosperity, needs reform to ensure that this continues - and that the mistakes of the 1930s are not repeated. For the IMF, which has had a central role in the system, to continue to play its part, it needs the support of its membership as it adapts to a changing world economy - and it urgently needs the quota increase.

Stanley Fischer is first deputy managing director at the International Monetary Fund. The views expressed in this article are those of the author. They are not necessarily shared by the International Monetary Fund's executive board.

VP / B Reed

Should we try to get more ~~people~~ cities to do this? — BR

1-4-99

NYT 11/13/98 p. 23

Teen-Agers Turn Agents to Fight Sale of Cigarettes to Minors

By ROBERT D. McFADDEN

She is an unlikely undercover agent. But for six months this year, Alexa Martinez, who is 16 and looks it, went around with inspectors from New York City's Consumer Affairs Department as backups, and asked to buy cigarettes at newsstands, candy stores, delicatessens, supermarkets, drug stores and hotels.

City law prohibits the sale of tobacco to anyone under 18, and sellers are required to request photo identity cards from anyone who seems younger than 25. But the law is widely flouted, as Alexa learned, strolling away again and again with cigarettes, no questions asked.

"If they'd sell to me, I'd pay for them and walk out to the vehicle," Alexa, a nonsmoker who is an 11th grader at Adlai E. Stevenson High School in the Bronx, said yesterday. "Then, one of the inspectors would go back in to give them a summons, and I would fill out an affidavit."

From April through September, in what officials called the nation's most ambitious crackdown on merchants who illegally sell tobacco to minors, Alexa and 30 other teenagers, most of them 14 to 16, put the test to nearly 8,200 of the 15,000 retailers in New York that sell cigarettes.

Yesterday, the city said the crackdown, called Smoke Out '98, had led to a 66 percent decline in cigarette sales to minors in the stores being tested, apparently as word of the undercover operations spread and merchants were hit with fines and tobacco license suspensions.

To keep the pressure on, Mayor Rudolph W. Giuliani, who has toughened laws against selling the box cutters that young thugs use as weapons and cans of spray paint used for graffiti, proposed yesterday a law that would triple fines and increase license suspensions for anyone selling tobacco to minors and would step up and streamline enforcement.

"This new legislation should sound a clarion call to merchants that if they sell cigarettes to kids, they will lose their license to sell tobacco," said Jules Polonetsky, the Commissioner of Consumer Affairs.

The bill would raise the fine for a first offense from $300, to $1,000, and for a second offense, from $500, to $2,000. It would also provide for automatic suspension of tobacco licenses on the second offense within two years, instead of the third offense, and would consolidate licensing and enforcement in the Consumer Affairs Department.

Under present laws, two-year licenses to sell tobacco are issued for $10 by the City Finance Department, which uses them largely for taxation purposes. The Consumer Affairs licenses, also good for two years, would supplant them and cost $110.

And to tighten a loophole in which merchants facing license suspensions or heavy fines have escaped penalties by fictitiously "selling" their businesses to relatives or friends, then reincorporating under new names, the new law would have licenses issued to business premises, rather than names. It would strip an offender of its license for two years, regardless of a change in ownership.

No one knows how many minors buy cigarettes in the city. A national survey by the Department of Health and Human Services suggests that more than 48 percent of male minors and 36 percent of female minors have tried smoking, and experts say most adults addicted to nicotine started smoking as minors.

To gather information for a new anti-smoking law, the city last spring hired 30 minors under a summer jobs program, using a $740,000 grant from the State Health Department. For $6.25 an hour, Alexa and the others worked five to six hours a day, on weekends during the school year and on alternate weekdays in the summer, accompanying inspectors on 8,154 visits to tobacco sellers.

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THE WHITE HOUSE

WASHINGTON

This is very good
should be a major
part of SOTU—
B.

December 28, 1998

MEMORANDUM FOR THE PRESIDENT

FROM: Bruce Reed
Mike Cohen

SUBJECT: ESEA Reauthorization Proposal

We have been working with the First Lady's office, OMB, the Vice President's office and the Education Department to develop the strongest possible proposal to reauthorize the Elementary and Secondary Education Act, with the objective of transmitting it to Congress by March 1. While there is still much to be done to shape and finalize this proposal, we have made progress in addressing some of the most significant issues. (Although Secretary Riley has not reviewed our suggestions in detail, Deputy Secretary Smith has been very closely involved in the process.) This memo looks at how the 1994 reforms are working, where they are falling short, and what improvements we are considering. We are planning to meet with you in early January.

I. Progress Report on the 1994 Reauthorization and Goals 2000

Our reauthorization proposal will build on the framework for federal aid to elementary and secondary education established in Goals 2000 and the Improving America's Schools Act, the 1994 reauthorization of ESEA. In principle, both of these Acts overhauled federal elementary and secondary education programs by:

- *Insisting that every state set challenging academic standards that all students are expected to reach.* Goals 2000 required states to set academic standards for all students and develop assessments aligned to those standards. Title 1 of ESEA built on this requirement by mandating that states use these standards for disadvantaged students, thus ending the practice of setting lower expectations for low-income students.

- *Providing schools, school districts, and states with the flexibility to determine how best to educate students to meet high standards.* Goals 2000 provided states and districts with tremendous flexibility in how funds could be used, and for the first time allowed the Secretary of Education to waive federal requirements if they impeded state or local reform efforts. ESEA reduced regulations, paperwork, and reporting requirements; launched your initiative to establish 3,000 charter schools; and permitted high-poverty schools (with 50% or more students eligible for Title 1) to combine funds from separate streams and use them to improve the whole school.

- *Holding schools accountable for the results they achieve, rather than for compliance with*

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rules and regulations. Title 1 now requires states to set annual goals for each school and district relating to the number of students who must reach academic standards; to report progress annually for each school (disaggregating data by demographic subgroups); and to intervene in schools that fail to make adequate progress.

These reforms have sparked considerable state and local education reform activity. There is, however, still much more to be done to achieve significant improvement in elementary and secondary education, especially in high-poverty schools. The key lessons from the implementation of Goals 2000, ESEA, and related state and local reforms include:

- *Standards-based education reform works.* A recent Rand study of education reform in North Carolina and Texas -- the two states with the best track record of improving achievement generally <u>and</u> closing achievement gaps between minority and white students -- shows that a sustained, statewide approach of raising academic standards, providing schools with the flexibility and tools they need, targeting resources for extra help to low-performing students and schools, and holding schools accountable for results produces results, particularly for disadvantaged students. Other studies also have shown that states and school districts -- including urban school districts like Philadelphia, Boston, San Francisco, and Chicago -- that have adopted similar approaches have shown significant gains in reading and math. This data indicate that our overall strategy is sound. If we maintain the recent direction of federal education policy while intensifying our efforts, we can improve elementary and secondary education across the nation.

- *States have adopted policies effecting standards-based education reform, but these policies do not go far enough.* Forty-eight states have set new, more challenging academic standards, and most states are working to develop or adopt new assessments aligned with these standards. Fewer states, however, have adopted accountability systems along with the standards. Only 25 states provide for intervention in low-performing schools, as required by Title 1. In addition, only 17 states provide extra help, such as summer school or tutoring, for students who do not meet the standards, and only five states require students to demonstrate they have met the standards as a condition for promotion.

- *Implementation of state policies providing for standards, assessments, and accountability leaves room for improvement.* Title 1 includes a series of deadlines for implementing state policies on standards, assessments, and accountability. Although not all of the implementation deadlines have been reached, it is already clear that many states are not on track to meet them. In addition, some states are failing to implement these policies as envisioned. For example, some states have evaded the full extent of their responsibility to set goals for "adequate yearly progress" for students and schools. And although half the states have policies that provide for some kind of intervention in low-performing schools, many have shown themselves unable or unwilling to take the actions necessary to turn around these schools so they provide an acceptable education.

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- *Improvements in the quality of teachers and teaching are urgently needed.* Governor Hunt's National Commission on Teaching and America's Future has underscored the difficulty of recruiting and retaining talented and well-prepared teachers, especially in schools with the most disadvantaged students. About 50,000 teachers each year enter the profession with emergency or substandard licenses. Nearly one quarter of secondary school teachers lack even a minor in their main teaching field, and in schools with the highest minority enrollment, students have less than a 50% chance of having a math or science teacher with a license and degree in the field. On average, 22% of new teachers leave the field within three years, and in urban areas 30-50% leave within five years. Paraprofessionals are widely and increasingly used to provide instruction to low-achieving students in Title 1 schools, with as many as 20% of Title 1 instructional aides providing instruction without a teacher's supervision. By one estimate, instructional aides account for roughly half (67,000) of the entire Title 1 instructional workforce, and Title 1 aides are being hired at twice the rate of Title 1 certified teachers.

  The Eisenhower professional development program, the main federal program to improve teacher quality (Goals 2000 and Title 1 also provide some funds for this purpose), has failed to improve the situation in any significant way. Recent evaluation data suggest that in many districts, the Eisenhower program funds activities of limited effectiveness. And even where the activities are effective, the program often fails to fund them at an adequate level. The Higher Education Act you signed last year includes a new program to provide scholarships to highly qualified individuals who commit to teaching in high-poverty schools, but the current appropriation is sufficient for only about 1,400 of these scholarships.

II. Major Changes to ESEA

Our budget contains a number of initiatives to expand educational opportunity in the elementary and secondary grades: school modernization, class size reduction, after-school funding connected to social promotions policy, and an increase in Title 1 funding for the specific purpose of intervening in low-performing schools. Our ESEA reauthorization can build on these initiatives by insisting on what the studies suggest we most need: accountability -- for students, teachers, and low-performing schools. With this Congress, we may not be able to enact every ESEA reform we want -- indeed, we may not be able to get ESEA done at all this year -- but we can frame the debate in the right way by putting forward a bold vision of the future of education reform.

Our proposal would include a new set of accountability requirements as a condition for any state or district to receive any ESEA funds (not just Title 1). States and school districts would be required to produce annual school report cards, end social promotions, intervene in the lowest performing schools, and end the use of unqualified teachers. Taken together, these new requirements represent a fundamental change in federal aid to elementary and secondary

~~What about intensity in low performing schools [illegible] too?~~

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education. For the first time, the federal government would link investment in state and local education systems with their commitment to take the steps necessary to enable all students, teachers, and schools to meet high standards. In effect, we are saying that the best way for the federal government to help students is to insist that states and local school districts live up to their responsibilities, rather than to try to compensate after-the-fact for their failure to do so.

Along with the investments in your budget, this approach is intended to help close the opportunity gap by lifting achievement in low-performing schools and making sure that disadvantaged students are not left behind. We think the approach would be compelling enough to unite most Congressional Democrats, the education community, and the public, as well as to counter an expected Republican push for vouchers and block grants.

A. Annual School Report Cards. Our proposal would require annual report cards, easily understood by and widely distributed to parents and the public, for each school, school district, and state. The report cards would include information on student achievement, teacher quality, school safety, and class size. Where appropriate, the data collected and published -- especially on student achievement -- would be broken down by demographic subgroups, to allow a greater focus on the gaps between minority and majority, low-income and more advantaged students.

B. Ending Social Promotions. Our proposal would require states and districts participating in ESEA to adopt policies that (1) require students to meet academic performance standards at key transition points in elementary and middle school and for high school graduation; (2) use objective measures -- i.e., tests valid for these purposes -- to make an initial determination if a student has met the standards; and (3) permit other, non-objective factors, including teacher judgment, to enter into a final determination as to whether the student has met the standards. States and school districts would have to show how they will help students meet promotion standards by (1) strengthening learning opportunities in the classroom with steps such as clear grade-by-grade standards, small classes with well prepared teachers, high quality professional development, and the use of proven instructional practices; (2) identifying students who need help at the earliest possible moment; (3) providing extended learning time, including after-school and summer school, for students who need extra help; and (4) providing an effective remedial plan for students who do not meet the standards on time, so that they do not repeat the same unsuccessful experiences. The proposal would phase in this requirement over five years; design the requirement to fit state governance systems (allowing "local control" states to delegate responsibilities to the local school district); and base the requirement on state or local rather than national standards. The Secretary would review and approve each state's plan, with continued funding conditional on adequate annual progress ii implementing the plan.

To reinforce this requirement and encourage local school systems to address it even before the enactment of ESEA, your FY2000 budget contains a $400 million increase in funding for the 21st Century Learning Center program, half of which will be reserved for after-school and summer school programs in school districts implementing policies to end social promotions.

1-9-99

C. Accountability for Teachers. Our proposal would require states and local school districts participating in ESEA to phase out the use of unqualified teachers over five years. In particular, states and school districts would have to end the use of (1) teachers with emergency rather than full certification; (2) secondary school teachers teaching "out of field" -- i.e., teaching subjects for which they lack an academic major or minor; and (3) instructional aides serving as lead instructors. Ending these practices is particularly important for high-poverty schools, where the practices are most prevalent. States also would have to adopt teacher competency tests for new teachers, including tests of subject-matter expertise for secondary school teachers. States and school districts would be able to use funds from a number of ESEA programs, including Title 1, bilingual education, and a new grant program focused in part on teacher quality, to help meet these requirements.

In addition, we are working with the Education Department to fashion a requirement for states and school districts to deal with low-performing teachers. We are exploring a number of approaches, including (1) requiring periodic recertification of teachers, and (2) requiring school districts to adopt procedures to identify low-performing teachers, provide them with needed help, and remove them fairly and quickly if they do not improve. We will work closely with the NEA and AFT over the coming weeks to try and fashion a provision that will meet our objectives while addressing their concerns.

D. Accountability Fund for Title 1 Schools. Our proposal would strengthen accountability requirements in Title 1 so as to require and adequately fund immediate and significant state and local intervention in the lowest performing schools. Because the schools of greatest concern are invariably Title 1 schools and because Title 1 already contains certain accountability provisions, we believe we should incorporate these provisions into Title 1, rather than imposing a broader ESEA requirement.

Our proposal would retain current provisions for states to adopt performance standards and assessments by 2001. In addition, it would strengthen the current provisions in Title 1 relating to low-performing schools by: (1) requiring the immediate public identification of and intervention in the lowest performing schools in each state -- i.e., schools with very low levels of achievement that have made little or no improvement over the previous three years; (2) setting aside 2.5% of Title 1 funds to support aggressive intervention in these schools, including an external assessment of each school's needs and the implementation of needed improvements (such as addressing school safety and security needs, providing better teacher training, acquiring up-to-date textbooks, technology, and curriculum materials, and extending learning time to help students catch up academically); and (3) requiring states to provide recognition or rewards to Title 1 schools showing the greatest improvements.

To increase the appeal of this approach, your FY2000 budget contains a significant increase in Title 1 funding, of which $200 million is specifically dedicated to this initiative.

1-4-99

III. Other Changes in ESEA

A. Charter Schools and Public School Choice. Earlier this fall you signed the Charter Schools Expansion Act of 1998, which strengthened incentives for states to (1) increase the number of high-quality charter schools, (2) strengthen accountability for charter schools, (3) maximize flexibility for charter schools, and (4) provide charter schools with their proper share of federal program funds. We believe, along with most in Congress, that no further changes relating to charter schools are needed in the ESEA reauthorization process.

Our proposed ESEA legislation, however, would include new authority to enable the Education Department to support other, new approaches to expanding public school choice. At present, the Department has authority only to support specific approaches to choice, such as intra-district magnet schools in the context of desegregation efforts, and (as of last year) high schools on community college campuses. We will propose a new competitive grants program that will give the Education Department the ability to support a much wider range of choice approaches, including district-wide public school choice systems, interdistrict magnet schools and other interdistrict approaches, work-site schools, schools-within-schools, and post-secondary enrollment options.

As a first step in this direction, your FY2000 budget proposal will contain funds and necessary authorizing language for three specific choice initiatives: $10 million in grants to school districts to establish work-site schools; $10 million to support interdistrict magnet schools; and (as already authorized) $10 million to establish high schools on community college campuses.

B. Bilingual Education. Our proposal would make changes to the Title VII Bilingual Education program and to Title 1 (which serves more than 1.1 million LEP students) consistent with statements you and Secretary Riley made in opposing California's Unz Initiative. These statements called for (1) expanding the flexibility given to local communities to select the programs they believe will best educate LEP students; (2) making sure teachers are well trained to teach LEP students; and (3) strengthening accountability for programs serving LEP students by including a goal that all LEP students reach English proficiency within three years.

To expand local flexibility and parental choice, we would remove the Title VII provision in current law that limits expenditures on English-language (rather than bilingual) programs to 25% of the funds available. We also would require parental approval for participation in any program funded under Title VII. To improve teacher quality, we would phase in a requirement that schools receiving Title 1 funds provide LEP students with appropriately trained teachers. We also would strengthen the teacher training provisions in Title VII by giving funding priority to school districts and institutions of higher education that have implemented proven programs to hire, train, and support new ESL and bilingual teachers.

In Title 1, we would require that LEP students be included in the assessment and accountability requirements for each school. Assessments would be in their language of instruction and, after three years of schooling in the United States, in English. We would require schools to disaggregate data, so that they would report -- and be accountable for -- both the academic achievement and the English language proficiency of LEP students. We also would require schools receiving Title 1 funds to provide alternative instructional strategies for LEP students who do not make adequate progress in English proficiency after three years. Finally, we would cut off Title VII funding to a program after three years if it could not show that students made significant gains in both English and academic subjects.

C. Safe and Drug Free Schools Program. As you announced at the White House Conference on School Safety, we would significantly overhaul the Safe and Drug Free Schools Program to improve its effectiveness at promoting drug-free, safe, and disciplined learning environments. Our proposal would accomplish this by (1) requiring states to allocate funds to local school districts on a competitive basis, with funds going to the districts with the greatest need and highest quality proposals; (2) requiring local school districts receiving program funds to develop and implement a rigorous, comprehensive approach to drug and violence prevention based on proven practices; (3) requiring every school district receiving funds to have a full-time program coordinator; and (4) requiring all schools to issue report cards that include data on crime, disorder, and substance abuse.

D. Class Size Reduction. We would include authorization for our Class Size Reduction initiative in our ESEA package, since the provisions in last year's Omnibus Appropriations Act provide funding and authority for only one year. Although we do not expect Congress to enact the ESEA reauthorization this year, we believe that transmitting authorization legislation will strengthen our ability to fight for additional funds for class size reduction in the FY2000 appropriations bill. Unlike the provision enacted last year, our original proposal required local school districts to provide matching funds (an average of 20%, with a sliding scale based on poverty levels). We intend to include the matching requirement in our ESEA authorizing proposal, so that we can reach our goal of providing 100,000 teachers within 7 years. In all other respects, our proposal would reflect the agreement reached with Republicans last year, which itself was fully consistent with our original proposal.

E. School Modernization. We also intend to include our school modernization proposal, with only minor changes from the one introduced last year, in our ESEA package.

F. Ed-Flex. Our proposal to expand Ed-Flex (which gives states the authority to waive many statutory and regulatory requirements in ESEA) to all 50 states died last year, caught between Democrats who opposed granting greater flexibility and conservative Republicans who insisted on a more sweeping block grant proposal. Governors of both parties aggressively promoted Ed-Flex until the very end of the session, and Governor Carper has indicated that the NGA will take up the cause again next year. Although we believe we should continue to support some version of Ed-Flex, we will need to think carefully about the scope of the proposal. We think it would be a mistake to allow states to waive the full set of accountability provisions described above or the requirement for using class size funds to reduce class size to 18 in the early grades.

G. Preschool Education. Our ESEA proposal would retain provisions in current law allowing the use of Title 1 funds for pre-school, and would expand the Even Start Family Literacy program to reach greater numbers of children and adults. We also would strengthen the quality of pre-school programs and enhance school readiness by providing funds to local school districts, on a competitive basis, to (1) work with Head Start and other pre-school programs to identify the basic language and literacy skills that children need when they enter school and to design a curriculum to help students acquire these skills; and (2) provide professional development for child care providers and other providers of early childhood services to help children build these basic language and literacy skills.

IV. The future of Goals 2000 and continuing support for standards-based reform.

Goals 2000 has been the flagship Administration initiative promoting standards-based reform, and recent studies show that it has been successful. We do not believe we should let the program expire simply because of the political opposition it faces in Congress. At the same time, we do not believe it is wise -- either for substantive or for political reasons -- to submit a proposal that simply extends the current program. We are instead looking for a way to advance standards-based reform in a somewhat different form -- a kind of second-generation proposal that will reflect the current state of the standards movement.

Most educators agree that while states have made significant gains in developing standards, they still face great challenges in actually putting those standards into place in the classroom. To meet these challenges, schools must have talented and well-prepared teachers, who themselves have the tools — curriculum materials, instructional approaches, technology, and the like — to engage all students in learning to higher standards.

Several currently existing formula grant programs — Goals 2000, the Eisenhower Professional Development program, and the Title VI Block Grant -- could contribute to this objective. We are considering a number of approaches involving these programs, including proposals to consolidate some or all of them into a larger program, which would be designed to help move standards into the classroom and would have a strong focus on improving teacher quality. Such a proposal effectively would create a "responsible block grant," with clear purposes and accountability. Some Congressional Democrats -- including Senator Kennedy -- are also looking at this approach, in part because it would respond to the Republican push for block grants and in part because it would create a large funding stream to address issues of teacher quality. We still have much work to do on this issue, and we will outline more concrete options in a subsequent memo.

THE WHITE HOUSE

WASHINGTON

Date 1/4

To: Marin Fitzwater

From: The Staff Secretary

This is the issue we discussed briefly re: NSC/NBC correspondence. I've got a couple of ideas on how to address the problem -- give me a call when you have a moment to discuss

Phil

NATIONAL SECURITY COUNCIL

12/24

Sandy - FYI

Phil Caplan wants to talk to John Podesta about NEC's disinterest in answering POTUS mail, (backlog of NEC-related correspondence at 25 and climbing). Holly can't tackle because she's doing briefers for Lael.

Glyn

Glyn —

Make it clear to Phil / John that I would rather have nothing to do with this stream of ~~[illegible]~~ international economic correspondence which takes 3-6 mos to answer.

B

12/23

NATIONAL SECURITY COUNCIL
WASHINGTON, D.C. 20504

Phil/Sean/David

I'd like to send this to NEC in hopes it might spur some action on bad backlog of int'l econ-related POTUS correspondence. O/K? -Glyn.

INFORMATION

MEMORANDUM FOR JONATHAN KAPLAN

FROM: GLYN T. DAVIES

SUBJECT: Presidential Correspondence

Replies to the public, Members of Congress and foreign officials are one of the most important tools we have to articulate policy. The President has indicated on a number of occasions the priority he assigns to timely responses to correspondence. This memorandum alerts you to a change we are effecting to better ensure that the NSC and NEC work together to answer the President's mail on time.

Currently, the responsibility for *tracking* draft responses for all of the President's foreign policy correspondence resides with the NSC. Responsibility for *drafting* responses to letters pertaining to international economic affairs resides, however, with the NEC. This division of responsibility results in a high number of late responses to international economic affairs-related correspondence. The only way to improve this situation is to place responsibility for drafting *and* tracking this correspondence with the same organization -- the NEC.

To effect this change, I will ask the Staff Secretary to assign all correspondence that is predominantly economic in nature to the NEC for action. Of course, draft responses will still need to be coordinated with the relevant NSC staff members and Mr. Berger should cosign the memorandum to the President. However, the responsibility for assigning the correspondence for staff action and tracking the action through to completion will reside with the NEC.

Our objective in taking this step is to better serve the President. Transferring all responsibility for responding to correspondence related to international economic affairs to the NEC will empower you and help us both accomplish this objective. Please let me know if the NSC can assist you in any way as we implement this change.

Glyn- I'm with you in spirit but I'm very nervous about this system without some assurance that the NEC actually has a system. Can we talk about this?

Phil 12/23

12-29-98

To Burkhardt
for Reply

Ok - I guess so.
Any idea what
this is?

국기
KUKKIWON · WORLD TAEKW

단 증

번 호 : 090008
태권도 : 명예 九 단
국 적 : AMERICAN
성 명 : WILLIAM JEFFERSON CLINTON
생년월일 : 1946년 8월 19일

위 사람은 본원 심사 규정에 의거, 태권도 발전에 공로가 지대하므로 위 명예단을 수여함.

1998년 6월 20일

국 기 원

원장 김 운 용

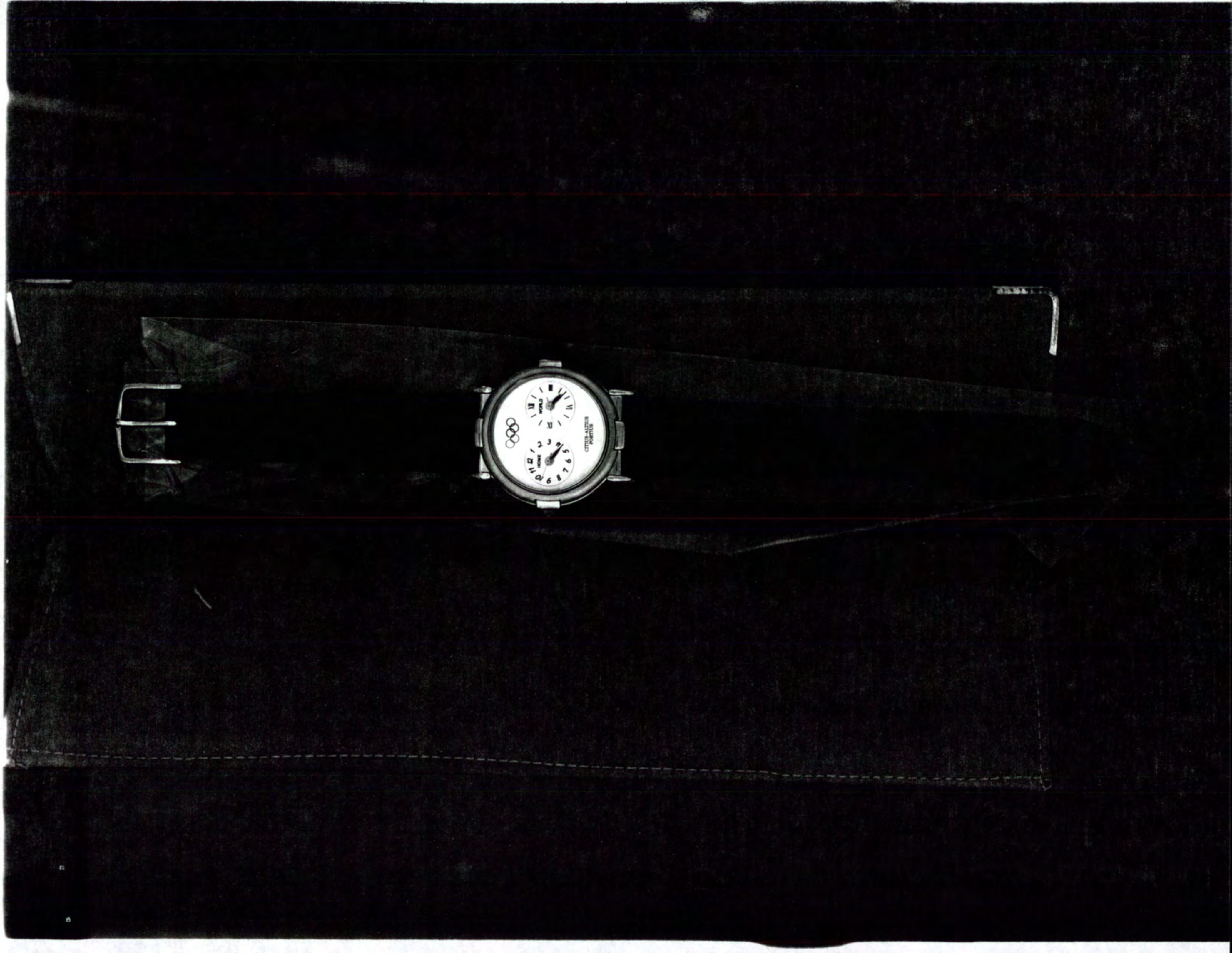
WORLD TAEKWONDO HEADQUARTERS WORLD TAEKWONDO HEADQUARTERS WORLD TAEKWONDO HEADQUARTERS WORLD TAEKWONDO HEADQUARTERS

DAN CERTIFICATE

No. : 090008 20 JUN. 1998
Taekwondo : **The Honorary** 9th Dan
Nationality : AMERICAN
Name : WILLIAM JEFFERSON CLINTON
Date of Birth : 19 AUG. 1946

This is to certify that the person named above has attained the Honorary Dan in appreciation of his/her dedicated service and autstanding contribution to the development of Taekwondo in accordance with the Kukkiwon Regulations for Promotion Test.

Un Yong Kim
President, Kukkiwon


WORLD
HOME
CITIUS·ALTIUS
FORTIUS


UN YONG KIM
EXECUTIVE BOARD MEMBER
INTERNATIONAL OLYMPIC COMMITTEE

1-4-99

To Maria

Fyi - f. Rm. [illegible]

cop'd
Echaveste
Podesta

Mr. President,

The Empowerment Zone Program has been successful in helping reinvestment in our cities.

Could you propose a similar model to encourage reinvestment in our cultural diversity in support of cultural institutions?

Kimberly Camp
Executive director & CEO, The Barnes Fdn.

1-4-99

BETH EL
CONGREGATION

קהילת בית אל דבאלטימור

Strett | Nugeon
should seriously
consider this
[illegible]

copied
Streett
Moore
Podesta

To: Mr. Steven Grossman
Mr. Michael Bronfein
Mrs. Ann Lewis
Hon. Senator Paul Sarbanes
Hon. Senator Barbara Mikulski
Hon. Benjamin Cardin, M.C.
Hon. Mayor Kurt Schmoke
Mr. Taylor Branch

From: Rabbi Seymour L. Essrog and Rabbi Mark G. Loeb

Date: November 17, 1998

Friends:

We enclose herewith a copy of the letter that we have sent to the President regarding his participation in our Rabbinical Assembly convention to be held here in Baltimore this coming April. We hope that, if you can be supportive in any way, you will either write and/or call whomever you believe would help to effectuate our request.

It is our sincere hope that the President will respond affirmatively to our letter. We hope, if you can bring any influence at all to bear on him or his schedulers, that you will emphasize that he would be coming to a very friendly audience of bona fide religious people and that it would be overwhelmingly sympathetic and respectful—i.e. the kind of group with whose image it would be positive for him to be identified. In addition, we hardly need to add that the Rabbinical Assembly connects naturally to one of his key "core" constituencies. Thank you for your support and friendship.

Taylor: Thanks for whatever you can do. If he is unable to come, could we try Hillary? Best.
Mark

CELEBRATING 50 YEARS
8101 Park Heights Avenue, Baltimore, Maryland 21208 • 410-484-0411 • Fax 410-484-0434

99th Annual Convention - April 25-29, 1999
Baltimore, Maryland

November 15, 1998

The Honorable William Jefferson Clinton
President of the United States of America
The White House
Washington, D.C.

Dear President Clinton:

This coming spring, specifically April 25-29, 1999, the Rabbinical Assembly, the international body which represents 1,200 Conservative Rabbis from North and South America as well as Israel, will be holding its last convention in this century at the Sheraton Inner Harbor Hotel in Baltimore, Maryland. Similar to the spirit of your presidency, our convention's theme will be "Facing the 21st Century: Challenges to Faith." It is our prayerful hope that you will honor us with your presence at our Convention so that we may honor you with the presentation of a special Kavod Honorial Award in recognition of your dedication to peace and your commitment to social justice.

We know that you are aware that we represent the largest religious constituency of religiously-identified American Jews in over 1,000 synagogues, the overwhelming majority of which are in the United States. While we call ourselves part of the Conservative Movement, we also presume that you are quite clear that, while we are traditional in our approach to religious practice, we are definitely on the liberal, egalitarian side of public policy and social justice issues. The Rabbinical Assembly, for example, has been at the forefront of supporting the Camp David Peace Agreements, the Oslo Peace Process and your astonishing achievement in bringing Israel and the Palestinians together in your relentless efforts to achieve peace in the

Middle East.

We would be proud to receive you during our convention in Baltimore, on any day and at virtually any time that fits your scheduling needs. The ideal times for our Convention would be the days of Monday, Tuesday and Wednesday the 26th, 27th or 28th of April, mornings or afternoons on any day, and evenings on any day except the 27th. It is our fervent hope that we may have the privilege of sharing some of your precious time and expressing our affection and respect for your great efforts to serve our nation.

It is our hope that we may receive an expeditious response to our request so that we may prepare appropriately to receive you. Whenever this may be, please respond directly to our Convention's Chair, Rabbi Mark Loeb, Beth El Congregation, 8101 Park Heights Avenue, Baltimore, MD 21208. His telephone number is 410-484-0411, FAX 410-484-0434.

With our deepest respect, we are

Sincerely,

Rabbi Seymour L. Essrog
President

Rabbi Mark G. Loeb
Convention Chair

CC: Mr. Steven Grossman
Mr. Michael Bronfein
Ms. Ann Lewis
Hon. Senator Paul Sarbanes
Hon. Senator Barbara Mikulski
Hon. Benjamin Cardi n, M.C.
Hon. Mayor Kurt Schmoke
Mr. Taylor Branch

Middle East.

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With our deepest respect, we are

Sincerely,

Rabbi Seymour L. Essrog
President

Rabbi Mark G. Loeb
Convention Chair

CC: Mr. Steven Grossman
Mr. Michael Bronfein
Ms. Ann Lewis
Hon. Senator Paul Sarbanes
Hon. Senator Barbara Mikulski
Hon. Benjamin Cardi n, M.C.
Hon. Mayor Kurt Schmoke
Mr. Taylor Branch

410-664-1406

Taylor:

I spoke with a Chip Payson (Ms Streatt was at lunch). He said he'd check into it for me and call back.

He also indicated that sometimes one can indicate that one would be equally pleased to have a visit from the First Lady or a Cabinet Secretary if the President is not available. He did check and found out that the weekend of the 24th and 25th of April is the time when the President will be in Washington to observe and to participate in the 50th anniversary of NATO, but the 26th, 27th and 28th seem possible.

Whatever you can do will be deeply appreciated.

Merry Christmas and a Happy New Year to you and yours.

Marie Loeb

'99 JAN 4 PM4:05

(TRANSLATION)

7 December 1998, Prague

Dear Mr. President, dear friend,

Please allow me to send you and your wife the most sincere greetings and to thank you, once again, for the way in which my wife and I were treated during my Official State Visit to the United States of America in September of this year.

I have the fondest memories of this visit and the visit of Mrs. Hillary Clinton in Prague. I am already looking forward to the April Summit of the NAC and the EAPC in Washington in which we will take part, hopefully, as full members of NATO.

Please allow me to sincerely wish you, your family and the citizens of the United States of America, good fortune and great success in the New Year 1999.

Sincerely yours,

(signed)
Václav Havel

His Excellency
Bill Clinton
President
Washington, D.C.
United States of America

1/4/99

Send to NSC?

Yes ✓

No

C

Prezident
republiky

V Praze dne 7. prosince 1998

Vážený pane prezidente,
milý příteli,

dovolte, abych Vás a Vaši choť co nejsrdečněji pozdravil a ještě jednou Vám poděkoval za přijetí, kterého se mně i mé manželce dostalo během mé státní návštěvy ve Spojených státech amerických v září t.r..

Na tuto cestu a na návštěvu paní Hillary u nás v Praze velmi rád vzpomínám a velmi se již těším na dubnový summit NAC a EAPC ve Washingtonu, kterého se snad již zúčastníme jako plnohodnotní členové NATO.

Dovolte, abych Vám, Vaší rodině a občanům Spojených států amerických ze srdce popřál hodně štěstí a mnoho úspěchů v novém roce 1999.

Váš

Václav Havel

Jeho Excelence
Bill Clinton, prezident
Washington
Spojené státy americké

ROK

NEW YEAR

99

Václav Havel ♡

Dagmar Havlová

Jeho Excelence

Bill Clinton, prezident

Washington

Spojené státy americké

Bill Licamele sends Margaret Carlson's article, "The Clinton in Us All" from the December 28 - January 4 issues of *Time*.

Bill
You probably saw this. If not I found it insightful.
Happy Holidays
Warm Regards
Bill Licamele

copied
Ricchetti
Podesta

THE PRESIDENT HAS SEEN
Ricchetti 1-4-99

good piece

[illegible]

[illegible] copy

PUBLIC EYE/ Margaret Carlson

THE PRESIDENT HAS SEEN
1-4-99

THE CLINTON IN US ALL

Those who hate him seem to bear more than a passing resemblance to him

MY FAVORITE COMMANDMENTS ARE THE EASY ONES. I DON'T covet anyone's spouse; I don't want to kill anybody. A day of rest? No problem. But I'm in a constant struggle with the commandment Republicans have chosen as the one needing the full force of government sanction: Thou shalt not lie. I know honesty is the best policy, but I've been known to try the second-best policy when I have to justify the fact that the Christmas tree isn't up or that I haven't watched every minute of the historic debate TIME magazine pays me to cover.

But that's me. Republicans apparently never, ever tell a lie. Moreover, they don't count the other sins as sins unless compounded with a lie. Mother Marita Joseph didn't see it that way. Who would have thought the family-values party would be saying, in the interest of distinguishing Clinton's behavior from its own, "It's not the adultery, stupid; it's the lying." When it seemed last Thursday that the world couldn't spin any further out of control—bombs falling in eerie green light, members of Congress starring in a morality play without the morality—here was Speaker-elect (although not for long) Bob Livingston announcing that because he wasn't "running for saint," his occasional affairs shouldn't be held against him. He called what he did "straying," said he had "sought spiritual counseling," and "received forgiveness" from his family. Sound familiar? Lest this remind anyone of you-know-who, he asserted, "These indiscretions were not with employees on my staff, and I have never been asked to testify under oath about them."

Not quite an instant classic in a league with "It depends on what your definition of *is* is," but it had promise as hairsplitting of a high order. For one thing, no one had charged that Monica Lewinsky was hit upon against her will, as Livingston implied. And the Livingston rationale ignored his good fortune in having Larry Flynt, not Ken Starr, with his subpoenas and a grand jury, pursuing him. Thus Livingston could cling to the claim that in a sting operation run by a desperate prosecutor, he was the kind of guy who would have come clean. But the ultimate parsing in Livingston's comments was contained in his description of who it is he had slept with. He hadn't strayed with an employee, he said, skipping over the issue of whether his indiscretions might have caused a different set of problems. That discussion might have required too much parsing even for this Republican. And so he quit.

In any case, this is the kind of legalism we hate Clinton for, and it misses what matters. The worst part of cheating on your spouse is what it does to your marriage, not what it does to your oath taking. To take such an important aspect of yourself and give it to someone else is to live the biggest lie imaginable, whether or not it's repeated in court. Lately there's been a terrible tendency to dismiss adultery lightly if no official lying is involved. Henry Hyde describes a long affair with a married mother of three as a youthful indiscretion (he was 41); Dan Burton says his affair with a state employee and the secret child it produced is O.K. because he pays child support; Helen Chenoweth excuses her affair with a married man who was a business associate because she wasn't married and it took place *before* she was elected. What message does that send the children?

DIANA WALKER FOR TIME

And the rule for Republicans seems to be that lying under oath about things other than adultery is not actionable. Hyde explained this standard best when excusing lies in the Iran-*contra* affair. It did not make sense, he said, to "label every untruth and every deception an outrage ... in the murkier grayness of the real world, choices must often be made." Ronald Reagan could remember very little about his efforts to arm the *contras*, but when confronted with facts indicating that he'd been told about it, he insisted his "heart and [his] best intentions" proved otherwise. After Ollie North bragged about his own lying and got off on a legal technicality, the G.O.P. wanted him to be the Senator from Virginia.

The Clintons on a boat ride in Botswana after a safari last April

We all have a little Clinton in us, and like it or not, that's one of the reasons he remains so popular. At the same time—and it's part of the same truth—those who hate Clinton the most seem to have more than the average share of him inside them, which may be one reason that spittle forms at the corners of Representative Bob Barr's mouth when he talks about the President. Hear his Clintonian combination of self-pity and feigned ignorance after he was called a racist for addressing the Council of Conservative Citizens, a group that proudly calls itself white supremacist. "It is a sad day in our country when a member of Congress cannot speak without ... an exhaustive investigation to determine if one of their members has ever written an offensive or ridiculous column."

Clinton isn't above the law, but he should be above doing what he did. Livingston's resignation and the impeachment of Clinton teach children exactly the wrong lesson: that other people's deepest secrets can be plundered for political gain. Clinton is weak, not evil. He violated the Commandments, not the Constitution, and should be solemnly censured for it. In this season of Christmas, perhaps some Wise Men will appear in the Senate. One will do. If he comes, he could be next year's Man of the Year. ■

Proctor Jones
3625 Sacramento Street
San Francisco, CA 94118-1914
Telephone: (415) 922-9222

Staff secretary

December 21, 1998

I don't know what you want to with this - Dawn

President of the United States
The White House
Washington, D.C.

'99 JAN 4 PM4:16

Dear Mr. President:

Harry Ward and I are co-fathers-in-law and now co-grandfathers! I am the lucky one because little Alice lives in San Francisco and adds to the happiness of each day.

You and I have had dinner together twice in San Francisco and once in Paris at the Elysée Palace. I say these things not to impress you but whoever reads this material first. I also provided you with copies of my work on Napoleon Bonaparte.

The xerox material I enclose for you represents a scholarly and readable analysis, written circa 1930, of Andrew Johnson's impeachment procedures. You will see that past events have certainly cast their shadows to this very day, re-enacting the same scenario with the same miserable personalities.

It is possible that the Library of Congress will have a copy of The Age of Hate. If it does not, information contained in this material should be of some importance to you and to your advisors.

Sir, be assured of the loyalty of people like myself who are incensed by the vicious acts of unconscionable people.

Courage!

1/4/99
Send to Burkhardt?
Yes ✓
No

Proctor Jones, J.D., D.F.A.

I don't know what you want to with this - Dawn

Fax: (415) 922-8837

"The history of mankind is the history of its great men; to find out these, clean the dirt from them, and place them on their proper pedestal, is the true function of a historian."

CARLYLE.

THE AGE OF HATE

ANDREW JOHNSON AND THE RADICALS

by

GEORGE FORT MILTON

NEW YORK
COWARD-McCANN, Inc.
1930

Printed in the U. S. A.

1-4-99

To Leg. Affairs for reply?
Yes ___ No ✓

FAX TRANSMIS

ROSEWOOD CARE CENTER
1911 OAK PARK BLVD.
PLEASANT HILL, CA 94523
(925) 935-6630
FAX: (925) 933-0583

To: President Clinton Date: 1/4/98

Fax #: 202-456-~~2467~~ 2215 Pages: 2, including this cover sheet.

From: Meg, ~~Admissions~~

Subject: Joanne Bluer's Peace Prayer.

COMMENTS: Dear President Clinton -

Joanne Bluer, a resident at our skilled nursing facility, wanted me to share the following "Peace Prayer" and the tribute to her.

Thank you,

Meg

Vol. 140 WASHINGTON, THURSDAY, MARCH 10, 1994 No. 26

Congressional Record

Joanne — you are an inspiration to us all!

Congressman Bill Baker

TRIBUTE TO JOANNE BLUER

HON. BILL BAKER

OF CALIFORNIA

IN THE HOUSE OF REPRESENTATIVES

Thursday, March 10, 1994

Mr. BAKER of California. Mr. Speaker, I rise today to pay tribute to a survivor of polio, heart disease, lung disease, and breast cancer. She is Joanne Bluer, a Jewish-American poet from Walnut Creek, CA.

Her heroic struggle should serve as an inspiration to us all.

Among her most recent accomplishments is a book of poetry entitled "I Believe * * * The Thoughts of Joanne Bluer."

I would now like to share with you her poem "Peace Prayer."

PEACE PRAYER

I stand, or should I say "kneel" before Thee, O Lord
Not as a beggar, but as a child kneels before the flame
And watches the fire rising as a strong compound an falling as ashes.

I'm scared and I seek your strong hand to guide me.
Why should I be afraid? Why, why?
Because my legs are only flesh.
My steps are only human mechanisms.
The spirit that should rise and lift me above all that is of the world is lacking.
It's not gone, just withered and tired.

Help us have faith in You, so that we may rededicate our lives to Your truths and laws of reason and respect for all.

In these troubled times, good people reach out to good people.
It is not black and white, yellow and red.
It is good against evil.
As Rousseau said, "Evil triumphs because men of good will do nothing."
He also said "Man is neither good, nor is he bad. He is neutral and can be influenced to change and can be corrupted by the society in which he lives."

These are important points
Because people can initiate change
And they must do so now.
All good people must pray together
And what is more important,
Must work toward this end actively and with great hope in their hearts.
I hate to think how our society will hemorrhage if we fail now.
We must not fail.

World Poetry Day was Oct. 15 and to celebrate, the residents and staff members of SunRise Rosewood Care Center, on Oak Park Boulevard in Pleasant Hill, took part in a poetry reading.

Featured were works by resident **Joanne Bluer**, a Bay Area poet and winner of the 1992 International Poet of Merit Award that was presented by the International Society of Poetry.

"Joanne started writing when she was 8 years old and became a serious poet at age 14 when she contracted polio," said **Meg Jefferson**, admissions coordinator, in a news release.

"Her poetry is joyous in its expression, and is, in spite of a life of illness and disability, both optimistic and life-affirming. Instead of letting her world contract, Joanne has always been determined to expand her horizons and reach out to others."

Although she's confined to a wheelchair and must live in a skilled nursing facility, she continues to write poetry and giving poetry readings to churches and other community groups.

Anyone interested in contacting Bluer at SunRise Rosewood can call her at 935-6630.

ABOUT JOANNE BLUER