My comments focus on four major areas of international economic policy in the Clinton years. Bear in mind that actual policy actions represent a mixture of what is economically desirable and what is politically feasible. One way to judge economic policies is the degree to which they sacrifice economic efficiency and welfare for short-term political advantage. Another standard by which we should judge policy decisions and actions is the degree to which the policy benefits the present at the expense of the future or the reverse. And all administrations must choose where they will devote time, energy and political capital. We can judge their priorities both to praise good choices and criticize what they neglected.

At a deeper level, we should inquire whether an administration's actions served to strengthen democratic government, the rule of law, and the protection of personal and property rights. Policy actions are often a response to events, rather than a deliberate choice of a policy path. The Clinton administration responded to crises in Mexico, Asia, Russia, and elsewhere. Crisis response often is the occasion for actions that stretch the meaning and intent of laws. This was certainly true in the 1990s.

Trade Policy

The Clinton administration had two different trade policies. One sought to open markets. It produced ratification of the Uruguay Round of trade liberalization and the approval of the North American Free Trade Agreement (NAFTA). Purists may criticize NAFTA for the trade diversion that it created or the administration for emphasizing, incorrectly, job creation instead of productivity and welfare enhancement. These pale beside the accomplishment. President Clinton and his administration put much energy and political capital into getting ratification.
This was a real achievement, against strong opposition, much of it coming from its own core constituencies, the labor unions and the environmental activists. The administration later followed these achievements by working effectively to win Congressional support for admission of China to the World Trade Organization, again working for long-term benefits, providing a public good and sacrificing the interests of its own constituents.

The other side of the ledger shows two major failures. First is the failure to get new negotiating authority (called fast track) to work out an agreement with Latin Americans or another round of global market opening. To an outsider, the administration seemed unwilling to mount an effort comparable to the effort it had used for NAFTA or China. Freer trade creates a global public good. The United States failed to lead the region and the world toward greater openness. This was a failure of Clinton policy, a choice of narrow, short-term political advantage over long-term benefit to us and others.

The President compounded this failure in Seattle by scuttling his administration's initiative for a new round of negotiations. This time President Clinton pandered to the labor union activists and the crowds in the street by supporting labor and environmental provisions that were unacceptable to most developing countries. This action sacrificed the economic development of emerging market countries through trade for electoral support of domestic anti-trade groups. It sacrificed extensions of the rule of law for domestic political advantage.

The Strong Dollar Policy

Rhetoric aside, it is hard to know what this policy is. Economists understand that changes in the nominal exchange rate---the rate that is quoted in the market---have little lasting importance. The only ways to weaken the dollar in more than a temporary way are to either inflate faster than our trading partners or slow productivity growth relative to growth abroad, say by taxing capital or investment heavily.

The dollar strengthened after the middle 1990s in large measure because U.S. productivity growth increased. With higher productivity growth, relative to Japan, Europe, and many other parts of the world, capital flowed here from abroad. The capital inflow is the way foreigners share in the higher profits and expected future profits that new technology is expected to bring. Because the increased productivity growth reflected, in part, new techniques, new processes, and new products, foreign companies invested directly, usually by buying U.S.
companies. Other foreign firms bought hotels, retailers, theaters and other domestic firms that profited from the spending boom. And foreign investors bought shares in U.S. companies.

The strong dollar resulted from the individual decisions of individuals and firms abroad, not from the administration's dollar policy. There was a surge of foreign investment toward the U.S. The appreciation of the dollar was not policy induced.

What can we say about the rhetoric? What does it mean to say we have "a strong dollar policy?" Perhaps it means that administration officials did not criticize the Federal Reserve publicly or insist on lower interest rates and more inflation than Federal Reserve actions produced. This is commendable and a great improvement over the rhetoric of its predecessors in the Bush administration. It is praiseworthy. But we should not confuse rhetoric with substantive policy.

The exchange rate is a price. With a floating exchange rate that price adjusts to current and anticipated future economic conditions here and abroad. A floating exchange rate is a policy. Given the floating exchange rate, it is hard to know what a strong dollar policy is.

Financial Crises and International Financial Institutions

The size and frequency of international financial crises increased dramatically in the 1980s and 1990s. Latin America, Mexico, Asia, Russia, Brazil, and most recently, Argentina and Turkey drew hundreds of billions of dollars in rescue packages. Two nearly universal features of these rescues were, first, moral hazard, lenders suffered few losses, while the citizens of the affected countries suffered often-devastating losses of real income. Second, the International Monetary Fund (IMF) often pressured by the Clinton administration, insisted on a lengthy list of conditions because, as former Secretary Summers has said many times, crises provide excellent opportunities for insisting on reforms. The current IMF management has now recognized that most of these reforms had no bearing on a country's liquidity, solvency, or macroeconomic stability. This was a command and control system with a vengeance.

The command and control system had many flaws; two are major flaws. First, it subverted democratic processes. Although I deplore the methods chosen by the street demonstrators, many of their criticisms of the command and control system are correct. Second, for better or worse, the command and control system is ineffective. While there are difficulties in all studies of the effect of IMF conditionality, most find no significant effect on real income.
The safest conclusion at this stage is that any positive effect is small. Certainly, no strong, positive effect leaps out of the data, whether the research is done within or outside the IMF.

Recently, the World Bank has advanced roughly $20 to $30 billion a year for poverty relief and economic development. The largest part, about 70%, goes to middle income countries that can borrow in the international capital markets. For example, China receives $60 billion annually in private investment and loans from the capital market. It pays an interest rate only slightly higher than the rate at which the World Bank lends. Why should the World Bank lend to China? Would not the benefit be much greater if the Bank financed effective programs in poor countries? As Jeff Sachs has emphasized, elimination of tropical diseases, and improvements in tropical agriculture and forestry are examples of programs that could benefit many people in very poor countries.

In 1999, Congress voted to establish a Commission to consider reform of the principal international financial institutions. The Clinton administration vigorously opposed establishment of the Commission. It agreed, finally, as the price of getting congressional approval of $18 billion in additional funding for the IMF.

The international financial institutions have important roles to play. The Report of the International Financial Institution Advisory Commission called on the International Monetary Fund (IMF) to supply three valuable public goods: first, improvement in global financial stability and reduction in the magnitude and frequency of financial crises; second, improvement in the quantity and quality of information available in the market and in the timeliness of that information; and, third, provision of the services of a quasi-lender of last resort during financial panics.

The Commission's most important reforms proposed an incentive system for the failed system based on command and control at the IMF and proposed far-reaching reforms of the World Bank and other development banks. These reforms would increase efficiency and effectiveness of multilateral development finance by making grants instead of loans to raise the quality of life in the poorest countries of the world, by providing incentives for initiating and sustaining the structural reforms necessary for permanently raising living standards, and by financing regional and global public goods.

To this observer, admittedly an interested observer, the Treasury's response can only be characterized as hostile. The administration made prodigious efforts, including telephone calls
from President Clinton and Secretary Summers, to members of the Commission urging them to oppose the report. These efforts failed to prevent a bipartisan vote in favor of the Report. Later, the Treasury rejected every major recommendation in the Report when it submitted the comments required by Congress. This hostility seems strange and counterproductive in view of the more cordial reception of the proposals at the IMF and the later endorsement by Secretary Summers of the proposal for grants.

I can only speculate on the reasons. There is, first, IMBIBU--it must be invented by us. Second, was a commitment to command and control practices, a belief that we can impose policies on countries in times of crisis. The Commission rejected this approach as flawed and unproductive. It subverts democratic processes abroad, encourages resentment and street demonstrations, and undermines institutions like the IMF, the WTO and the development banks that, if restructured, would remain as important providers of public goods.

In the 1994-95 Mexican crisis, the Clinton administration, with connivance of the Congress, used the Exchange Stabilization Fund (ESF) to lend money to Mexico. This action was extra-legal. The ESF, created to support the dollar was used as a ready slush fund to avoid the budget process after Congress showed little inclination to approve a large loan to Mexico. Actions of this kind subvert the budget process and undermine the rule of law.

The Clinton administration developed a modern version of the medieval morality play. When the play's action reached a point at which it became impossible to bring the pieces together, it was time for the Deus ex machina. God descended in a basket and resolved all conflicts. In the Clinton years, the Treasury and the IMF rode in the basket. The *Deus ex machina* was cash to prevent default by the debtor. Few lenders lost money. Often they earned substantial fees for restructuring the debt. Risk and return were separated. Moral hazard, excessive reliance on short-term capital to finance long-term development, and weak financial systems that relied on short-term capital increased the risk of crises and instability.

**Japan**

Japan's problems are mainly homemade. Mainly, but not entirely. The U.S. Treasury had a role, too. It recommended publicly, and I am told privately, that Japan should rely on fiscal stimulus and avoid sufficient monetary stimulus to depreciate the yen/dollar exchange rate. In the Japanese system, fiscal stimulus meant increased government spending, and spend it did.
Japan has little to show for its massive fiscal spending except some social capital, much of it with low productivity, and the largest ratio of public debt to GDP of any developed country. Unemployment in Japan is now higher than in the U.S. for the first time in fifty years. Deflation persists.

In 1998, monetary stimulus showed signs of depreciating the exchange rate. The yen/dollar exchange rate depreciated to 145 in June from about 100 a few months earlier. Then Deputy Secretary Summers came to Tokyo and ended that policy. The yen soon appreciated to 105, a massive and foolish change in an economy with falling prices and rising unemployment.

The policy was mistaken, wrong, and it failed. The major mistake was a failure to recognize that the yen was overvalued. If Japan could not depreciate its nominal exchange rate, prices had to fall until Japan had a real exchange rate that was consistent with steady growth and stable prices. This took time and is still continuing. Where was the strong dollar policy?

This failure was extremely costly to Japan, to Asia, and to us. A stronger, more rapidly growing Japanese economy would certainly have mitigated, and possibly prevented, the Asian financial crisis. Japan would serve as a source of demand for Asian exports now, when U.S. demand has slowed.

A lesser Asian crisis would have avoided the unsustainable U.S. current account deficit. The Federal Reserve would not have found it necessary to use heavy monetary stimulus in 1998-99, running the risk of higher inflation to prevent the Asian crisis from spreading and deepening. Our expansion permitted many Asian countries to export their way out of the crisis, but the stimulus also helped to produce soaring stock prices and their aftermath.

Do not misinterpret what I have said. Under the circumstances, the administration and Federal Reserve program was the right policy in the Asian crisis and its aftermath. The world economy would be much worse, if the U.S. failed to expand. But the expansion might have been unnecessary and would certainly have been smaller, if the Japanese economy had not followed the Clinton administration’s advice or if the advice had a more long-run, and less of a short-term U.S. domestic political orientation.

The Clinton administration talked endlessly about its prudent fiscal policy and the budget surplus they left behind. They don't mention that they also left a large current account deficit that cannot be sustained permanently. We have not seen the end of that story. We can hope the
ending will come slowly so that the story ends happily. But, we do not know that, and we cannot
draw a final conclusion about the record of the 1990s until we do.