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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

February 12, 1999

SECRETARY OF THE TREASURY

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MEMORANDUM FOR THE PRESIDENT

FROM: Robert E. Rubin *RSR*
SUBJECT: French President Chirac's Visit

Since international finance is likely to be one of the major themes of your discussion with President Chirac, I thought it might be helpful to review the major points I expect President Chirac will make with you on international finance and tell you how I think we should respond.

President Chirac's Objectives

President Chirac apparently has three key objectives: (1) to give a political push to global financial reforms (he may offer to host a summit of leaders from the emerging market economies and industrial countries this summer); (2) to make the case that the United States and Europe have a global responsibility to provide "stability" between the euro and the dollar and to gain U.S. agreement for greater G-7 cooperation on exchange rates; and (3) to present the euro in a positive light, and informally position himself as the leading spokesperson at the leaders' level for the "eurozone." President Chirac also may want to discuss European representation in the G-7, French proposals for IMF reform and debt relief.

President Chirac is planning to meet with the IMF's Managing Director, Michel Camdessus, and the President of the World Bank, James Wolfensohn, the day before he meets you.

International Financial Architecture

President Chirac is reported to have been impressed by your Council on Foreign Relations speech and is in broad agreement with its main points. However, Chirac may make some specific proposals which we oppose. You will want to stress the importance we attach to producing a set of sensible reforms to improve the international financial system. We think the needed reforms should be centered around building stronger incentives for emerging markets to adopt sound policies and for getting markets to pay more attention to the risks of certain types of financial activity, and examining changes in the roles of the IMF and the private sector in crises.

It also important to focus attention on the concrete steps we are taking to reform the financial architecture. We hope that Chirac will support us in pressing for implementation in existing areas of G-7 agreement, such as the proposed Contingency Credit Line in the IMF.

Exchange Rate Coordination

President Chirac is likely to call for “a system of enhanced cooperation” among the G-7 to assure a “satisfactory degree of exchange rate stability among the dollar, euro and yen.” This system, according to the somewhat vague reports we have heard, would include closer international surveillance of exchange rates, particularly the dollar/euro rate, and strengthened co-operation on macroeconomic policies. We support strengthening the G-7 process to assure better policies for coordinated growth in G-7 economies, but agreeing to French proposal for enhanced cooperation on exchange rates does not make sense, for a number of reasons.

- Our priority should be the promotion of strong, coordinated policies to promote growth. Exchange rates are not a particularly effective tool for this -- indeed, attempts to constrain exchange rate movements could force us to adopt pro-cyclical policies at times. Exchange rate movements are likely to be symptoms, rather than causes, of disparities in our recent economic performances.
- Coordination in support of current levels -- the obvious benchmark -- could help lock in the trend of increasing U.S. current account deficits. France’s desire to stabilize exchange rates may be linked to a desire to keep the euro “competitive” and facilitate export-led growth, which is more palatable than the difficult structural reforms needed to jump-start their economy.
- Markets might misinterpret any statement about exchange rate coordination as implying some commitment for U.S. policymakers to act in ways that may not always be beneficial to the U.S. economy. Markets may (correctly) judge such a commitment to be non-credible, thereby threatening the credibility that the administration has worked hard to earn over the past six years.

I would recommend that you respond to Chirac’s proposals by arguing that our priority should be the promotion of strong, coordinated policies to promote growth. The U.S. has long been the main engine of growth in the world economy, but the current imbalance in growth is not sustainable. Schemes that focus on exchange rates focus on the symptoms, rather than the cause, of disparities in economic performance. You might also want to note that inappropriate swings in exchange rates are best dampened by sound and credible policies in all countries.

Leaders’ Summit on Global Financial Reforms

President Chirac previously has suggested a meeting of the heads of state of the countries represented on the IMF’s Interim Committee. He may renew his offer to host such a meeting later this year to give political impetus to architecture reforms. If he does, you should emphasize that such a meeting could raise expectations that might not be met and that we need to figure out what specifically we can do in terms of concrete reform before we delve into the mechanics of a new summit. We also question whether the Interim Committee brings together the right group of countries. You could point out that President Chirac’s desire for progress on architecture would

be best served by focusing on the immediate G-7 process, the next step of which will be "G-7 plus" outreach to involve a broad group of countries.

French Agenda for IMF Reform

President Chirac may raise French proposals to transform the IMF's Interim Committee into a Council that would provide the IMF with greater "political" guidance. We do not support the French proposal to create a Council. It is, at best, a solution in search of problem, and at worst, likely to prove counterproductive. It does not address what we consider to be the core problems with the Interim Committee: the existing constituency system does not provide for adequate representation of emerging markets (Europeans, in contrast, are over represented) and Interim Committee meetings are overly formal, poorly attended and fail to provide opportunities for real dialogue. Plus, creating a Council risks upsetting the governing structure of the Fund and undermining the effectiveness of the Fund's current Executive Board. We support reforms to make the Interim Committee more representative and favor more frequent, and less formal meetings at the deputies level rather than more frequent formal ministerial meetings.

If President Chirac raises the subject, you should emphasize that the U.S. is committed to making the Interim Committee more effective but does not want to undermine the effectiveness of the IMF. You should also note that finance ministries are working on this topic.

Debt Relief

German Chancellor Schroeder's recent statements on broadening and deepening the debt relief initiative for the heavily indebted poorest countries (HIPC) are welcome. They reflect positions that United States and others have taken for some time. But as it currently stands, this initiative is under funded. G-7 finance ministries have been tasked to produce concrete proposals for the Summit. You may want to indicate how important it is for the United States and France to work together to flesh out realistic debt relief proposals.

Regulation of Capital Movement

President Chirac may push for more transparency and disclosure from "hedge funds" and stricter regulation of off-shore financial centers. You may want to note that we are working on the difficult, technical questions raised by "hedge funds" in the President's Working Group on Financial Markets. France (like many other countries) does not have "hedge funds" although French banks can and do lend to them, and engage in similar activities.

France also has emphasized the importance of orderly and gradual capital account liberalization and proposed allowing emerging markets with a liberalized capital account to employ emergency "financial safeguards" in the event of severe instability. You should note that we are also concerned about the boom/bust cycle in emerging market finance. We think the right solution is improved policies in emerging markets and more disciplined investment decision in industrial countries (including better regulation), not heavy-handed controls on capital flows.

Global and European Economic Outlook, EMU

January's launch of the European Economic and Monetary Union proceeded smoothly, but we are concerned about slowing growth in Europe. France's economy grew at 3% in 1998, but is estimated to slow to 2% in 1999 – too slow to reduce France's 11.5% unemployment rate. Japan's recession and the increasing U.S. current account deficit have made it more critical that France and other European countries tackle politically difficult structural reforms to enable domestic demand led growth to accelerate and support global growth prospects. In addition to indicating that the priority now in Europe should be on policies to promote growth, you may want to ask President Chirac to join us in urging that the Government of Japan take aggressive actions to stimulate its economy.

Euro Representation in the G-7

Following the creation of the euro, the Europeans have proposed including the President of the European Central Bank, the European Commission and the finance minister in the presidency of the Euro-11 council in the G-7 process. We have resisted expanding the group's size to preserve its small, informal working nature. The Treasury Department and the Federal Reserve are working with their European colleagues to identify the appropriate way forward here.

Talking Points on Global Economic Issues Meeting with French President Chirac

Financial Architecture

- The United States attaches great importance to producing a set of reforms to improve the international financial system. We think the needed reforms should be centered around building stronger incentives for emerging markets to adopt sound policies and for getting markets to pay more attention to the risks of certain types of financial activity, and examining changes in the roles of the IMF and the private sector in crises.
- We strongly support reaching out to other countries in a global dialogue and are looking for your support on this, through the G-7 plus process.
- It also important to focus attention on the concrete steps we are taking to reform the financial architecture. We hope that you will support us in pressing for implementation in existing areas of G-7 agreement, such as the proposed Contingency Credit Line in the IMF.

Exchange Rate Coordination

- Our priority should be the promotion of strong, coordinated policies to promote growth. Exchange rates are not a particularly effective tool for this – indeed, attempts to constrain exchange rate movements could force us to adopt pro-cyclical policies at times. Exchange rate movements are likely to be symptoms, rather than causes, of disparities in our recent economic performances.
- Markets are very sensitive to signals about exchange rates. A statement calling for greater coordination on exchange rates could be viewed as signaling a change in our policy, which ultimately would not be credible.
- The experience of Europe shows that tremendous political will and economic convergence is required for a concerted monetary and exchange rate policy. The current situation among G-7 countries differs from Europe in this respect.
- Inappropriate swings in exchange rates are best damped by sound and credible policies in all countries. The G-7 process is a dialogue in which we hope to learn from each other in an attempt to reach better policies. We certainly favor strengthening the G-7 process, in particular, to assure better policies for concerted growth.
- I understand that Secretary Rubin, Minister Strauss-Kahn, and their G-7 colleagues will explore these issue further this weekend.

Global Economic Outlook and Japan

- U.S. economy is still strong. But it is very important that Europe and Japan strengthen domestic demand.
- To date, the United States has born the entire burden of current account adjustment from the crisis countries; this cannot continue.
- We think the priority now in Europe should be on structural and other policies to bolster growth and hope you will join us in urging that the Government of Japan take aggressive actions to stimulate its economy.

If raised: French Proposal for a Leaders' Summit on Global Financial Reform

- A meeting of the heads of state on global financial reform could raise expectations that could not be met. We need to figure out what specifically we can do in terms of concrete reform before we delve into the mechanics of a new summit.
- We also question whether the Interim Committee brings together the right group of countries.
- Our common desire for progress on architecture would be best served by focusing on the G-7 process, including the planned G-7 plus outreach to emerging markets.

If raised: IMF/ Elevating the Role of the Interim Committee

- The United States is committed to making the Interim Committee more effective but does not want to undermine the effectiveness of the IMF. Our finance ministries are currently working to do this.

If raised: Speculative Capital Flows/ Capital Controls

- I am also concerned about the boom/bust cycle in emerging market finance. We think the right solution is improved policies in emerging markets and stronger incentives for more disciplined investment decisions in industrial countries, not heavy-handed controls on capital flows.

Debt Relief

- It is extremely important for the United States and France to work together to flesh out concrete and realistic proposals. German Chancellor Schroeder's recent statements on broadening and deepening the debt relief initiative for the heavily indebted poorest countries (HIPC) are welcome: they reflect a position that United States and others have taken for some time. The key problem to be resolved now is funding.

Euro

- Your leadership was critical for the successful launch of the euro. I sincerely believe that if EMU (Economic and Monetary Union) is good for Europe, it will also be good for the United States.

If raised: Euro Representation in the G-7

- Important to find solution to representation issue that is sensitive to Europe's needs, yet preserves the small, informal nature of the group.
- Decisions about informal meetings at the ministerial level are best left to the ministers themselves.



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

January 29, 1996

SECRETARY OF THE TREASURY

MEMORANDUM FOR THE PRESIDENT

FROM: Robert E. Rubin *ER*

SUBJECT: Visit of French President Chirac

I want to make you aware of two issues that the French President is likely to press you on in your meeting on February 1:

First, President Chirac is likely to seek your support for an initiative at the Lyon Summit to improve international monetary stability. I would advise you to discourage him from putting commitments to limit exchange rate fluctuations up for discussion.

Everyone would rather not have big exchange rate swings like we saw last spring. Then, the dollar dropped more than 20 percent against the yen and 14 percent against the German mark before recovering with help from purchases of dollars by us and other major countries. But the costs of limiting swings in exchange rates can be much higher than the costs of letting the markets run until conditions are favorable for turning them around. In addition, there are times when exchange rate adjustment is needed. We were not willing to have the Fed raise interest rates and derail the domestic economy in order to keep the dollar from declining a year ago. Looking to the future, we don't want to boost the importance we attach to exchange rates further, lest we be faced with a choice between raising interest rates or not doing what we promised on exchange rates.

Buying and selling currencies cannot be counted on to do the job without interest rate adjustments. And, as European experience has shown, even large interest rate increases sometimes fail to do the job. The French have been through this, most recently in 1992, and Chirac has consequently been lukewarm about re-fixing a tight link between the French franc and the German mark. But he would love to have others on the hook in the hope that this would reduce the cost to France of maintaining fixed parity with the mark.

Exchange market developments have been reasonably favorable since last spring, and this is not the time to contemplate a change in an approach that has, on the whole, served us well.

CLINTON LIBRARY PHOTOCOPY

Chirac may propose an alternative approach to improve monetary stability, where we could find more common ground. He is concerned about the role of financial derivatives as a destabilizing force in the market. I think this is way overdone by the French -- speculative players in these markets are froth on the massive global financial market. Moreover, they are not completely free of supervision. Nonetheless, there are issues here that merit close attention internationally. I am more concerned about risks of failures in these markets than in any contribution to exchange rate volatility. Supervision by both management and the regulators has not kept up with innovation. It is worth giving ample attention to supervision of these cross-border markets, as was agreed at Halifax. Another push to the regulators at the Lyon Summit would be useful, although the French would probably go too far in stifling innovation if we let them.

Second, Chirac is likely to raise IDA, the World Bank's concessional lending facility for the poorest developing countries. He will likely be extremely critical of our failure to meet our commitments to IDA and the other multilateral development banks, and our inability to commit to participating in the next IDA replenishment. He may note G-7 commitments made in Halifax to support IDA. This is a serious problem since it will take an increase from 1996 appropriated funding levels just to make up our outstanding arrears in this fiscal year. Meanwhile, the rest of the world is ready to go forward with new commitments of multilateral assistance to the poorest countries. I recommend that you stress: 1) that you are committed to participation in IDA; 2) that you have made meeting existing U.S. commitments to IDA a top priority; and 3) that we are working hard to be in a position to pledge a new U.S. contribution -- at a credible level with realistic prospects of Congressional support -- at the earliest possible date.