

# *Strengthening the Global Economy: A Report on the Bush Administration Agenda*

A FOCUS ON RAISING PRODUCTIVITY GROWTH AND INCREASING ECONOMIC STABILITY

By John B. Taylor



*John B. Taylor was appointed Under Secretary for International Affairs, U.S. Department of the Treasury, by President Bush in 2001. He is a globally recognized expert on international monetary and financial issues, and he serves as the principal adviser to the Secretary of the Treasury on*

*those issues. His previous government experience includes serving on the Council of Economic Advisers. He was a professor at Stanford University, where he received numerous awards for excellence in teaching. He is the creator of the Taylor rule for monetary policy. He received a BA in economics summa cum laude from Princeton University and a Ph.D. in economics from Stanford University.*

*The Bush Administration's international economic agenda emphasizes increased economic growth and improved economic stability throughout the world. However, effective international policy begins at home, and the macroeconomic policies are in place for sustained, non-infla-*

*tionary U.S. growth. On the international side, the Administration is focused on raising productivity growth in the industrialized countries, emerging markets, and the developing world. Because there is little the U.S. can do to remedy the structural problems that are holding back growth in Japan and Germany, much of the Administration's focus is on developing and emerging economies. For developing economies, much of the emphasis is on increasing assistance to those developing countries that pursue constructive growth policies. Much of this increase is through multilateral agencies as well as direct bilateral assistance. For the emerging market countries, policy focuses on improving conditions for private investment by better preventing financial crises, reducing contagion when crises do occur, reducing reliance on official finance packages, and increasing predictability in the sovereign debt restructuring process. Free trade is another cornerstone the Administration's international economic policy; and now that the President has trade promotion authority, free trade negotiations will move ahead quickly on several bilateral and multilateral fronts. Removing terrorist access to finances and rebuilding Afghanistan have been unanticipated additions to foreign economic policy, and the Administration is moving forward in these areas, as well.*

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**I**t is a pleasure to have the opportunity to discuss the international economic policy agenda of the Bush Administration with fellow economists—to give a brief overview of key goals and to highlight some of the important accomplishments. The Administration's international economic agenda was big when we came into office last year, and it has grown, especially since the September 11 terrorist attacks. But I believe that we have stuck to our overall strategy and have made good progress on implementing the strategy, even as we have added such items as terrorist financing and Afghanistan reconstruction to our agenda, as I discuss below.

Two goals have guided our international economic agenda: (1) increasing economic growth, as measured by improvements in productivity and higher per capita income, and (2) improving economic stability, as measured by a reduction in the severity, length, and frequency of economic downturns and crises. These goals apply to the United States, to other industrialized nations, to emerging market countries, and to the developing world as I will now try to make clear.

### **Economic Growth and Stability in the United States and Other Industrialized Countries**

My economic research on models of the world economy taught me long ago that getting one's own economic policy right is ninety percent of getting international economic policy right. So I should start with a discussion with the U.S. economy.

It should be clear to any economist that fiscal and monetary policy in the United States responded remarkably quickly and decisively to last year's recession. The President's tax cut was well timed, and along with the automatic stabilizers, helped mitigate the recession. The Federal Reserve moved early and aggressively to lower the federal funds rate. Low interest rates are still a factor supporting the economic recovery.

Tonight we are already completing one full year of economic recovery—a recovery that is close to what we forecast last year and about what one should expect following a shallow recession. It is very good news that productivity growth has held up so well during the recession and that inflation remains low as the recovery proceeds. We expect economic growth to return soon to the long run potential of between 3 and 3.5 percent.

With the right policies there is no reason why the current U.S. economic expansion cannot be as long-lasting, or even longer-lasting, than the expansions of the 1990s and of the 1980s, which were the first and second longest peacetime expansions in American history. As the economy recovers, it is essential that we make the tax cuts per-

manent, control the growth of government spending, reduce the deficit, continue to remove barriers to job creation, and insist on corporate responsibility.

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Economic growth for the other G-3 countries still leaves much to be desired, however. Japan has not yet recovered from its long period of slow growth, deflation, and instability. The higher rate of growth of the monetary base by the Bank of Japan since last year should be maintained and accompanied by changes in the banking sector that will allow the growth rate of bank credit and M2 + CD to increase as well. Germany is also growing very slowly. I believe that supply-side factors, which are holding down the growth rate of productivity and of potential GDP, must be addressed if real GDP in Germany is to grow more rapidly. Productivity growth should be higher, not lower, in Germany and Japan than in the United States.

Fortunately, economic growth is better in other industrialized countries, especially our close friends to the north in Canada. But as I refer to the need for pro-growth policies in many countries, let me stress the importance we place on country ownership. It does little good for us to lecture or to try to force other countries into the right economic policy. Rather, we feel it is important to use the many opportunities for bilateral and multilateral discussions to show the benefits of pro-growth policies and to give and take constructive advice.

### **Economic Growth and Stability in the Developing World**

A major thrust of our overall international economic agenda has been the adoption of policies designed to promote economic growth and stability in the developing countries. Over one billion people live on less than a dollar a day. Why? I do not need to tell an audience of business economists that the answer is productivity. Wealthy countries are those where productivity is high. Poor countries are those where productivity is low. If we want to

reduce poverty in the world, we need to pursue policies that promote productivity growth in the poorest countries.

Economic theory tells us that—holding other things constant—the poorest countries where the productivity level is lowest should have the highest rates of productivity growth. It is in these parts of the world where there should be the greatest return for adding capital and applying ideas to raise productivity. You see this kind of “catch-up” in productivity growth if you look at the United States since the nineteenth century or at the original members of the OECD since 1960. But if you look around the whole world, you don’t see this. The reasons for this lack of catch-up are related to bad policies that have inhibited, distorted, and restricted the flow of capital and ideas. The Administration’s development strategy endeavors to deal with these impediments to catch-up.

The strategy has two parts: (1) it provides for substantial increases in development assistance, and (2) it aims this assistance at countries that have good policies and where results can be measured.

How are we implementing this strategy? President Bush has already made several significant proposals for increasing development assistance. In July of last year, the President called upon the World Bank and the other multilateral development banks to increase the portion of their assistance provided as outright grants rather than loans for education, health, nutrition, water, and sanitation in the poorest countries. One year later, we succeeded in finalizing agreement on a substantial increase in grants within the International Development Association (IDA)—the arm of the World Bank that provides assistance to the poorest countries. As a result of this agreement, nearly one hundred percent of IDA assistance will be provided on grant terms for education, health, nutrition, potable water, and sanitation in countries whose people live on less than a dollar a day. On top of this, the Administration proposed increasing the U.S. contribution to IDA—as well as to the African Development Fund—by eighteen percent, reversing the downward trend of U.S. contributions during the 1990s.

Moreover, the President has proposed that the United States increase its core assistance to developing countries by fifty percent over the next three years—resulting in a \$5 billion increase over current levels in FY 2006. The increased assistance will be put into a new account called the Millennium Challenge Account (MCA).

Now, where are the examples of performance and measurable results? One is that the funds from the MCA will be provided only to countries that are—to use the President’s terms—ruling justly, investing in people, and encouraging economic freedom. In other words, countries

that have demonstrated the right leadership in pursuing sound policies for economic growth will be eligible for the increased U.S. development assistance. Another example is that the recent replenishment agreement for IDA provides for the development of a system to measure and evaluate results in the areas of education, health, and private sector development. For the first time, this enables donors to link their contributions to the World Bank to the achievement of measurable results on the ground. The U.S. contribution is linked in this way. This helps direct scarce donor dollars toward the activities and projects that are actually improving people’s lives.

### **Economic Growth and Stability in the Emerging Markets**

An important part of our growth strategy is to create the conditions for private capital flows to emerging markets to increase from the low levels observed in recent years. Averaging nearly \$150 billion per year from 1992-1997, private capital flows fell off to less than \$50 billion per year in 1998-2000, as the frequency of financial crises has discouraged investment and damaged expected profitability in affected economies. The United States has a critical interest in seeing a restoration of strong private investment flows at lower interest rates into emerging market countries, so that these countries can invest in the productive base of their economies and raise the living standards of their people.

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*An important part of the Administration’s strategy for emerging markets is to create the conditions for healthy flows of private capital.*

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The core principles of our emerging markets strategy are these. *First*, emphasis on crisis prevention, which refers both to early detection of potential crises and to action to address sources of vulnerability. Improved crisis prevention requires that the IMF focus on issues that are central to its expertise—monetary, fiscal, exchange rate, financial sector, and debt management policies. *Second*, efforts to reduce contagion. In recent years, investors have become much more skilled at differentiating between countries and markets based on fundamental economic assessments, with the result that contagion has fallen dramatically. We have sought to promote a further evolution

in this direction by emphasizing that policy decisions will not be based on unfounded claims of contagion. *Third*, limits on official finance, which is needed to increase predictability in the market. The policy challenge is to move gradually in the direction of less reliance on large official packages, so that investor expectations can adjust smoothly to new official sector policies. *Fourth*, improved predictability in the process by which sovereign debt is restructured. This *does not* mean lowering the cost of debt restructuring or increasing the likelihood of default. The introduction of new collective action clauses into debt contracts will facilitate a more predictable and transparent resolution of sovereign defaults when they occur, while further development of a statutory approach could provide an additional tool to address this issue. *Fifth*, avoidance of coercion of the private sector, since *ad hoc* interventions that affect private contracts increase uncertainty in the markets and can accelerate crises.

The Administration has made significant progress in implementing and applying the key elements of its emerging markets strategy. Months of discussion among the G-7 Finance Ministers and Deputies culminated in agreement on an historic G-7 Action Plan for emerging markets last April. It calls for improved IMF crisis prevention and surveillance, limits on IMF lending, introduction of collective action clauses into sovereign debt contracts, and further development of a sovereign debt restructuring mechanism.

Progress has been made on all these fronts since April. The IMF has introduced a new analytical framework for debt sustainability analysis, which should help strengthen early identification of unsustainable situations and aid crisis prevention. With respect to limits on official finance, the United States has indicated that it does not support an IMF quota increase. As U.S. Treasury Secretary Paul O'Neill has said, "Limiting official resources is a key tool for increasing discipline over lending decisions."

In June 2002, key representatives from the private sector stated their support for the introduction of collective action clauses, and work over the summer months helped further refine the specific form that these clauses would take. A meeting last week between the representatives of the private sector and senior officials from the G-7 and some key emerging markets reinforced the consensus on key aspects of this approach. Finally, the International Monetary and Financial Committee welcomed the progress made on collective action clauses and called for further work on how a statutory sovereign debt restructuring mechanism might function before its next meeting in the spring.

## Free Trade

President Bush is a strong advocate of free trade as an essential part of his Administration's pro-growth international economic agenda. It is no secret that both the Administration and the Congress have received criticism for certain decisions in the international trade area during the last year, but passage this summer of trade promotion authority deserves strong praise. For the first time since 1994 the President now has the authority to negotiate substantial trade agreements, including the new round of multilateral negotiations begun at Doha. We are now planning to move quickly on free trade agreements with Chile and Singapore. The Central American countries and Morocco are next. Australia and South Africa are interested in exploring free trade agreements. By 2005 we hope to have a free trade agreement for the whole hemisphere—the Free Trade Area of the Americas will create the largest free trade zone in history.

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Since the agreement in Doha last November to launch multilateral trade negotiations, the United States has proposed the elimination of all agricultural export subsidies, the reduction of average agricultural tariffs from sixty-two to fifteen percent, and a cap on domestic subsidies at five percent of domestic agricultural production. We have similarly advanced a proposal for the global liberalization of trade in services.

In addition, recently passed legislation renews for five years the Generalized System of Preferences that lowers tariffs on 3,500 products and expands the Andean Trade Preference Act to benefit Colombia, Peru, Bolivia, and Ecuador. Finally, domestic safeguards on steel imports have helped to solidify domestic support for further trade liberalization, while the Administration has eased the impact on U.S. steel consuming industries through exclusions covering twenty-five percent of steel imports.

## Terrorist Financing

When I was sworn in as Under Secretary in June 2001, I never dreamed I would be spending a large amount of time chasing down terrorist assets around the world. Yet, since President Bush placed combating terrorist assets high on his list of actions to fight terrorism, this

is exactly what I have been doing. About one year ago we set up a “War Room” in Treasury to coordinate the international aspects of this fight. To be effective all countries have to participate in freezing the assets of terrorists. And we have seen an extraordinary amount of cooperation.

Since September 11, 2001, over 160 nations and jurisdictions have joined the United States in issuing orders freezing the funds of terrorists and terrorist organizations. This effort has frozen over \$112 million in existing accounts and more than 2,400 people have been arrested on terrorist charges. Our information is that these actions have disrupted the pipelines of terrorist finance and forced terrorists to use riskier and more unwieldy means for raising and transferring funds. We are now continuing our work to stop flows of terrorist money through alternative remittance systems known as “hawalas” and to protect charitable organizations from abuse by terrorists.

### **Afghanistan**

Our international economic agenda involves close interactions with many individual countries; and it is, of course, impossible to summarize all these operations. But, but by way of example, I would like to spend a few minutes on Afghanistan.

It is hard to believe that one year ago Afghanistan remained under the control of the repressive regime of the Taliban. The U.S. military campaign and the establishment of a new Afghan government have provided the hope of a better future for the Afghan people. I saw this during a visit to Afghanistan in September 2002. While the economic challenges to building that better future are enormous, the United States and other international donors are committed to helping the Afghan people succeed. These efforts, combined with the creativity and determination of the Afghan people, give me reason to be optimistic.

At the donor pledging conference held in Tokyo in January 2002, donors from sixty countries and fifteen international organizations pledged a total of over \$4.5 billion in reconstruction assistance. Of this amount, \$900 million has been disbursed.

The challenge now is to make the transition from humanitarian relief to reconstruction assistance, and to ensure that this reconstruction assistance is delivering measurable, visible results on the ground. The \$180 million in road assistance recently announced by the United States, Japan, and Saudi Arabia is an example of the kinds of projects that are needed to lay the foundation for economic recovery.

The Afghan government has made accountability and transparency among its top priorities. We have an adviser to the Afghan Finance Ministry working in Kabul to help put

in place the financial systems needed to monitor aid donations and expenditures by the Afghan Finance Ministry. The Afghan government is firmly committed to the private sector. The cabinet ratified a new investment law that allows for full repatriation of profits. The Central Bank and the Finance Ministry have laid out plans for a new currency that will be introduced on October 7. The new Afghani will unify three different currencies now in circulation and increase confidence and monetary stability.

As the Afghan government does its part, the international community must follow through on its role by providing the government with aid for infrastructure as well as essential health and education services to facilitate economic recovery. Providing tangible results is crucial in demonstrating to the Afghan people the international community’s commitment to Afghan reconstruction.

### **Conclusion**

The United States shares with all nations a common interest in increasing economic growth and improving economic stability in the global economy. The Bush Administration’s international economic agenda reflects a policy program dedicated to raising standards of living and promoting prosperity in all parts of the world—industrialized nations, emerging markets, and developing countries. We have made good progress on this agenda over the last few months. I look forward joining you again to report on the important work that will be completed in the months ahead. ■

