The highest ranked woman in the Clinton White House, Laura Tyson was the president's national economic advisor from 1993-1995. She is currently dean of the London Business School in England.

Tyson discusses her experiences in the Clinton administration, views on international trade, and the impact of technology on the global economy.

The Clinton Campaign

INTERVIEWER: How did you become head of the Council of Economic Advisors?

LAURA TYSON: I had been active in the 1980s with various groups that worked on the issue of changing global competitiveness, U.S. competitiveness, and changes in trade relations. Through that set of commissions, I met a number of people like Bob Rubin and Bob Reich, who ended up being involved in the campaign for President Clinton. They asked me if I wanted to join on because we work on these issues through these commissions. I read what the then-candidate Clinton was espousing, and I was in support of his vision, so I agreed to sign on to the campaign. I didn't do a whole lot during the campaign; I stayed out here in California. But then I got a call to work on the transition team, and from there I was asked by the president to become head of the Council of Economic Advisors.

INTERVIEWER: How important were economic and global economic issues in the campaign?

LAURA TYSON: Economic issues were obviously central to the campaign, like the famous slogan "It's the economy, stupid," but I would say the issues were primarily domestic in focus. There were some international issues that came up—the issue of human rights and trade with China came up. There was the issue of the North American Free Trade Agreement, whether we should proceed with NAFTA and what conditions we would impose. In addition to those two, concerns about whether there was unfair trade competition with Japan was probably the third [international] area. Other than that, the focus really was on the revitalization of the domestic economy. That was central to the campaign.

INTERVIEWER: In [Bob] Woodward's book on [Alan] Greenspan, he talks about a meeting held between President-elect Clinton and Robert Rubin at a dinner in New York during the transition period. I think that was the first time they met. What was going on that we can talk about?

LAURA TYSON: I wasn't involved in the New York campaign. Although I knew Bob Rubin a little bit from previous work I had done with him for Governor Cuomo of New York state, I was not involved in his initial meetings with then-candidate Clinton. As far as the relationship between the president and Alan Greenspan is concerned, I've always felt that the book by Woodward overstated the influence of Alan Greenspan on the decisions that we made, on the decisions that the president made. The truth is that there was a growing consensus in the United States among both Democrats and Republicans, and among business groups, labor groups, and educational groups, that the United States was on a sort of unsustainable fiscal course. And at the top of everybody's list was the need to reduce the budget deficit. So it wasn't like we discovered something that was amazing or revolutionary, and it wasn't that Alan Greenspan was the only person who had that idea. What was clear is we all felt that doing something about the deficit in an incredible way would allow the intrastate environment to be an easier environment. So in that sense there clearly was an interaction.

INTERVIEWER: So during this time, was the thinking of President-elect Clinton changing regarding international trade and international issues?

LAURA TYSON: I think that actually the president-elect's position on international economic issues was clearly indicated in the campaign itself. I think that his position on the North American Free Trade Agreement was actually very defining of his perspective. He understood the need for a continued sort of trade-liberalization engagement. As a governor, he understood the benefits to the U.S. economy that come from that. He said many times: "I've been a governor of a state where we've benefited a lot from foreign investment, and from foreign trade. At the same time, we need to worry about the fact that there are certain issues, such as treatment of labor or environmental issues, that need to be on the international agenda." So I think that defined him, and I think it stayed with him through his international policy. The other thing that I think came up was really the issue of what is fair competition and what is free and fair trade. Of course he did spend a considerable amount of his energy in the first term on issues of U.S.-Japan trade and U.S.-China trade, negotiating intellectual property agreements with China that were all part of a free- and fair-trade agenda that he had again defined in the campaign.

The Team Mentality of the Clinton Cabinet

INTERVIEWER: I want to ask you about [when the Clinton administration] came into office. Just set the stage for us: January 20, 1993. What did you really set out to do in those early months?

LAURA TYSON: The president had very much of a team orientation to his administration, and he had been careful, I think, to choose individuals who would work together as a team. I think it mainly reflects who he is as a person. I think it was also partly a response to what had gone on before. If you look at George Bush Sr. and his economic team, there was actually a tremendous amount of conflict within it. The budget director didn't talk to the Treasury; the secretary didn't talk to the CEA [Council of Economic Advisors] director. By the end they had competing forecasts for the economy, and this was written about quite a lot in the press. The other thing they had was rather strange relations with the Federal Reserve. This was not considered to be very healthy from the point of view of the financial markets, which are looking at the situation for leadership and seeing tension between the Treasury secretary and the head of the Federal Reserve.

So what you see going into the administration is two things: Number one, the president wants to have a team and choose individuals who are going to work as a team. And number two, we're trying hard to make sure that when we disagree we work out our disagreements internally and therefore don't end up with the image of being internally split. In fact, we weren't internally split. One of the things I have to laugh about again is the Bob Woodward book, *The Agenda,* which has two main theses: First is that there was this huge influence of Greenspan on the president. Second was that there was huge conflict in the administration between the deficit hawks and deficit doves. If you actually look at the numbers involved here, it is impossible to make that case. We were basically disagreeing about $20 billion over five years. Do you know in a $6 trillion economy that $20 billion over five years really doesn't matter? ... There really wasn't much choice but to do something very serious on the deficit. That was what you needed to do first. What I think the president needed to hear from his advisors that was so important were certain things that he might want to start with—middleincome tax relief or a bigger public investment agenda—but really weren't options that were available to him. So I think there was actually a lot of agreement among the individuals who were advising him.

How NAFTA and the WTO Came to Top the Democratic Agenda

INTERVIEWER: Let's talk about NAFTA, which, you know, of course, was negotiated in the Bush administration. How did that plan pan out? How was the decision made to really push the plan in a very public, very exposed way?

LAURA TYSON: There was the issue of how to move through a legislative agenda, and having spent the first nine months or so on the budget, we got the basic economic plan in place. There was ongoing [discussion] toward the end of that process about what we should next focus our legislative efforts on coming off of that very difficult struggle. The possible answers to that were health, welfare, and trade. Again, I would say to a certain extent that choice was driven by the fact that we were almost ready to go on NAFTA. ... The [health care] reform proposal was so complicated and involved so many players, [we] really couldn't have moved on it even if we'd said that's what we should move on. Welfare seemed to be something we really thought that we could do along with health, or should be doing in some sense together with health. So since health wasn't ready, neither was welfare. ... There were very strong views, and here I would say Secretary [Lloyd] Bentsen was very important in [saying] that a good thing to move on was the North American Free Trade Agreement.

There were economic reasons for doing that, and there also were sort of leadership reasons. Having spent a considerable amount of time on domestic policy agenda, it was important to take on an aspect of international economic agenda and sort of move it forward. And politically, you could imagine here, as in all trade areas, you're going to end up with a greater possibility of bipartisan support. Unlike today, where the Democrats are indicating they are willing to work with the president on his economic agenda, the Republicans indicated that they just would not do that in '93. They sat out the entire domestic agenda process. So in order to engage them in any kind of activity, [President Clinton] had to move into an area where they had some interest. That was another consideration. So the issue was right for movement. It had been developed, so it was ready for legislative movement, and it was an area where we could work with Republicans. It was an area where a number of people of the economic team, most people on the economic team, felt that there were benefits, economic benefits, although one of the things we emphasized—and I would say this is true today if you look at the relative size of Mexico and the United States—is [NAFTA] is much more important for Mexico than the United States. I mean, it's not really a significant factor from the point of view of the U.S. economy. From the point of view of the Mexican economy, it's a very significant factor. And furthermore, to the extent that economic stability and prosperity in Mexico has political benefits to the United States and immigration pressure benefits to the United States, doing something good for Mexico's economy is also good for ours. But to a smaller extent, it would generate larger benefits for us in terms of political and long-term economic benefits.

INTERVIEWER: I was just wondering whether there was a thinking at the time that, in a way, this was the beginning of a push toward trade liberalization. Was that a conscious choice at the time, or did it just happen to follow after NAFTA?

LAURA TYSON: I think I would argue that if you go back and look at the whole evolution of thinking about trade issues in the '80s going into the '90s, this was a kind of reflection of a long process of thinking that had gone on in the United States, and then-Governor Clinton had been part of that thinking. The thinking was, we need to continue to develop the international trading system so that the rules are fair; that is when we benefit. The United States benefits the most when foreign markets bring down their barriers to us. The more the rules of international engagement on the trade front are enforced, the more we benefit from the rules. So I think there really was a very firm sense among the economic team—and the president shares this—that the United States should lead on trade liberalization because there were important economic benefits to the United States. And again, I would say that was not a revolutionary concept. I mean, there were disagreements. I, for example, who had done a lot of trade arguing, felt that we had some serious competitive issues with Europe and Japan. I didn't argue that what we should therefore do is become protectionists or disengage from trade liberalization. Actually, I argued quite the opposite. I argued that we should have multilateral agreements on high-technology trade. We should have multilateral agreements that are enforceable on trade in aircraft. We should have a stronger GATT, which then became the World Trade Organization. So yes, there are barriers to trade, but we're not going to build our own [barriers] in response. We're going to use our national leverage and our leadership with multilateral institutions to break down barriers around the world. That was, I think, the view that was behind a lot of what we did.

INTERVIEWER: And just following on that, how did that actually sort of happen? I mean, how was it that GATT was transformed into WTO? What was the administration's role? [What was] your role that made that happen?

LAURA TYSON: There had been about 30 years of negotiations on the Uruguay Round, and there had been the concept of a WTO that was actually a U.S. concept. So the United States had been pushing the view throughout 1986 that we needed a faster, more powerful multilateral institutional mechanism for enforcement of trade rules, because what happened is, if you look at the history of trade disputes adjudicated by, say, the GATT, the United States normally won those disputes. That is to say, the United States is the most open, major international economy. The United States is the most open economy, and we were always mostly engaged in trying to open up foreign markets for American companies and American producers. So we wanted to have an international enforcement mechanism, an adjudication mechanism, which was powerful. So that idea was there.

In that sense the Clinton administration was continuing a strategy that had started back in '86. I think there were issues that had to be resolved. There were a lot of issues of precisely how the organization would work that needed to be resolved. There were political issues of getting enough of our partners to agree to what we wanted. There were political issues at home about getting enough people to be willing to vote for the Uruguay Round. So I would say that we worked on it both in terms of finishing up substantive issues on how the system would actually work, but also in terms of working with our international allies and the U.S. Congress to set up a political circumstance in which this piece of legislation would actually be passed and other countries around the world would sign on.

INTERVIEWER: About the WTO ... and the political quest—how engaged was the president in that?

LAURA TYSON: The president was very engaged in the strategy of the administration in the sense of thinking about which priority to be pushing, and how so. For example, if I think about both the WTO vote and the North American Free Trade Agreement vote, he worked very much with political and congressional advisors to try to figure out the right strategy to get enough of the Democrats involved in a positive way, to get enough of the Republicans as well, and to enforce conditions that would force him to get it done. And so I would say in both areas he was deeply involved on the political strategy side. He had been during the whole issue of the North American Free Trade Agreement, and the conditions really were his decision. Therefore, I would say even in the broadest policy terms, he had been very important as an architect.

He was less involved in the day-to-day development of a particular clause within the WTO and electoral property agreement than he had been involved in domestic budget issues. It was on the domestic budget issues involving the nitty-gritty of how U.S. government policy worked and at what level it should be funded that he was there on a daily basis. The same thing was true in health. He was there on a daily basis talking about the U.S. system and what he knew about it, which was a staggering amount, and what should be changed. In international trade areas, he was at a higher level of vision and general goals. He allowed his trade negotiators and his more professional staff in those areas to sort of do more of the day-to-day work.

Rapid Changes in Technology and Trade

INTERVIEWER: Was all this happening during the early days of the explosion in emerging markets, and then in information technology, which was speeding things up? Was that really a time of rapid change on a lot of levels, political and economic? You had a lot of forces coming together, and that brought about a very rapid expansion of trade and investment from the United States into emerging markets. What was going on?

LAURA TYSON: We probably didn't realize the effects of technology as much as [we have] with the benefit of hindsight. ... In the first four years was the change from a Cold War world, a world in which many societies had barriers to international trade and investment as part of their development strategy to a world in which countries were embracing the global system, saying that the history of development indicated that it was much better to be engaged and to break down trade barriers, even unilaterally, to open capital markets to foreign flows of private money. We were struck by the fact that around the world, this revolution in thinking was going on that therefore was making the global economy a more open place. Our concern, then, was to try to work on the appropriate rules for this more open, global economy.

Our second set of concerns was how to safeguard or help countries that had opened to international forces if they ran into difficulty. Now why would you help them? You'd help them because you feel they're doing the right thing and that if they run into some difficulty, it might encourage them actually to reverse and move away from liberalization and engagement. That would be something not in our interest. So I think we thought a lot about what countries were doing, and what we could do to help countries become more and more engaged globally. We thought less about the technology in the first four years. I was only there for one term, but my understanding of the second four years from talking to people was that was the period where people realized the extent to which the inner dependencies had become much more powerful and much faster-working because of the technology.

The Mexican Crisis of 1995

INTERVIEWER: Let's just talk a bit about Mexico. How did you first get the sense or feel of a crisis, and why the decision to take a very unpopular political stance?

LAURA TYSON: It was something where we didn't have much advance notice. I think that caused us to look internally and to ask, "What is it that is wrong about the sort of decision-making information base of the government that we ended up facing a crisis with very little warning?" You get National Security briefings on a regular basis if you want. I tended not to get too many, because I really felt it was hard ... If you got a National Security briefing, you had to be careful not to use the information you shouldn't have. I just felt it was easier not to have it. In National Security briefings you would get information, but you would think that somehow or other there would have been information through the process of a year of increasing signals that Mexico was going to run into difficulty that would have led us all to be a little concerned over a long period of time. In fact, the Treasury got concerned only in the last few months of 1994. The Federal Reserve got concerned during that period as well. I was still at the Council of Economic Advisors, so it was in the transition period of Bob Rubin to the Treasury and of me to the National Economic Council. I was essentially called to a meeting at the Treasury to discuss the economic difficulties, the developing financial difficulties, in Mexico and whether we needed to do anything to try to address them. And that was probably only a month before we really felt a need to do something.

So the first thing was, it was sudden. The second thing was, it really did initially involve the Federal Reserve deeply in the sense of working with the administration, in particular with the Treasury. And then the Treasury called in other actors to try to analyze what was going on and to figure out what would be a reasonable response. The third thing, I would say, is that set of discussions did not involve the president. It was really about bringing a problem and a proposed solution to the president at a moment in time. So he had not [involved himself like he had] in the budget discussions and health care discussions where he had been almost a daily participant. This was something where a group of his economic advisors, working with the Federal Reserve, analyzed the problem and made a recommendation to the president.

Now, why did we recommend doing anything? This is something that is being discussed now with the new administration. You know, you shouldn't intervene. There shouldn't be crises, and if there are crises you shouldn't intervene. First of all, I actually disagree with the new Treasury secretary [Paul O'Neill], whom I actually know. I think the crises are, in fact, absolutely inherent aspects of capitalism. I think that if you read any book about the history of capitalism, you see that these crises essentially come from animal spirits, irrational exuberance, hype, euphoria, and then gloom. And until we change human nature, we are not going to get rid of crises in capitalism. So the question is, what do you do when you confront one? In this case I feel absolutely clear in my mind about what our thinking was. Our thinking was not that we wanted to bail out a bunch of investors who had been greedy. It was not that we wanted to bail out a bunch of government decisions in Mexico that sort of ended up taking out a lot of risk. Our decision was that if Mexico, in fact, ended up defaulting on these instruments that there would be a spillover effect in other financial markets, and this might cause a number of other emerging-market economies to get in trouble, because money would be pulled back from all of them, not just from Mexico. People would then reassess the risk involved in lending to emerging-market economies. All of these emerging market economies were embracing this liberalization, which we thought was a good idea. They were also embracing various forms of democracy, which we thought was a good idea. We didn't want to see the Mexican government, which was a government committed to NAFTA and to democracy—albeit slowly—be destabilized. So we decided that for the spillover effects, and for these sorts of stability effects in Mexico, it was worthwhile to try an intervention. I say "try" because we did not have high hopes that intervention would work. We were actually very uncertain that the intervention would work.

So here is a very good deal for your president. You go in and say: "Here is a big crisis that could happen. We can tell you something to do about it, but we can't tell you it's going to work. It's very risky, and we know it's extremely unpopular, but we think you should do it anyway." In this case, as in many cases, the president did the right thing. I mean, he basically understood completely. It's not as if it took him a little while to understand the arguments. He understood them right away, and he basically said: "I think you're right. We really must intervene."

Contagion of the Asian Financial Crisis

INTERVIEWER: So I know you were out of the government at the time, [but let's] talk about Asia, Russia, [Latin America]—[their financial] crises.

LAURA TYSON: In 1995 we thought that we had actually done something to prevent spillover. At that moment in time we [thought that way] because if you looked, there had been a few signs in Latin America and in Central Europe that there was going to be some spillover effects from a default in Mexico. Having precluded the default, we reined in the spillover effects. I think that the problems in '97-'98 in the rest of the world show how our concerns were justified in the sense that I think everyone widely agrees that what we were worrying about and calling spillover effects in 1995 became contagion effects in '97 and '98, and they were extremely powerful. There were no particular reasons to expect Malaysia or Indonesia to be brought down by financial difficulties in Thailand. Thailand is a very small economy. It didn't have a lot of links to Malaysia or Indonesia. It's in the same general region of the world, but actually the links between those countries are primarily with developed countries, and not with one another. Malaysia and Indonesia absolutely had a political problem, but Indonesia didn't have any obvious sort of macroeconomic imbalances, nor did Malaysia. So you have a crisis in a small country, and it's not exactly in your backyard the way Mexico is. Furthermore, the administration, and particularly the Treasury, had come under enormous criticism for the way in which the Mexico intervention had been financed through this stabilization fund of the Treasury. So the Treasury could not—and this tends to be forgotten—have done in the summer of 1997 what we chose to do in the winter of 1995, because the U.S. Congress had put a limitation on the use of the Treasury's funds to intervene in this way.

In any event, the United States chose not to intervene in Thailand, thinking it was not going to spill over. Why would it? What effects the contagion would have were not apparent to anybody. And the administration didn't really have the capability to do much because it had one arm of discretion tied behind its back by congressional legislation that was due to expire in another year. So in this case, the contagion effects became very powerful very, very fast. And it was really only when Korea became a serious issue toward the end of '97 that the United States really became engaged in trying to work both through the IMF and through the Treasury Department to try to get Korea's debt rescheduled. That was really the first major item of business.

Global Capital Flows

INTERVIEWER: What do you say to people who argue that in the first term you all moved too fast with trade equalization? Is that because it happened so quickly that the architecture wasn't in place?

LAURA TYSON: I wouldn't say trade equalization. I think the distinction people debate is about capital-market liberalization, and I think that's a fair point. The point is that you can engage countries in breaking down barriers through trade, so you buy and sell products, but you can still choose to limit the amount foreigners can invest in your financial instruments. Take the case of China, which is a good case here. China has had a dramatic growth in its international trade if you look at China as a developing country and you look at the share of trade in its GDP. You would say it's quite an open economy. It also has allowed a lot of foreign direct investment into China to build facilities and run operations. What it has kept out of China is a sort of financial capital. It doesn't sell its short-term government debt to foreigners. It doesn't allow foreigners to hold large amounts of Chinese currency. Therefore it's not indebted in a short-term way to global private capital markets. And it doesn't have the possibility that global private capital markets can start selling and buying their securities. And what the countries that were most affected by the financial crises of '97-'98 had done is they had opened their capital markets. They were bringing in huge amounts of foreign short-term money, and they were doing it by selling debt instruments to them, corporate debt and government debt. Selling equities to them was a great way to bring in a lot of money.

The problem was the money was very volatile. It's money that could easily be pulled back, and [when there was] any sort of uncertainty about returns, you could see the money just turning over. And unfortunately, that danger turned out to be a real phenomenon in '97-'98. It really was the movement of short-term capital when the markets liberalized on the capital side, allowing such money to come in, and then the very quick exit of such money when foreign investors got concerned.

INTERVIEWER: So how do you prevent that from happening?

LAURA TYSON: You can do it, first of all, for countries that haven't yet liberalized, like China. You just don't sell those kinds of [debt] instruments; you don't make them available to foreigners. You simply don't, in that sense, allow foreigners to deposit money in your domestic institutions or buy your government debt. And in a way it's easier to prevent it from happening if you haven't gone down that path. Once you've gone down that path, it's really hard. This, of course, is what Malaysia did. What you have to do is basically say to people that are holding these kind of assets that they have to hold it for a certain amount of time before they can sell. You can do it by saying, "If you sell before that time, you have to pay a very big tax penalty." So you can put a restriction on holding—how long, if you buy an instrument, you must hold it to avoid a very big penalty on selling. It's almost like a savings account with a penalty for early withdrawal. So you can do things like that. If you've gone down the path of not doing that, and then all of a sudden you try to do that, you run the risk that a lot of money is going to leave even faster in order to get around your new restraints. That's why it's more difficult as soon as foreign investors think you're about to do that. They're going to pull their money out as fast as they possibly can, and that depresses your currency, it robs you of finance, and it drives up your cost of borrowing so it just gets harder to do.

I think that what has become our conventional wisdom is oftentimes wrong, that many of these countries may in fact have opened up their short-term capital markets too soon. What does that mean? It means that there weren't enough regulations in place to control whether assets being sold were creditworthy accounting for how much of this was actually going on. No one was keeping track of how much the banks were becoming indebted in the short term. No one was keeping track of how much the companies were becoming indebted in the short term. The governments knew how much they were becoming indebted in the short term, but you just didn't have the data, the accounting structure, or the regulatory structure to prevent what, in retrospect, is clearly much too much dependence on this very flighty and expensive foreign capital.

What's at the Root of Anti-Globalization?

INTERVIEWER: There's a lot of anxiety that you hear around the world about globalization. Where is that coming from, and what does it mean?

LAURA TYSON: You know, I have to confess that I find it a bit mysterious. I came back from Washington in early '97 before the global financial crises of Asia. I came to Berkeley, and one of the first things I saw was a poster for a big anti-globalization rally at Berkeley, which actually turns out to be one of the capitals of anti-globalization forces. So I kind of looked at this poster, and I said, "I don't understand why people are concerned. What is the concern here?" I feel that while the issue of global environmental standards is a very important issue to me, I think I'm also very concerned about global warming. I think we should be doing more. I think there are huge moral questions about how companies should behave when they're in a foreign location. Should they adhere to the U.S. standard or the local standard? I think that's a moral question more than anything else, but I don't see how the appropriate responses to those issues include not engaging in international trade and capital flow. So I can say that I think everybody—the world, the United States, and the other countries—are better off than they would be with more integration.

But at the same time, I can understand that more integration is not necessarily going to solve those other problems. Those other problems exist independent of the integration. The integration doesn't cause the problem, and I don't think that the integration can solve the problem either. So it's as if I can say: "Yeah, I understand your concerns, but I don't understand why you are blaming this on globalization. Globalization didn't start these problems, and it won't actually solve these problems, but it's not making them worse." So that's my confusion.

INTERVIEWER: What about this focus on the WTO?

LAURA TYSON: I don't understand that either. I was sort of involved in this discussion from the mid-1980s to the actual enactment of the WTO. It was a very simple idea. The idea ... is that you have disputes, and when you have disputes, you need to have an adjudicator mechanism. And the adjudicator mechanism you should have should be as non-politicized as possible. So there should be a bunch of trade experts, panels of experts who are appointed by a multilateral process so they're not representing any individual producer or any individual nation, to adjudicate which side is right and which is wrong in the dispute. So this is very much a U.S. lawyers' legal tradition, and I know that both prior to the WTO and since the WTO, that in disputes that have been adjudicated by either GATT before or WTO now, the United States has almost always been the winner. I believe in the process as it works. So when the United States is not the winner, when something that the United States does is viewed to be something discriminatory in its effects on its foreign trade partner, it is our responsibility to make adjustments in what we do. We can achieve the same goal if it's a domestic goal, but we can try to figure out how to do it in a nondiscriminatory way.

So I would say to people: "Gee, we're benefiting from these rules. We bring disputes there, and they tend to be adjudicated in our favor. We have designed a system that is not subject to political pressure the way that you would expect if you just had a company going in and arguing its case with very highly paid lawyers. It's not designed to solve the problems of the global environment. It's not designed to solve the problems of whether labor should organize in Country A or in Country B, so why are you criticizing it? Because it's not doing the things that it's not designed to do?" So those are some of the ways in which I am confused by the discussion.

"The Relentless Nature of Quarterly Profits"

INTERVIEWER: One of the things we're looking at in film is the idea of the relentless nature of quarterly profits. Let's talk about that and its impact.

LAURA TYSON: Well, I think, like many things in economics, there are drawbacks and there are benefits to the development of financial markets. There are tradeoffs. Thinking about it from the United States's the point of view, I think that the financial markets have funded venture capital through IPOs and through equity markets. They have been the basis for this technological flowering of the new economy, and they've created a tremendous amount of investment in real productive capacity, not just in the United States but around the world. So it would be hard to say that the financial markets haven't had an important beneficial effect, been a beneficial force in the creation of the new economy. At the same time, because they are so tightly linked internationally, and because they are so fast moving, they are very volatile. In fact, one of the things that we do know pretty certainly from the last several years is that the new economy, the new technologies, have made financial markets much more volatile. So there's more information. They move fast, and they move up and down more rapidly. All of this means that any little piece of financial information can cause a rather large and sudden change in behavior. I think the quarterly reports are just one manifestation of that. People on boards, CEOs, and company leaders know that particular quarterly adjustments, even by a few pennies that might be because of something special that happened within that quarter without any long-term significance can actually have a pretty dramatic effect on the value of the stock.

One of the things that I've found interesting here is that because financial markets have become more volatile and more fast moving, every piece of information can generate a large change. One of the things that the SEC has been doing is saying, "All right then, we're going to really have to improve the information." So a lot of the SEC's rules on new accounting procedures, how you measure revenue or how you massage earnings, have been built around the reality that the quarterly reports are becoming more important in their impact. And therefore you have to do more and more to try to tease out the right information from the quarterly reporting. Rather than saying that markets are so sensitive to quarterly reports, the view has been, "They are sensitive to quarterly reports. It's hard to imagine getting them less sensitive to quarterly reports. So let's figure out how to make the quarterly reporting process a more fair process." That's the new SEC rules on fair disclosure, or how to make the numbers that are actually reported, say the earning numbers to the revenue numbers, more precise. So everybody is taking it as a reality. We can't get out of the bind of having the quarterly numbers be very powerful in their effects. So we have to deal with it. We deal with it by changing the process of reporting the numbers. Even rules like the independence of the accounting firms have really been, I think, the result of acknowledging these numbers are really very powerful now. So therefore, we have to do everything we can to make sure that they [the numbers] are credible and that they are fairly distributed to everybody at the same moment in time.

Trade Liberalization and Technology: Seeing the Benefits, But Not the Risks

INTERVIEWER: Let's go back to the Asian crisis. You said that some of the countries maybe opened up their capital markets a bit too quickly. Some people say that the administration actually bears a responsibility for that, for pushing them.

LAURA TYSON: ... There may be some truth to that. I was not deeply involved in that part of the administration's agenda for the following reason. If you go back to [Clinton's] first term, a lot of the international approach of the administration on economic issues was to break down barriers to U.S. firms. It really was this idea of free and fair trade. So we were taking the position that "We're Democrats, and we believe in fair trade. We're not protectionists, though. We're not going to build barriers around ourselves. We are going to engage our trading partners and encourage, cajole, convince them to bring down their barriers." One of the areas in which we were doing this was financial services, and this came out of a tradition of working with Japan on liberalization of their financial services industry in the 1980s. ...

The Agricultural Department, for example, would lead on the issue of liberalization of trade in agriculture. And the Treasury would lead on liberalization in trade and financial services. And we were saying to countries like Korea: "Gee, you want to be part of the organization of economic cooperation development, and you want to be treated like an industrialized nation. In order to do that, we want you to open up your capital markets to flows of U.S. dollars. For investors who want to invest in Korean assets, we want you to liberalize your equity markets." So yes, I think we did do that. You know, I guess what I would say is, we did it for the right reasons. I think, with the benefit of hindsight, there is concern that my profession overestimated the benefits to the country of doing that, or maybe we underestimated the risk to the country. There were some benefits. I think we got the benefits right, but we didn't pay enough attention to the risks. And so I would put more of the blame at my profession's doorstep. The Treasury ended up being the lead negotiator on those kinds of issues, probably being most engaged in those. I was never involved in them. I don't want to claim that I would not have done it. So I think it's a fair issue. It's an issue that I think one only sort of understands with the benefit of hindsight.

INTERVIEWER: You mentioned also that you didn't quite anticipate the role of technology in all this. I wonder whether those two went hand in hand. In other words, the risks were much greater because of technology.

LAURA TYSON: The risks were greater because the magnitude and speed of change were so [great]. The amounts of money involved were much larger than would have been the case had you not had the ability to move money around the globe by hitting a button. The same thing with the speed, and, I would say, related to that is the volatility. If you'd asked people at the beginning of the 1990s, "Do you think that very sophisticated trading technologies and very sophisticated management technologies would make financial markets dramatically more volatile?," I don't think there would have been a resounding yes to that. There might have been a maybe. There might have been a "Gee, well, you know, on the one hand it could make it more volatile because there's more money moving and it can move faster, but on the other hand, more information might actually lead to a more stable financial market because the information is widely available to people at a moment in time and you get fewer mistakes." You know, I think that the technology clearly did play a role, but I think the role it played would not have been easy to predict.

INTERVIEWER: How important was what was happening there, and how at the time did you really think that Silicon Valley would be ... important?

LAURA TYSON: I think at the time there was a beginning of an awareness that manifested itself in the following way. First of all, at the end of the '80s there was a sense that what was called high technology was where the United States had the greatest competitive advantage. There was also a sense that we needed to worry about the rules of international engagement—commercial engagement in high technology—so we needed to have rules for intellectual property protection. We needed to look hard at rules for liberalizing international telecommunications markets, another very important high-technology area. So there was recognition that high technology was our competitive strength and that more and more we were going to have to get into these nontraditional areas like regulation, and try to do some harmonization, or something in the international regulatory environment to bring down barriers to trade. That was understood.

A second thing that was more speculative was, gee, was it going to be the case that as the technology diffused rapidly, we really did get a fundamental improvement in long-run growth? I remember back in the '90s, our first term, that we did have discussions about that. The projections for the budget ... All projections are based on sort of 10-year growth numbers. Well, what's a 10-year growth number? Well, it depends upon how fast you think the technology is going to affect productivity. So even then we were talking about those kinds of issues and doing ranges of estimates. What I think was not known was that there was going to be substantially more volatility in financial markets, and that you were going to have this kind of technological, or sort of NASDAQ boom. That was not known.... [At the end of the first term] ... people were beginning to realize that [the Internet and international trade] was something that was going to become significant during the next four years.

When Should the U.S. Intervene?

INTERVIEWER: Before you mentioned Secretary O'Neill, who has raised concerns about when the U.S. should intervene in the crisis. Just generally addressing his concerns, if you look down the road, will there be more crises? Why should the United States and European Union take an active role in addressing those things? And do you think maybe when the Bush administration is actually confronted with a crisis they may actually realize that even if they want to, they have no choice but to [intervene]?

LAURA TYSON: Well, particularly interesting to me is to think about what Secretary O'Neill said, and then look at the first visit of the president to see Vicente Fox. My view, and it's an extremely strong view, is that had President Bush been the president in '95, he would have done exactly what President Clinton did, and he would have done it for exactly the same reasons. He would have recognized that there is a need. In order to try to do something to stabilize the flow of money to Mexico, to prevent the spillover effects of a Mexican default, to help the leader in power in Mexico continue on the trade-liberalization reform, you're going have to help out some private investors. That's a distasteful element to this. It's not why you're doing it, but there's no way around it. That will happen. But I can't imagine that President Bush would not do that.

Now, it seems to me that one of the things that's very important about '95, and actually is important about the Asian financial crisis as well, is that for intervention to be successful, it really does require a multilateral effort. It was not just U.S. intervention in '95. The United States actually used its negotiating strength with the International Monetary Fund to get a number of countries, including some emerging market economies, to put in some support for Mexico. And then in '97 and '98, ultimately the monies that were mobilized for the Asian economies were monies that were mobilized internationally through the IMF.

I think it's important here to recognize that the United States is not the single actor here. If we want to take a position where we're not going to intervene depending upon what happens, other countries may decide to go along without us. On the other hand, if we refuse to intervene, then we do run the risk that the effects will be negative for us. So if you look at '98, I'd be surprised if the current Treasury secretary were asked by the current Federal Reserve chair or told by the current Federal Reserve chair that we have another Long Term Capital Management (LTCM) problem on our hands. It's hard to imagine that the Treasury secretary would not be convinced that there really is no alternative. You know, sometimes what you have to do is pretty distasteful. On the other hand, the alternative is worse. And in Long Term Capital Management, again the view had nothing to do with that firm and nothing to do with the investors who had put a lot of their wealth in that firm. It had everything to do with sort of the system of global finance and whether it would be destabilized if this set of defaults by one institution cascaded into a variety of institutions. That's a very serious systemic concern.

INTERVIEWER: The stakes were that high?

LAURA TYSON: The stakes were that high. I'm sure of that. You know, I was not in the room when that was done. However, the Federal Reserve would never choose to bring together a group of private actors to do something like that had it not thought that the systemic risks were extreme.