file Rohatyn

FELIX ROHATYN

Telephone: (516) 283-6345

TELECOPY COVER SHEET

Telecopier Number: (516) 283-8433

Date: ____________ Number of Pages____

To: Name of Company
Name of Individual Mellane Verveer
Telecopier Number 202-456-6244

From: F.R.

Message: Mellane: Enclosed is speech I gave a couple of weeks ago plus excerpt as run by Herald Tribune. Also running in LA Times Syndicate + European press. Limited in scope but may be helpful concept.

Best to you and
[illegible]

"POPULAR CAPITALISM"

Ambassador Felix G. Rohatyn
1998 Europlace Financial Forum
Paris, France
July 2, 1998

It is a great pleasure and privilege to address this prestigious group at a time when the Euro is just around the corner and the development of financial markets in Europe is in full swing. France is a key player in all of these developments, a founding member of the Euro and a powerful financial center as well.

Let me first say a word about Franco-American relations. Our relations are now calm and stable. After a difficult period, where there were significant strains in the relationship due to differing approaches on issues such as Iraq, Iran and Transatlantic trade, the fundamental strength of our relationship, based on our common objectives and our common values, allowed us to find a mutually satisfactory resolution of those problems. I am confident that the current bilateral environment of realism and mutual respect will allow us to continually strengthen our cooperation; our shared commitments to peace, democracy and the protection of human rights are the most fundamental of ties.

I was in Washington two weeks ago in connection with Prime Minister Jospin's visit with President Clinton, as well as with the first meeting of the Franco-American Business Council. The discussions between the President and the Prime Minister were broad-ranging, cordial and open. The excellent personal relationships between President Clinton and President Chirac as well as those between Secretary Albright and Foreign Minister Vedrine have had a very positive impact on Franco-American relations. I am quite certain that the new relationship between President Clinton and Prime Minister

The initial meeting of the Franco-American Business Council, as some of you here can attest to, was significant in starting a regular dialogue between leading French and American CEOs. This is amply justified by the high level of reciprocal investment already in existence and, hopefully, will lead to even greater investment and economic activity, as well as a better understanding of each country's economic and social policies. Secretary Albright, Minister Strauss-Kahn, and Secretary Daley addressed the group, and both President Clinton and Prime Minister Jospin paid a visit to underline the importance both governments attach to this private sector initiative.

Seen through the prism of American eyes, France today is a puzzling mixture. The economy is growing strongly, inflation is low, the Maastricht criteria have been met and France is a founding member of the Euro. The French securities markets are at an all time high, foreign investment is booming, the French private sector is highly competitive, and the start of the privatization of companies such as France Telecom and Thomson has taken place. I think it is fair to say that, as recently as a year ago, very few people in my country would have wagered that this would happen and, even today, there are still a lot of question marks as to the evolution of the French economy and of the French social structure. The role of the French State in the economy is still a concern in the eyes of American investors; the perceived need for structural reform in areas such as labor markets and taxes is still very strong. To many Americans in business and finance, there are still many questions about France, although the overall attitude is clearly much more positive than it has been. One of the themes of this conference is the impact of the Euro and Paris' role as a leading European financial center. The two are closely linked.

Paris' future as a financial center will obviously be in competition with London and Frankfurt. To put it most simply, I believe that the role Paris will play as a financial center will depend on the evolution of France towards what I would call "popular capitalism". Two powerful forces will determine that evolution. At the macro-economic level, the Euro will exercise powerful monetary and budgetary disciplines which should stimulate growth and the creation of wealth and employment. At the micro-economic level, "corporate governance" and the influence of major international institutional investors will create pressures for higher levels of profitability and competitiveness in the private sector, which should stimulate investment. These forces, however, will only generate their expected benefits if the structural reforms required by the globalization of the economy are allowed to take place in both the public and private sector, not only in France, but in all of Euroland. Europe would then be in a position to fulfill its objective as a true Transatlantic partner to the American economy; that would benefit all of us.

This process is one that we have gone through over the last decade. It has led to what I call "popular capitalism" in the United States because it has created more wealth and distributed it more broadly than at any other time in our history; and it also indicates that the private economy does a better job of meeting the needs of its citizens while can create. It started for us with the hard restructurings of American industry in the 1980s accompanied by painful employment cuts, but it really found its impetus in the policies adopted by President Clinton since 1992. Clinton found a country just coming out of recession, with a federal deficit of almost $300 billion, or 5% of GDP, 8% unemployment and interest rates. His first budget in 1993 proposed tax increases on upper income Americans coupled with stiff expenditure controls; this was a very courageous initiative for a Democratic president. The budget, incidentally, was adopted with a margin of one single vote.

These actions brought the deficit down dramatically, while parallel interest rate reductions caused the securities markets to rise sharply. The huge increases in private investment resulting from this cheap and ample capital, especially in the higher technology sectors, helped bring about the strong and sustained economic growth that we have enjoyed for almost 8 years, drove unemployment and interest rates down by nearly one half and brought our budget into surplus 2 years before it was expected. The $300 billion which was eliminated from the federal deficit is now available for private investment. It also helped to create "popular capitalism".

I am not here to argue for our model of economic and social structure. But I believe it is of interest to any city or country wishing to become a dominant factor in the financial markets. The wealth effects of "popular capitalism" have undoubtedly been a

economic growth. They are, in part, due to the proper functioning, great liquidity, transparency and sophisticated reputation of our financial markets. They are also due to significant socio-economic changes in our country. They have political consequences. They are relevant to your deliberations.

More Americans are now invested in the markets than ever before and stock ownership is not limited to a small wealthy class. As of the end of 1997, 44% of US families had direct or indirect stock holdings (including mutual funds, private pension economic growth. They are, in part, due to the proper functioning, great liquidity, transparency and sophisticated reputation of our financial markets. They are also due to significant socio-economic changes in our country. They have political consequences. They are relevant to your deliberations.

More Americans are now invested in the markets than ever before and stock ownership is not limited to a small wealthy class. As of the end of 1997, 44% of US families had direct or indirect stock holdings (including mutual funds, private pension funds, etc.) as opposed to 31% in 1989. By the end of 1997, according to the Federal Reserve, the value of those stock holdings had reached $9 trillion as opposed to $2.5 trillion at the beginning of the decade. They amounted to 42% of the financial assets of American families, compared with 21% at the beginning of the decade. More interestingly, the increase is spread among all income groups, with the highest increases among the lower income brackets. Stocks now represent a greater share of personal wealth than homes, and individual investors are now the biggest holders of American stocks and bonds. Their holdings exceed those of banks, insurance companies, and big business. An increasing number of middle and lower income Americans, investing in the markets is seen as an essential component of achieving the important goals of owning a home, providing for their children's education and ensuring a dignified retirement.

As you know very well, and as Minister Strauss-Kahn has emphasized many times, an important feature in America's "popular capitalism" and a key contributor to the dynamism of our economy is the high level of entrepreneurship. The reasons for this high level of risk-taking and innovative activity include the ample availability of risk capital, coupled with the speed of technological innovation and the involvement of academic institutions. Silicon Valley, whose technology probably accounted for a significant portion of U.S. growth for the last decade, is home to one-third of the 100 largest technology companies created in the U.S. since 1965; three of these companies alone, Intel, Cisco and Oracle, have a combined market value of about $200 billion.

As a result, Silicon Valley is the best example of a key aspect of "popular

As a result, Silicon Valley is the best example of a key aspect of "popular capitalism", namely employee ownership of corporate equity as well as profit sharing. Probably more than any other sector of American business, Silicon Valley has pushed the culture of employee ownership to the maximum and has created tens of thousands of millionaires among its employees. The rest of American business has followed. According to a study last year by the National Center for Employee Ownership, employees now control more than 8% of corporate equity in the U.S. (or almost $1 trillion of market value) through ESOPs, 401(k) and profit-sharing plans, or through broadly granted stock options and similar programs. This represents a dramatic increase from the 1 to 2 percent of corporate equity owned by employees about a decade ago. In a number of cases employees, through their ESOPs, have acquired control of large public companies. One such case, in which I was personally involved, was the acquisition of 55% of United Airlines by the pilots and machinists unions in exchange for $6 billion

worth of salary and other concessions. Five years later, the company is operating very profitably and the unions have realized a profit of several billion dollars on their investment. A number of studies have shown that the combination of employee ownership and participative management have resulted in significant gains in corporate performance. It is also no coincidence that the attitude of labor toward management also has become less confrontational. Despite some high profile strikes such as the UPS strike two years ago and the current GM strike, the number of days idle due to work stoppages was less than 4,500 in 1997 after averaging over 20,000 as recently as the late 1970s.

Another factor encouraging "popular capitalism" is "corporate governance". The transparency of board selection and management and the high quality of accounting standards is key to attracting capital, and even though there have been criticisms made that U.S. firms are unduly focused on short-term profits, in general the concentration on shareholder value and profitability leads to growth and job creation. Managements and Boards of Directors have also become more and more responsive to demands for greater competitiveness coming from financial institutions, including in many cases employee pension funds.

A final little-noticed but important phenomenon is the impact of "popular capitalism" on our not-for-profit institutions. The biggest beneficiaries of charitable giving in the U.S. are religious institutions followed by universities and cultural institutions. These have benefitted enormously from enhanced stock ownership and gifts

of appreciated securities. For instance, the endowments of colleges, libraries, churches and concert halls in and around Atlanta have benefitted to the tune of hundreds of millions of dollars as a result of the increase in value of Coca-Cola shares that were given to them by families of the founders of the company. This is a phenomenon that is repeated all over the U.S. and charitable giving, which amounted to $143 billion in 1997, is currently at an all time high as a result of very widespread stock ownership.

"Popular capitalism" is not without risk. Markets go down as well as up and the broader the popular participation, the greater would seem to be the risk to the general economy. So far, however, this has not been the case. Indeed, it would appear that the steady and almost automatic savings programs have provided some of the underpinning of the markets and that the wealth effect of that momentum has spurred overall economic growth. The huge amount of tax revenues generated by this phenomenon has also contributed to our budget going into surplus with the resulting interest rate decreases. But the risk is there and it must be recognized.

Some day markets are likely to turn down and "popular capitalism" will encounter some difficult moments. Whether that downturn is what is euphemistically called "a correction," whether it reflects what Chairman Greenspan called the "irrational exuberance of the markets", or whether it is simply the result of the business cycle remains to be seen. Despite that possibility, it is now a general perception that, over long periods of time, and despite large fluctuations, the returns on equities in the U.S. have

significantly outperformed any other investments and I would expect that, barring some unexpectedly serious and lengthy downturn, "popular capitalism" in my country is here to fde Bohatyn

10/13 17:00

AMBASSADOR'S PREPARED REMARKS FOR AGORENA (10/13/98)

It is now just over one year since I assumed my functions as the American Ambassador to France. It has been a challenging year, with a number of significant achievements involving France, Europe and the U.S. We congratulate France on being one of the founding members of the Euro. Since Jean Monnet's vision of a European Common Market and George Marshall's recovery plan for Europe, the U.S. has steadfastly supported further European economic and political integration. It is, therefore, quite logical that we wish the Euro to be a success. This is also true because we have invested over $1 trillion in Europe, with three and a half million Europeans working for American industries, of whom about 400,000 are in France. What is good for Europe is good for the U.S. and vice versa.

The Atlantic Alliance is a platform of stability for the entire world. It is crystal clear, when we look at the world today, that a strong and stable Europe linked to a strong and stable America is a prerequisite to global peace and prosperity.

The Alliance faces very different challenges today from where we were 50 years ago. Communist ideology and military confrontation are largely a thing of the past. Risks for our security interests now come from outside the North Atlantic theater (i.e. Mid-East, Africa, as well as the Balkans) and often take non-traditional forms, such as terrorism and ethnic cleansing; they can also include economic distress.

France's priorities, at this point, are concentrated on the construction of a Europe that can act as a truly independent and effective political and economic power. A strong and prosperous Europe is not inimical to U.S. interests. On the contrary; it is necessary, as long as it remains a partner and not a rival, to work with the U.S. and other powers on controlling those forces that most threaten our future: the proliferation of weapons of mass destruction; the threat of international terrorism; the traffic in drugs and the power of international crime; ethnic conflicts and their murderous consequences; the fragility of the international financial system. We must always remember, however, that the keystone to this relationship is the Atlantic Alliance and the shared benefits and responsibilities that it brings to its partners.

The world has also become a very small place. Nuclear explosions in India and Pakistan earlier this year were an unwelcome reminder that we cannot take nuclear peace for granted. The Persian Gulf and the Middle East are still potential dangers -- and the Asian financial crisis and the collapse of Russia remind us that we are connected with every part of the globe by a financial umbilical cord which may be quite fragile. Neither France, nor Europe, nor the United States can avoid the terrible repercussions if these crises get out of control, and we face the absolute necessity of working together in multilateral institutions to resolve them. Occasionally, we may have to act unilaterally. However, for most of the international challenges we face, 'going it alone' is not the right approach for America or Europe. They require alliances, based on shared principle and functioning through legitimate institutions.

Most of these institutions exist today; they are the UN; the IMF and World Bank; NATO; the OSCE; and the EU. Some of them undoubtedly require changes and reforms due to the rapid changes taking place in the world. But they are vital to the world's stability and the prosperity. President Clinton is committed to supporting these institutions and is working to get Congressional approval for full funding of the United Nations and the IMF. Congressional approval for IMF funds is probably the single most important action that can be taken promptly to restore some confidence to the financial markets and avoid a global recession.

The realities of the global economy have motivated some of our recent initiatives here at the American Embassy in Paris. The advent of the Euro is enhancing the economic significance of regions and regional markets. Consequently, American firms are increasingly inclined to establish presences in regional centers, bypassing capitals. As a result, and subject to consultation with Congress, we are planning to increase our regional representation, beginning this fall with Lyon, and we hope, over time, to open small representational offices in several other cities to better serve our constituents. This will enable us to better serve America's enterprises on the ground as well as to connect more directly with French public opinion outside the capital.

Furthermore, the changing nature of the global economy has made dialogue between our respective private sectors as important as dialogue between our two governments. As a result, we have encouraged the creation of the French-American Business Council consisting of about 25 CEOs each from leading French and United States companies to meet on a regular basis. The first meeting of this council took place in Washington in June of this year and was attended by both President Clinton and Prime Minister Jospin. We look forward to its next meeting next June in Paris in the presence of President Chirac.

The global economy is a fact of life. While we, in America, have had success in meeting many of the new economic challenges, we do not pretend that what works for us necessarily works for everybody. Insofar as economic policy inevitably affects social policy, we understand that France (as well as other European countries) demands a higher level of social protection than ours. Your economic policies obviously have to be geared to your social priorities, insofar as economic realities allow it.

The perception among many in Europe, that America has little or no social protection, is contradicted by the actual facts. We have strong economic growth as well as a strong social safety net, which takes up more than 50% of our budget. While we still have many unresolved problems, we have made considerable progress. One source of such progress in recent years has been the private economy itself, where economic growth has allowed us to balance the budget while financing social protection. Broad participation in ownership has created more wealth, more broadly distributed than at any previous time in our history. Despite the recent downward pressures in the financial markets, "popular capitalism" is a trend that will continue in my country, short of an unexpectedly serious and lengthy downturn in our economy. However, "popular capitalism" will be put to a serious test in the near future by the global financial crisis.

The financial crisis that is now shaking the world includes three components, quite different in character, but linked by the umbilical cord of the global financial markets. As a result, they reinforce each other and create contagion around the world.

The first component was Japan's deflation and the Asian financial crisis together with the devaluations and credit collapse in Thailand, South Korea, Indonesia, and later, Russia. The second is the significant, and in some cases dramatic, downturn in the securities markets of Japan, Western Europe, Latin America and the United States. The third is the continuing fallout from the near bankruptcy of LTCM and the wild swings in the currency and bond markets as many hedge funds unwind huge speculative positions in search of liquidity.

The result of these events has been the vaporizing of trillions of dollars of wealth all over the world, an incipient credit crunch together with a flight to safety, a significant slowing of the world economy, and serious social problems in many countries hit by the crisis. A further result is likely to be an intellectual and political backlash against modern market capitalism and the positive aspects of the global economy.

Continental Europe, for some time, has debated the social implications of *"le capitalisme sauvage"*, as many of France's leaders refer to the market-based, Anglo-Saxon economies. This is a view that holds that U.S.-style market economies are lacking in adequate social protection and are solely driven by financial objectives with little or no regard for the human cost.

The fact that American-style "popular capitalism" has provided more employment and more wealth to more people than ever before in my country does not offset, in the eyes of many in Europe, its harsh discipline. Market economies and "popular capitalism", together with the globalization that go with them, are going to come under severe intellectual and political pressure in many parts of the world.

Seen through the prism of European eyes, the most damning aspects of the current situation are, first, the unemployment and poverty inflicted on developing countries as a result of massive short-term speculative capital flows and of the harsh measures required by the Western-directed financial institutions in the process of stabilization.

The second is the risk to the global financial system caused by reckless speculation symbolized by so-called "hedge funds" such as LTCM. The result of these activities, namely the recent dramatic fluctuations in the foreign exchange markets and debt markets, are seen as dangerously destabilizing elements in a highly fragile global system.

These are valid issues and it is important that the international community be seen as dealing with them. Otherwise, we may see the rollback of market-liberalizing measures that have fostered economic growth over the past 50 years and, most importantly, have helped spread democracy around the world.

It has been over 50 years since the Bretton Woods Conference, and the institutions created there have performed remarkably well in fulfilling their roles. However, the recent meetings of the World Bank and IMF underlined the need for reform of these institutions as well as of the system, both to deal with the spreading financial crises and to restore confidence in global financial markets. President Clinton's proposal for emergency credit lines for the IMF, Japan's suggestions for a special fund for Asia, France's proposals for transparency and a political directorate, and Prime Minister Blair's call for a new Bretton Woods all indicate recognition by world leaders of the need for new initiatives and for clear and vigorous action.

It appears to many on this side of the Atlantic that too much faith may have been placed in the markets and too little attention paid to the lack of institutional infrastructure in many developing countries; that too much emphasis was placed on monetary reform and too little on the social costs that are sometimes the result. I believe that "popular capitalism" is the best way for advanced democracies to deliver higher standards of living to their people, by providing strong and sustained economic growth. However, as Federal Reserve Chairman Alan Greenspan has repeatedly indicated, modern market forces must be coupled with advanced financial regulatory systems, a sophisticated legal architecture and a culture supportive of the rule of law to generate, in a safe manner, the benefits that can be derived from the global economy. This, with a few exceptions, is the case in the United States and in Europe; it is not the case in many other parts of the world where unwise financial practices resulted in disaster. These are some of the issues the IMF, the World Bank, and the West's finance ministers are rightly concentrating their deliberations on.

However, even in the highly regulated markets of the U.S. and Europe we find vivid examples of the dangers of modern capitalism. The fact that so-called "hedge funds" are allowed to operate without the disclosures usually required by our laws, almost created a systemic financial crisis when LTCM nearly went bankrupt recently. A last minute rescue, organized by the Fed, prevented a crisis. But both the Congress, as well as bank and securities regulators on both sides of the Atlantic, will have to come up with recommendations on how to prevent a recurrence of this type of risk-taking. They will hopefully include enhanced disclosure requirements and changes in bank lending procedures.

Hedge funds are an old phenomenon under a new name. The leveraged investment trusts of the 1920's like the Shenandoah Corporation contributed heavily to the market collapse which led to the Depression of the 1930's. The main difference today is the level of the speculative positions of the modern hedge funds which operate in secrecy and have been estimated to control nearly $400 billion in assets on a minimal capital base. Unbridled speculation and reckless credit practices are as dangerous in developed countries as in emerging ones. They are the Achilles's heel of capitalism.

If we are to prevail in the arguments to come, we must make it clear that while we believe in a market economy, we do not believe that open markets mean the end of government and the sacrifice of social protection. For example, the rescue of New York City from bankruptcy could not have occurred without active cooperation from the Federal Government and the State of New York. Together with the city's banks and labor unions, the participation of government was critical to a recovery plan that succeeded as a result of a combination of expenditure control, economic growth, and a stretch-out of the debt. The key to crisis management at that level will always be the quality of political leadership. We were fortunate, in New York, to have had a Governor, Hugh Carey, who fully lived up to the task. As a result of his leadership, we were very conscious of the need to allocate sacrifice fairly among all New Yorkers. This played a critical role in our success and in the recovery of the city.

It is important to remember that today's financial crises may become tomorrow's political or security crises if we do not pay close attention to the social consequences of financial solutions. We resolved the New York City crisis with a combination of tough expenditure control together with new investment; this combination generated economic growth while ensuring fiscal discipline. These must go together if the seeds of social upheaval are to be kept from taking root; above all there must be a fair distribution of burdens and benefits. Unemployment and poverty are not the road to democracy and opportunity

Jim Wolfensohn, President of the World Bank, has said recently that social policy must walk hand-in-hand with financial policy, and Treasury Secretary Rubin has argued for "burden sharing". If we ignore this advice, tomorrow's crises will not be dealt with by finance ministers but by foreign ministers and, more likely, by defense ministers. The whole world will then be much poorer and much more dangerous.

Recognizing these issues will not solve the world's economic crisis. As President Clinton recently stated, only sustained, growth-oriented policies among the United States, Europe and Japan can hope to achieve that goal. In the meantime, recognizing the European point of view on some of these issues may reduce the backlash against market-based policies that is otherwise likely to spread.

To deal with today's issues requires cooperation among the leading powers, whether dealing with security in Kosovo or Iraq, or with financial crises in Brazil or Russia. There are those who believe that competition between the Euro and the Dollar, as between Europe and the U.S., will lead to serious divergences between our countries and our continents. I do not share that view although I recognize the risk. On the contrary, I believe that the successful launch of the Euro and the further integration of Europe, in which France will be such a key participant, will further strengthen our relationship. The current confidence in the French economy is a welcome recognition of the strength and competitiveness of the French enterprises. We must continue to work together to face the crises of the world that no single country can resolve on its own. We wish to see France, our oldest ally, strong, prosperous and confident, in a strong, open, prosperous and confident Europe. Those are the real stakes we have in protecting our historic relationship.

5/98 - trip

file Rohatyn

Summary Testimony of the Honorable Felix G. Rohatyn U.S. Ambassador to France

"The Report and Recommendations of the Overseas Presence Advisory Panel"

Committee on Appropriations' Subcommittee on Commerce, Justice, State, the Judiciary and Related Agencies

April 12, 2000

Embargoed until Delivery

Mr. Chairman, Members of the Committee: It is a pleasure for me to be here with you.

I was privileged to be a member of the Kaden Commission. The Commission, appointed by the Secretary of State with the support of the President and the Congress, concluded "that the overseas activities of our government are critical to the advancement of the nation's interests and that the way the U.S. Government conducts these activities needs significant improvement if the strategic goals of U.S. foreign policy are to be achieved."

The views I will express here are my own as one individual member of the Kaden Commission. They do not purport to reflect those of the State Department or any one of its senior officials. As you know Mr. Chairman, I am not a career diplomat, having spent practically all my working life in the private sector. My views, therefore, are those of a private sector executive, with extensive experience of the globalized marketplace, attempting to adapt a very large embassy to some of the forces which are driving the post-Cold War world. These are: the primacy of the private sector; the growing importance of regions and cities; the role of public diplomacy in the daily competition for ideas and policies. I would like, if I may, to discuss three specific recommendations of the Kaden Commission in the light of these new forces:

1) Create the right size and sites for our overseas presence, including the latest in communications technology.

2) Adopt the best private sector practices in human resource management.

3) Refocus the role of the Ambassador.

We have a very important presence in France which is a reflection of the breadth and depth of our common interests. My recommendations are aimed at enabling us to support these common interests more effectively through greater presence and a restructured presence.

When I came to France, about three years ago, I noted that we had almost 1,000 people located in Paris and thirty (30) people in our two remaining consulates, one in Strasbourg and one in Marseille, together with Agriculture and Interpol missions in Lyon and Montpellier. We had a lot of people in Paris, but what seemed to me to be completely inadequate representation in the regions for a country of 60 million people, a key member of the European Union, and one of the founders of the Euro.

The rise in importance of regions and cities has created new structures of economic and political activity where representation is critical. The classical "big embassy" structure in developed countries is today akin to using mainframe computers in the age of the Internet and PC. I believed that we could restructure and downsize Embassy Paris, reassigning personnel to the regions without increasing our overall costs.

As a result, we developed a model that we call American Presence Posts (also known as "APPs").

The APP is a small post that takes advantage of modern communications technology to avoid heavy staffing and heavy costs. It does not have, and must not have, classified communications capability. It is staffed with personnel transferred from the U.S. mission in France (or assigned to France), where we continue to absorb its operating costs. We as an Embassy are simply doing what American businesses do every day: we are following our customers - and we are restructuring ourselves to do it more efficiently.

President Clinton and Secretary of State Albright strongly support the new posts; congressional leaders including you, Mr. Chairman, Senators Helms, Stevens, Gregg, and Biden, Congressman Ben Gilman, and many others from both sides of the aisle, have also firmly expressed support. The Secretary inaugurated the first APP in Lyon in December 1998 where it was received with enthusiasm by the people of Lyon, and by American companies in the area.

The APPs ensure that our operations keep pace with the new Europe and do so effectively and economically. These new posts service American companies where they locate, as well as French companies wanting to go to America. They connect with French public opinion through regional media. They develop closer contacts with French mayors, who are a powerful political force in France. By next July, we expect to have a total of five APPs in the main regional centers in France, in addition to our two original consulates. We will then be in those areas where significant American economic interests are located and will have increased to 60% our coverage of the French economy. We are grateful for your continued support, Mr. Chairman, and that of your colleagues in the Senate and the House. We could not have accomplished this without your support.

The APPs are succeeding because they place a particular value on active public diplomacy in all of its dimensions - economic, political, social and cultural. This gives an enormous morale boost to the junior and mid-level officers assigned to APPs, plus invaluable experience in leadership and innovation. In the private sector, globalization has been accompanied by decentralization and greater efficiency. Twenty-first century diplomacy should follow the same path. The APP is a model that could be put in place in many other countries.

When we have completed our program, we will have five APPs staffed by five officers and 12 FSNs, in addition to our two consulates, and we will have begun, in a small way, the restructuring of Embassy Paris. At this time, the aggregate State Department cost of our first three APPs, amounts to $200,000 per annum. Our annual operating budget in Paris is $35 million, so these APPs are a huge bargain.

Embassy Paris has been requested, along with several other U.S. embassies, to provide "right-sizing" models for their operations. Such models can only be built up by the embassies in cooperation with the State Department and other agencies represented at post, based on their priorities.

Some embassies may require more and/or different personnel; some significantly less. These studies will take time and are likely to be controversial. Any actions taken will require forward planning, but we can begin to establish some criteria now.

My statement for the record describes how Embassy Paris uses a 903-person staff, and how they represent 43 entities of the USG. I also detail how our staff breaks down functionally and propose a transfer of some support functions to existing facilities in the U.S. As you will see, our operation is heavily driven by other agency staffing and a heavy administrative and support structure.

I believe in the principle that "smaller is better--", where feasible better for efficiency, better for morale and better for security. That means, first of all, that the embassy should eliminate functions not critical to its mission which can be performed somewhere else, at lower cost, and in greater security. Secondly, that some of its functions should be regionalized, along with similar functions of other European embassies, in Brussels, Frankfurt, or elsewhere. And third, that the remaining functions be reviewed individually, to determine their priority and to adapt them to their role.

In the first category, a key recommendation of the Kaden Commission is the creation of an Overseas Facilities Authority (OFA) to manage our physical plant. The OFA would become the construction and real estate manager to the State Department, with the Secretary maintaining full siting and security authority, but it would operate as would a separate private concern. This critically important recommendation should be implemented expeditiously.

The key benefit of such an organization would be to provide assurance of long-term financing to a critical function that is now subject to the vagaries of annual appropriations and to provide it with an independent management structure.

The same category includes the function of the Regional Financial Services Center ("FSC") in Paris. This operation employs 117 people, fills most of a building and efficiently serves as paymaster to our embassies in Europe and Africa. However, this entire operation (with the exception of a few specialists) should be relocated to the U.S. and folded into existing operations in Charleston, South Carolina. Such a transfer will take some time, but a decision could be taken promptly and executed over a defined timetable, possibly 2 years. Such a plan would obviously have to take into account our obligations to employees who would be affected by such a move.

The dollar savings in Paris would be significant, both in terms of operating costs as well as freeing up capital. Total operating expenses for FSC are budgeted at nearly $12,000,000 for FY 2000. The building could be sold for more than $26 million dollars. The cost of moving the operations stateside must be established but is likely to be a fraction of the savings and our physical security exposure in Paris would be reduced.

These first category actions would reduce our personnel by about 200 people. That still does not answer the question: what is the appropriate size for Embassy Paris? The answer will depend on the defining its mission vis-à-vis State Department and the represented agencies' requirements; on regionalizing certain activities; and, in a more general sense, on the role of diplomacy in a world in which the private sector and the internet are driving a revolution beyond the reach of governments.

Whichever way we look at it, Embassy Paris is larger than it needs to be. It is evident to me that a large proportion of actions bearing on Franco-American policies are the result of direct Washington-Paris contacts. These actions that drive the relationship are then reinforced by Embassy activities and reporting, carried out by representatives of the agencies at post. Given these realities, our embassy may not require the current number and configuration of people and the administrative support that goes with them. Moreover, our emphasis on outreach and on the embassy as a catalyst and platform for action will call for another look at our present staffing.

I would also like to make the point that right-sizing and efficient management do not mean just straight across-the-board cuts. We should look at functions instead of people, and reduce the number of functions in order to do them well. That should be a key objective of restructuring.

It is impossible to be definitive about the "right-size" for Embassy Paris until we have heard from State and the various agencies about their priorities; I would rather refer to a "reasonable" size. These should then be coordinated by an interagency process in which OMB has to play an important role.

I believe we should set as an objective for examination an Embassy Paris, together with our 2 consulates and 5 APP's, at a lower range of 400-450 people in the aggregate. The final number might be achieved over a 3-year period and should provide an appropriate platform for bilateral activities and would represent a sizeable reduction from the present. It is worth noting that the British Embassy in France is staffed by 240 people and the German Embassy by 180 people. Represented agencies can target cuts but a reasonable overall limit should be suggested. Without such a target, it will be impossible to really test the ability to downsize. A smaller, leaner embassy will also encourage those individuals who are entrepreneurial, accountable and prepared to act. It may require longer tours for continuity, as well as an evaluation and promotion system more akin to the best private sector practices of companies such as GE.

We want people to be more and more comfortable with the private sector. For instance, we have created a high-level group of French-American CEO's of about 70 companies, with 4.5 million employees and a market value over $2 trillion. Such a group can be very helpful on bilateral economic and financial issues. All of our senior officers are encouraged to develop relationships with the local business and cultural leaders. They are motivated to achieve total fluency with the language, in order to make use of media on a regular basis.

And finally, we need an overall mission objective, a transparent consolidated budget, and the authority for the Ambassador and DCM to manage toward this objective within that budget. Because budget control is spread among the agencies at post, these authorities do not exist today. The DCM should be able to serve as the Chief Operating Officer in an organization of which the Ambassador is Chairman. It is impossible for the Ambassador in a large embassy to fulfill his various responsibilities and be a day-to-day manager.

In closing, I want to make it clear that my judgment that a significant downsizing is appropriate for Embassy Paris (and possibly for other large developed country embassies) does not imply that a general downsizing is appropriate for all embassies. I strongly support an appropriate investment in our overseas programs and our overseas facilities. Many of our facilities are in disgraceful physical condition and impose significant hardships on our people. Restructuring our overseas presence means reducing investment where it is redundant and increasing where it is necessary.

State Department employees are extraordinarily able, dedicated and patriotic. Secretary Albright is a strong leader and I know that the Secretary supports the Kaden Commission. Fulfilling its mandate will require full partnership between the Congress and the Executive. It is a task that our position in the world requires.