



3-1, 3-2, 3-3

I intend to publish this collection of words in a volume that can provide important insights into the thoughts, priorities, and attitudes of major shapers of our culture; like you. Among the individuals who already have shared gifts of words or phrases are Former President Gerald Ford and your good wife, First

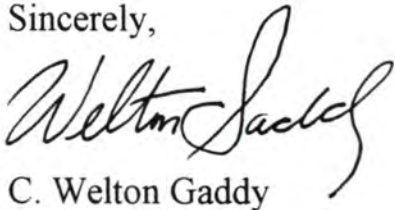
Don - ^{Carl} Coordinate w/ Counsel -
especially photos signature
on last page. ~~Don~~

Lady Hillary Rodham Clinton. A contribution from you is very important to me.

If you have time, I would appreciate also a sentence or two from you explaining why the particular word or phrase you share is important to you. Your spontaneous response may be best. I have enclosed a sheet on which you can pass along your word or phrase, record an explanation for your choice, and grant me permission to quote you. Please forward your word gift to me even if you choose not to explain the word's significance to you.

Knowing the many demands on your time, I am very grateful for your consideration of this request. I hope to hear from you soon so your contribution can be a part of this collection.

Sincerely,

A handwritten signature in cursive script, reading "Welton Gaddy". The signature is fluid and elegant, with the first name "Welton" and last name "Gaddy" clearly distinguishable.

C. Welton Gaddy

P. S. The publication of this collection of "word gifts" will not take place until your term of office has been completed.

Enclosure

Dr. Gaddy: -

I give you the following word (or phrase):

Gal 6:9 - Let us not grow weary in doing good
for in due season we shall reap
if we do not lose heart.

I offer this particular word (or phrase) to you because:

It has helped to sustain me
in hard times, to remind me of the obligation
to persevere through frustration, sadness, and
loss.

You have my permission to associate the above word (or phrase) with my
name and to quote my explanation for choosing to share this particular gift.

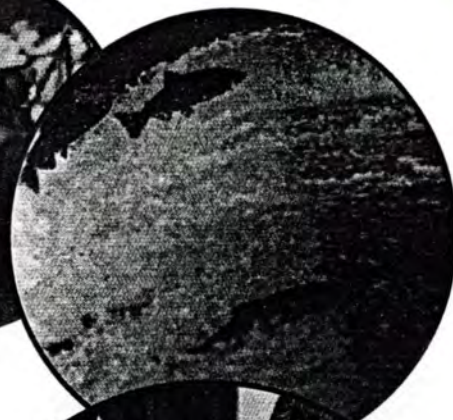
Bruce Chisler
Signature

3-11-2000
Date

Podesta
from my friend
Broun Van Dyke
former —
Pls see me
Mo: 700
PR

THE PRESIDENT HAS SEEN
3-13-00

Copied
Ricchetti
Podesta



California's Looming Water Crisis:

*A Status Report
November 1999*

California's Looming Water Crisis: A Status Report

Table of Contents

Overview	2
1989: A Water System On The Edge	6
Today: Environmental Rebound	8
Looming Water Supply Crisis	14
Water Quality Degrading	20
Outlook: Where Do We Go From Here?	22
Appendix	24

Presented by the
Association of California Water Agencies

HOLLYMEAD ELEMENTARY SCHOOL

2775 POWELL CREEK DRIVE
CHARLOTTESVILLE, VIRGINIA 22911
PHONE: 804/973-8301 . FAX: 804/978-3687

Cynthia C. Dragich
Principal

David A. Cushman

President Bill Clinton
C/O Scholastic News
555 Broadway
New York, NY 10012

3-13-02
Per Nancy- POTOS
wants letters to
go to all _____

Send to Burkhardt >
Yes _____
No _____

3 AM 9:06

Dear President Clinton:

I am writing to suggest some ideas that may make schools in our nation safer. I hope you will review them and consider looking into them further.

First of all, I feel there should be more in-school safety and educational classes on firearms and guns. This may help in understanding the dangers more clearly.

Secondly, more time should be directed to teaching about drug use and abuse. Sometimes we should be shown real life situations to give us the necessary guidance in making the right decisions.

Last but not least, I believe the schools should make everyone wear uniforms. Sometimes little things like this can cause a lot of problems. I understand some kids can't afford the "in clothing" and they are ridiculed to the point they become angry. Once they become angry and feel like they are different, they rebel and they fight back.

Well these are just a few suggestions, but they may make a difference. Thanks for reading my letter.

Signed,

Chris Jones
Chris Jones



FAIRFAX COUNTY
PUBLIC SCHOOLS

Newington Forest Elementary School

8001 Newington Forest Ave.
Springfield, Virginia 22153

7944 Forest Path Way
Springfield, VA 22153
10-21-99

President Bill Clinton
c/o Scholastic News
555 Broadway
New York, NY 10012

Dear President Bill Clinton:

I have read your article in the Scholastic News. I agree with you that schools and students should be safe from gun violence. The school I go to is called Newington Forest Elementary School. It is a very safe school but last year we had a bomb threat. Teachers in our school think that it was probably a student who wrote it. Even though there was no bomb, some kids were scared and confused at first. We had to stay outside in the field for a few hours. A lot of people were glad when we could go back inside. I have some ideas that I would like to share with you that have to do with decreasing gun violence at schools. My first idea is that we ask teachers to teach students about gun violence and why it is wrong. Another idea I have is that we could ask someone who is older and famous to talk to kids about gun violence and why it is wrong. A lot of kids and teens look up to someone they admire and will probably listen to him/her. Also, I think that if anyone is feeling mad, sad, or frustrated and will want to do something violent, they could immediately talk to an older kid, parent, counselor, teacher, coach, etc. I think since we all deserve to be in a safe school, we deserve to know that we are safe too. Please consider these ideas.

Sincerely,

Zahra Younoszai

Zahra Younoszai (age 10)

THE PRESIDENT HAS SEEN
3-13-00

Copied
Bergen
NSC W W Desk
Podiatry

Handy

What about the
and why are we
opportunity (Robin Newark)
discussing them

BK



BY SAMI SALLINEN—REUTERS

An Eritrean soldier peers through spy hole of front-line trench along Ethiopia-Eritrea border.

Progress in an African War?

Ex-Peace Corps Members Hopeful on Ethiopia-Eritrea Deal

By STEVEN MUFSON
Washington Post Staff Writer

Five former Peace Corps volunteers said yesterday they have made a breakthrough in peace negotiations that could settle a border dispute between Ethiopia and Eritrea that has cost each of the East African countries thousands of lives in fighting over the past two years.

Charles Dambach, one of the former Peace Corps volunteers who have been trying to help mediate the dispute, said that by changing the sequence of implementation measures in the settlement proposed by the Organization for African Unity, the group had resolved a major stumbling block in the talks.

But State Department spokesman James P. Rubin said that while the volunteers were "well-intentioned," their "efforts do not reflect the extent of the problem nor do the private efforts reflect the views and concerns of the leaders of Ethiopia and Eritrea."

Dambach said the hurdle has been that Ethiopia did not want to agree to a cease-fire until Eritrea withdrew to pre-May 1998 borders. Although Eritrea agreed to withdraw to that point, the two sides could not agree on where those borders were.

According to Dambach, Eritrean President Issaias Afwerki said yesterday he would accept a delay in a formal cease-fire until a commission appointed by the OAU demarcates the border in effect before fighting broke out in May 1998. The former Peace Corps volunteers said that Ethiopian officials yesterday said they would guarantee the commission's safety, accept the commission's demarcations and implement a cease-fire after Eritrea withdrew.

Two other important issues remain in the talks: the composition of an observer or peacekeeping force that would monitor the border and whether there would be any limitations on Ethiopian government powers in the disputed area.

But Dambach said that settling the technical issue of how to reestablish the border was critical and would bring an end to fighting between the countries, which split after a long civil war.

and OAU mediators should be able to "get [a deal] to closure."

Last year, a senior State Department official called the volunteers "naïve," and yesterday an administration official said the volunteers were "focused on a small subset of the issues" and that theirs was "not a serious effort."

Anthony Lake, former national security adviser and President Clinton's special envoy, returned from a two-week mission to Ethiopia and Eritrea last weekend. On Wednesday, the State Department said that during Lake's trip "consensus was reached on some of the provisions" of technical arrangements, "while others require additional mediation."

In a letter written Thursday, however, Issaias expressed frustration about the lack of progress in talks, lamenting that "the efforts of the past seven months have thus been wasted without any fruit." He complained that "the entire peace package is at a crucial crossroads and literally on the brink of collapse."

The former Peace Corps volunteers—four of whom served in Ethiopia when Eritrea was still part of Ethiopia—said they had discussions later on Thursday and yesterday that overcame the technical issues related to a cease-fire.

"I'm very optimistic," said Ghebre S. Mehreteab, a Washington businessman from Ethiopia who spoke to Issaias yesterday. The former Peace Corps volunteers, he said, "have the trust of the two sides, which is rare." He added that the former volunteers had "uncomplicated the process."

The former Peace Corps volunteers include Dambach, a past president of the National Peace Corps Association; Mike McCaskey, chairman of the Chicago Bears football franchise; John Garamendi, former California state official and former deputy interior secretary; William Canby, U.S. appellate court judge in Phoenix; and Melvin Foote, executive director of the Constituency for Africa.

The two countries went to war in 1998 over a relatively small, mostly barren and sparsely populated area. The war and the maintenance of large armed forces have contributed to the possibility of wide-

The Boston Globe

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Ethiopia's roadblock to peace

A nation where 8 million people are threatened by famine would be wise to end a senseless war immediately. Ethiopia ought to accept an African peace plan that calls for the peaceful settlement of its border dispute with Eritrea.

Yet late last month fighting broke out, as it has periodically since heavy combat ended last June. Eritrea blames Ethiopia, but whatever really happened, it is clear that Ethiopia is presenting the biggest roadblock to peace.

The Organization of African Unity devised a peace plan last summer that provided for a withdrawal from contested areas and the demarcation of the border by disinterested outsiders. This would be a textbook example of how a regional organization settles a border dispute if the Ethiopians would only agree to accept the plan in full.

Instead, they are haggling over the precise nature of the withdrawal and whether any weapons will be allowed in the disputed zones. These issues could be resolved with a minimal amount of good will. Ahmed Ouyahia, an OAU mediator, was in the

region last week in an effort to help out.

So was Anthony Lake, former national security adviser to President Clinton, who shuttled between the two capitals. Once the peace plan is accepted, the United States would almost certainly finance a peacekeeping operation in the disputed area.

The war is fueled by more than boundary disputes. Since Eritrea broke off from Ethiopia in 1991, the two countries have yet to devise an economic relationship that combines interdependence with independence. Eritrea controls the two ports through which most of Ethiopia's seaborne commerce flows, while the 59 million Ethiopians are prime customers for anything the 3.9 million Eritreans have to sell.

As it did 15 years ago, when it was fighting to prevent Eritrean independence, Ethiopia today faces a famine that could kill hundreds of thousands of people. Ethiopia was then ruled by Mengistu Haile Mariam, a brutal dictator. The international community needs to remind the present rulers, a more democratic group, that it must end the war to avert another humanitarian catastrophe.

Chicago Tribune

FOUNDED JUNE 10, 1847

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20 Section 1

Friday, February 4, 2000

To arms again in the Horn of Africa

The simmering border war between Ethiopia and Eritrea is poised to erupt again in bloodshed and agony for the people of those troubled nations in the Horn of Africa.

Despite the best efforts of the Clinton administration to negotiate a peace, some 250,000 troops have been assembled on each side of the disputed border, ready to resume a conflict that killed more than 70,000 people in 1998 and 1999.

War is seasonal there. The rains have passed, followed by a season of major arms buying and now the dry season. Tragically, there appears to be little, if anything, the U.S. or other outsiders can do to stop it.

President Clinton wisely has made Africa a growing priority in U.S. foreign policy. In fact, he has tried repeatedly, and personally, to persuade Eritrean President Isaias Afwerki and Ethiopian Prime Minister Meles Zenawi to make peace. He has sent his former national security adviser, Anthony Lake, along with other envoys, to keep up pressure. There is still hope for a negotiated solution, but it seems to be fading.

Some observers would like to see the U.S. turn up the heat by threatening to cut American and World Bank aid to the combatants. Others advocate a Camp David-style summit with Clinton providing both sides with political cover to back down and accept his

mediation. Chicago Bears Chairman Michael McCaskey, who taught school in Ethiopia for the Peace Corps in the 1960s, has joined other prominent former Peace Corps volunteers promoting a peaceful solution.

But Africa experts inside and outside the U.S. government correctly point out that Clinton and the Organization of African Unity have presented a workable plan. Both sides have accepted it in principle, but they are still at an impasse over its implementation.

Few argue the facts. After gaining independence from Ethiopia in 1993, Eritrea invaded parts of Ethiopia in May 1998, touching off conflict and trench warfare over the border region.

Ethiopia recaptured much of the disputed area, and Eritrea has agreed to "redeploy" from the rest of it under the OAU plan to demarcate the border. But Ethiopia still has technical problems with the plan and is demanding a full withdrawal by Eritrea before the border demarcation.

Negotiations continue, but in the end, the dispute may well erupt into war again until both sides fight to a stalemate or tire themselves out. What remains to be seen is whether it will cost tens of thousands of lives, yet again, to put this dispute to rest once and for all.

The U.S. has devoted substantial energy to the effort to broker a peace. Sadly, that sometimes isn't enough.


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NOTES FROM HERE AND THERE

Lewis Dolinsky

A WAY TO END ONE OF AFRICA'S TERRIBLE WARS

On February 23, there was a new skirmish in the Ethiopia-Eritrea war, the so-called war of cousins. Each side claimed that the other shot first and that the other sustained serious losses. Each side said it wants peace but won't be pushed. The clash was timed perfectly for the visit of President Clinton's envoy, Anthony Lake. After 10 days of shuttle diplomacy, Lake came back Sunday without a deal. But a private group of five former Peace Corps volunteers and staff, headed by John Garamendi, may have a solution.

Garamendi, a former California assemblyman, insurance commissioner and deputy secretary of the Interior, is now a partner in an investment firm with an office in Washington. His associates in this peace mission are Mike McCaskey, chairman of the pro football Chicago Bears; William Canby, a federal judge in Phoenix; Melvin Foote, director of the Constituency for Africa; and Chic Dambach, president of the Museum Trustees Association in Washington and past president of the National Peace Corps Association. All but Dambach served in Ethiopia or Eritrea (it was one country then) in the 1960s or '70s. They are heartsick over this war, which has taken tens of thousands of lives and jeopardized the futures of both nations. Neither can win.

The five Americans traveled to the Horn of Africa in June, met with top officials there and in Washington and with unofficial groups and concluded that both sides want peace. Garamendi says, "We're past the emotions on both sides -- they were very intense; they waned." But negotiations have stuck on one phrase, "status quo ante." That means as it was before May 6, 1998, when somebody invaded somebody and this absurd border war began.

In November 1998, the Organization of African Unity produced a peace plan. Ethiopia signed

Friday, March 10, 2000

San Francisco Chronicle

CHRONICLE SECTIONS

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on, but Eritrea was resistant until its troops were driven out of Badme, flash point for the original fighting. In August, the OAU announced the "technical" arrangements for carrying out its plan. Eritrea accepted, but Ethiopia objected to parts. It is unwilling to accept a cease-fire, then wait for the OAU to determine where everything was on May 6, 1998. For Ethiopia, the status quo ante has to be defined in advance.

Why the hell not? A collective lightbulb went off in the heads of the Garamendi 5. Why not create the map of May 6, 1998? People know where the checkpoints were.

From the reluctant Eritreans, the Garamendi 5 got lines on a map. From the reluctant Ethiopians, they got names of towns. They're trying to piece them together. The issue is no longer whose citizens were where. Eritrea doesn't even worry about the exact locations because it has confidence that it will win in the long run -- and be vindicated on the permanent boundaries, which will be marked by an OAU commission using colonial era-maps.

On Tuesday, there was a breakthrough. Dambach asked a "well-placed" Eritrean official, "If there's a big difference in how each side remembers the checkpoints, why not have a neutral commission determine them in advance?" The official said, "No problem." But one condition: Ethiopia must pledge to agree to whatever the panel decides if Eritrea makes the same pledge.

Yesterday, Dambach went to both embassies to see whether each side would really make that pledge. Each side said yes. But the lack of trust on each side remains.

It is easier for Eritrea to move toward peace. In that small country, President Isaias Afwerki is clearly in command. In Ethiopia, where some groups never accepted Eritrean independence, Prime Minister Meles Zenawi must rule by consensus. But there are new incentives to get out of this mess: Ethiopia has fires raging and a drought. The State Department says 8 million Ethiopians are in danger of starving. More significantly, Ethiopia now has what it needs. It can say: We defended our borders and can proceed to peace with honor.



الرئيس
The President

Asmara, 9 March 2000

The Honourable William Clinton
President of the
United States of America

Dear Mr. President,

Allow me to convey to you my best wishes for success and good health to your person during your last year of Office.

I have been writing to you, from time to time, to update you on developments regarding the conflict between my country and Ethiopia and to convey to you my candid thoughts and concerns with the aim of soliciting your vital contribution towards its peaceful and legal resolution.

As you will recall, Eritrea accepted in good faith the Technical Arrangements worked out with the participation of US experts when it was explicitly told that "these were not open to amendments". The latter provision originated in response to the express requests of the Ethiopian authorities. Indeed, as communicated to us by the OAU special envoy at the time, the Ethiopian authorities, which were casting doubt on Eritrea's acceptance of the Modalities of Implementation, suggested that the Technical Arrangements be elaborated by technical experts for submission to the conflicting parties as a "take it or leave it" document. The exact words of the Ethiopian Prime Minister to the OAU special envoy were: "decide and catch us".



الرئيس

The President

But when the TA were worked out under this premise, the Ethiopian authorities reneged on their prior commitment and forwarded 39 queries to the OAU. The OAU duly provided satisfactory clarifications to Ethiopia's questions, underlining in the process that the document remained non-changeable.

I hardly need to emphasize that the Technical Arrangements are a faithful elaboration of the Framework Agreement and the Modalities of Implementation endorsed by the OAU Summits. In this connection, I recall your words, Mr. President, describing the three documents comprising the OAU peace package as "comprehensive and fair".

When we appealed to you for pressure to be brought to bear on the Ethiopian leadership for rejecting the TA and impeding the peace process, you asked us to exert maximum patience and restraint as your envoys were working vigorously to "persuade" the Ethiopian authorities to accept the peace package.

Unfortunately, all the endeavours exerted in the past seven months have been in vain. The authorities in Ethiopia have been and continue to resort to obstructionist tactics to dilute and ultimately scrap the two basic documents (the Framework Agreement and the Modalities of Implementation) under the pretext that the Technical Arrangements require "modification". The Ethiopian authorities have even rejected the normative request for the two documents to be officially signed by both parties as a legal testimony of their acceptance. The efforts of the past seven months have thus been wasted without any fruit.

We have now learned – during the visit of the OAU special envoy, Ahmed Ouyahia and your special envoy, Anthony Lake to this country last week – that all the commitments made have been breached. Consequently, we have communicated to the OAU Chairman, President Bouteflika, to ensure the signature by both parties of the FA and MOI, and, inform us formally whether the Technical Arrangements are open to amendments.



الرئيس
The President

Mr. President,

In spite of seven months of tireless efforts, the entire peace package is at a crucial crossroads and literally on the brink of collapse. In the event, I renew my appeal to you to take the measures that are necessary to rectify the situation.

Accept, Mr. President, the assurances of my highest esteem.


Isaias Aiywerki

3-13-00

Copied
Frampton
Podesta**I·M·B·A**

INTERNATIONAL MOUNTAIN BICYCLING ASSOCIATION PO BOX 7578 BOULDER CO 80306 USA 303.545.9011 www

Date: February 8, 2000**To:** President Clinton
From: Ashley Korenblat**Re:** Bicycles in National Monuments

Geo Frampton
What about the?
Ashley's an old friend
BC

Dear President Clinton,

The International Mountain Bicycling Association (IMBA) heartily supports your land legacy initiative and your use of the Antiquities Act to create significant new National Monuments. IMBA greatly appreciates your efforts to protect our public lands and precious natural resources.

In your proclamation designating the Grand Canyon-Parashant National Monument, you stated that, "All motorized and mechanized vehicle use off road will be prohibited."

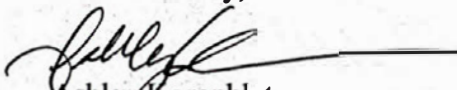
This wording bans mountain bicycles from trails. The International Mountain Bicycling Association (IMBA) believes that such a ban is inappropriate. Mountain bikes are silent human powered vehicles that can be safely ridden without environmental damage on dirt trails.

Therefore, we believe that future National Monument proclamations should allow bicycle use not only on roads, both paved and unpaved, but also on dirt trails where appropriate.

- The use of bicycles encourages visitors to enjoy National Monuments without driving their cars, helping to reduce traffic congestion and pollution, and improving the quality of the visitor's experiences.
- Federal agencies should remain open to the possibilities for bicycle access within National Monuments and other federal lands.
- Federal agencies should allow local or district managers to determine Monument management plans with regard to bicycles.

IMBA is available to assist with agency efforts to develop National Monument management plans. We appreciate your time and consideration and are grateful for your leadership in the creation of these important National Monuments.

Most sincerely,


Ashley Korenblat
President, IMBA

CC: Dan Sakuro, Council on Environmental Quality
Molly McUsic, Roy Wright, Department of the Interior



WESTERN SPIRIT CYCLING



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MOUNTAIN BIKE ADVENTURES

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During our trip, Ex-Im Bank announced a new program of \$1 billion in guarantees of loans in local currency - an effort to reach small- and medium-sized businesses that may hesitate to borrow US dollars to buy US goods but may borrow rupees. Ex-Im Bank also announced an agreement to provide \$500 million for the Power Finance

Corporation to support transactions involving US exports of energy-related technologies, goods and services.

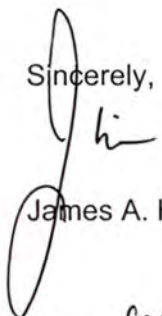
Ex-Im Bank could, however, make the most significant contribution to India and to US trade with India through financing infrastructure. The biggest infrastructure problem is electricity supply – much of the country receives unmetered power at very low rates and very poor quality electricity. This is a difficult problem, but there are signs of hope. We met with the Minister of Power, who has set goals for metering, unbundling and privatization of distribution. Although few independent power projects have been completed and State Electricity Boards may be insolvent, some states are moving in the right direction. Ex-Im Bank is considering selecting one or two states to support through a facility to buy US goods. This would provide credibility, build support for appropriate reforms and attract US investment in power projects. The central government would support and encourage this effort, and US companies would clearly appreciate this leadership. We believe Ex-Im Bank can structure this financing mechanism to be creditworthy.

Enclosed is our trip report for your staff's review.

Finally, I would very much appreciate the opportunity to meet with you regarding India and to discuss the future of Ex-Im Bank. I also wish to encourage you, again, to speak at our annual conference in April.

With best regards,

Sincerely,


James A. Harmon

I am enclosing on a separate page a list of message points for your consideration re. our Annual Conference - I need your support / participation at this event -
Thanks,

JH

**Export-Import Bank of the United States
Annual Conference 2000
April 12 and 13, 2000
Washington Hilton Hotel, Washington, DC**

Suggested Message Points:

- Seven years ago the Administration launched the National Export Strategy, which made the expansion of American sales abroad a cornerstone of our economic and foreign policy.
- The Strategy worked. Communities have been strengthened and American firms both large and small have benefited by joining in the global economy.
- Direct evidence of our success is that Ex-Im Bank supported more than \$100 billion of US exports in the past seven years, directly creating or sustaining more than one million US jobs.
- The Bank has strong support from the labor, environmental and business communities.
- Looking to the future, we cannot underestimate the importance of free trade in the new economy.
 - Re-enforce importance of trade with China...
 - Re-enforce importance of trade with India...
 - Re-enforce importance of trade with sub-Saharan Africa...

*Put my schedule
in (Don)*

3.13.00

Gunn/285

TRIP REPORT

Ex-Im Bank Chairman Harmon's Visit to India

February 21-26, 2000

Executive Summary:

During his first visit to India as Chairman of Ex-Im Bank, James Harmon: (1) underscored Ex-Im Bank's desire to significantly expand its financing activities in the Indian market, (2) discussed future business opportunities with senior government, financial and business leaders; (3) announced that Ex-Im Bank would for the first time in its 65-year history guarantee loans in local currency (rupees) up to an aggregate amount of \$1 billion, (4) signed a memorandum of understanding (MOU) with the Indian government-owned Power Finance Corporation to collaborate on projects; and (5) obtained a first-hand perspective on the current market conditions.

copied
Spurling
NSC

Ex-Im Bank currently has \$1.8 billion in outstanding loans and guarantees with India. As compared with other major Asian markets (\$6 billion in China, \$3.8 billion in Indonesia, and \$3.5 billion in Korea), Ex-Im is "under-invested" in India. This visit was timely for business development purposes because it followed the lifting of U.S. economic sanctions against India, followed recent and successfully democratic elections of new centre government leadership in India, and preceded by one month President Clinton's visit to India (which is the first U.S. Presidential visit to India in 22 years).

Chairman Harmon met with Indian centre government authorities including: a meeting with Finance Minister Sinha; Power Minister Kumaramangalam; Information Technology Minister Mahajan; Environment and Forests Minister Baalu; Reserve Bank Governor Jalan; Indian EXIM Bank Managing Director Desai; as well as officials at the state levels in Tamil Nadu and Maharashtra. All officials agreed that the rupee guarantee was a good idea and would likely be of use to Indian buyers.

Chairman Harmon met with various US exporters, Indian buyers and US and Indian bankers to obtain their perspectives on current conditions and future outlooks. Chairman Harmon stressed how the Ex-Im Bank financing can help Indian buyers meet their purchasing needs from the U.S. and help increase U.S. exports to India. During these meetings, we were able to discuss how best to implement the mechanisms needed to guarantee rupee-denominated loans and increase Ex-Im Bank financing to the small and medium-sized businesses in India.

A principal goal of this trip was to increase public awareness in India about Ex-Im Bank programs and our mission to support the purchase of U.S. goods and services in the developing world. Chairman Harmon utilized every opportunity to discuss Ex-Im Bank's commitment to India and its importance to the U.S. In accomplishing this goal, he gave a major speech in each of the three cities and conducted many interviews with Indian press (television and print). The Ex-Im Bank Office of Communications worked closely with the United States Information Service in arranging these media opportunities.

Ex-Im Bank Participants:

James A. Harmon -- Chairman

Clyde W. Robinson -- Vice President and Counselor to the Chairman

David Chavern -- Vice President, International Business Relations

Marsha Berry -- Vice President for Communications

Khalid Azim -- Special Assistant to the Chairman and White House Fellow

Meetings:

New Delhi, India February 21-22, 2000

- AmCham breakfast
- Meeting with Airports Authority
- Meeting with Indian Airlines
- Luncheon speech before the Federation of Indian Chambers of Commerce and Industry (FICCI)
- Meeting with Industrial Finance Corporation of India (IFCI)
- Press Interviews
- Meeting with Minister of Environment and Forests
- Meeting with Minister of Information Technology
- Embassy/FCS reception
- Meeting with Ambassador and Unocal CEO
- Country Team briefing
- Meeting with Ranbaxy CEO
- Meeting with Minister of Finance
- Meeting with Minister of Power
- Luncheon, MOU signing ceremony and meeting with Power Finance Corporation
- Meeting with Civil Aviation Secretary

Chennai, India February 23, 2000

- Breakfast with State officials and Consul General
- Round table on power sector
- Meeting with Office of Chief Minister
- Speech before local officials and students at Indian Institute of Technology
- Meeting and luncheon with Confederation of Indian Industries (CII)
- Round table on information technology
- Press interview

Mumbai, India February 23-25, 2000

- Jet Airways tour
- CII breakfast
- Meeting with Reliance Industries
- Meeting with Ratan Tata
- Environment speech before the U.S.-Asia Environmental Partnership, ERC, and Chemtech Foundation
- Press availability

- Meeting with Governor of Reserve Bank of India
- Meeting with Hinduja Group
- Bank of America reception with bankers
- Citibank breakfast with bankers
- Meeting with Jet Airways
- Meeting and lunch with Ex-Im Bank of India and Indian banks
- Meeting with Enron
- Press interviews
- Meeting with Uttam Steel
- Meeting with Industrial Development Bank of India (IDBI) and Small Industries Development Bank of India (SIDBI)
- Dinner with Ajay Piramal

Follow Up

- Make the \$1 billion rupee guarantee program operative
- Follow up on MOU with Power Finance Corporation for up to \$500M in power projects
- Follow up with the Airports Authority on the proposed \$100M Credit Guarantee Facility
- Follow up with Ex-Im Bank of India for MOU on co-financing arrangement
- Follow up with IDBI and SIDBI to establish an on-lending facility to Indian SMEs

New Delhi

Breakfast with AMCHAM

Speaking to the American Chamber of Commerce in India, the Chairman said there was a perception that, while India is on the cutting edge in technology, it is still too bureaucratic. This perception makes it more difficult to attract foreign investment. AmCham executives commented that India has become less bureaucratic with a significant improvement in the last 7 years. The executives believe that the current government appears to have the will to listen and try, but they need help de-regulating gas and electric power. In response to a suggestion that Ex-Im lend directly to India's states or municipalities, the Chairman said that idea had enormous appeal and noted that Ex-Im, first among export finance lenders, recently made such a loan directly to the city of Buenos Aires. Centre government has made some policy changes, but more reforms are needed at the state level. The Chairman stated his desire to try and make the states see the benefit of getting their financial houses in order. Another participant noted that Hermes and the Ex-Im Banks of Japan and Korea were very aggressively seeking more business in India by using the corporate sector to market their financing. Harmon agreed that the Ex-Im financing sector is becoming very competitive and that the U.S. Ex-Im needs to do a better job of marketing its services.

Meeting with Airports Authority Chairman Gupta

Harmon said airport privatization and upgrades were being done all over the world, and that this is an important area for Ex-Im. Gupta responded that Ex-Im financing of \$56 million had played a key role in acquiring Raytheon navigation equipment for India's airports, but that further upgrades were still needed. Gupta suggested tying the equipment upgrades to a new agreement, perhaps linking 80 of the country's 120 airports by Satcom. There could be

a formal decision on this by President Clinton's visit to India in March, Gupta added. Harmon said he thought the timing was right and that a comprehensive agreement should be pursued. Gupta asked if the Authority could fund against a previous financing request (that had a balance of approx. \$1M from a loan disbursed in Aug. 1999) to purchase instrument landing systems. Some discussion was held to explain local costs coverage and Ex-Im Bank's experience in securing debt with flyover fee revenue streams. Harmon and Gupta then agreed to pursue a new credit facility in the amount of \$100M to cover the procurement of various types of U.S.-made equipment and services needed for India's airports. (Within 24 hours, the Authority presented a letter to Chairman Harmon requesting the facility and specifying the types of US goods and services needed.)

Meeting with Indian Airlines Chairman Baijal

Indian Airlines Chairman Baijal told Harmon the timing of his visit was good; much of the airline's fleet was up for replacement and between \$1.5 billion and 2 billion dollars would be spent on fleet expansion within the next four or five years. Financing will play an important role in the aircraft upgrade exercise, Baijal said. Indian airlines is now restructuring, with a new financial advisor to be chosen by April and a strategic partner with 26 percent of the airline brought in by next march (the government would maintain 49 percent, with the remaining 26 percent to be sold to airline employees, financial institutions and other investors). Harmon noted that GOI regulations would prevent a foreign airline from coming in as a strategic partner, Baijal responded that the policy is now slated for review - as part of that review, the GOI's holding in the airline might even be reduced to 26 percent. IA's current fleet consisted of 12 Boeings and 30 Airbuses. Baijal asked about the parameters involved for MT/LT guarantees, such as the need for sovereign guarantees. Harmon discussed Ex-Im's asset-based financing program. Baijal also asked if Ex-Im Bank can assist IA in getting loans from bankers, to which Harmon responded that we do not pick banks for customers, and he offered a presentation to IA by Ex-Im's airport group.

Luncheon Speech Before the Federation of Indian Chambers of Commerce and Industry (FICCI)

Speaking to a meeting of FICCI, one of the country's leading business groups, Harmon announced Ex-Im support of up to one billion dollars for rupee-based loans aimed at India's small and medium businesses, which might not have access to dollar loans. The announcement received a warm welcome at FICCI, which noted that 50 percent of India's total employment is in the small- and medium-business areas the rupee loan program targets. The announcement was widely and positively covered by the Indian press.

Meeting with Industrial Finance Corporation of India (IFCI) Chairman Narasimhan

IFCI Chairman Narasimhan told Harmon the U.S. has traditionally been a major business partner for India. IFCI, as one of India's major financial institutions, has already worked with U.S. Ex-Im, Japan's Ex-Im, the World Bank and Asian Development Bank. Narasimhan said IFCI arranges \$5M to \$10M transactions and takes a consortium approach for larger projects. IFCI's traditional business is capital goods (e.g., power, telecom), but it is now looking at high tech licensing and other possibilities in non-traditional areas (e.g., pharmaceuticals, tourism, food processing). Narasimhan said IFCI has the impression that the U.S. is so big it is only interested in billion dollar transactions. Harmon responded that we want to change that impression and do

more in India. IFCI was interested in exchanging people for 1-2 week periods to learn each other businesses better.

Meeting with Minister of Environment and Forests Baalu

Harmon told Minister Baalu that Ex-Im wants to do everything it can to promote the sale of environmentally friendly products from the U.S. Baalu was skeptical, saying he thought the seven percent interest offered by Ex-Im was too high and that sanctions could always be imposed and then everything would be delayed three or four years. Harmon answered that he didn't think any country would give India better terms. Baalu said he was interested in a clean-water project in Chennai, in his home state of Tamil Nadu, but he was worried about fluctuations in the interest rate on any loans. Harmon responded that rates have not fluctuated much but, if this were a concern, the rates could be fixed. Baalu then declared that the environment should not be a commercial issue - the projects should be financed because they are the right thing to do, and India should not be made a perpetual debtor. Harmon discussed how the Ministry could take advantage of Ex-Im Bank's special program for the environment (e.g., local cost coverage, CIDC).

Meeting with Minister of Information Technology Mahajan

Minister Mahajan requested a meeting with Harmon to discuss Ex-Im support of high tech. Mahajan said India has the knowledge and popular interest needed to move ahead in high tech, but lacked the financing. There is not enough seed money available, so the GOI is starting a fund to promote high-tech start-ups. Harmon said Ex-Im could provide financing to companies buying hardware or software from the U.S. He said he had recently raised the issue of exports with a major U.S. software producer, who responded that he was so successful in the U.S. market that he had not really considered the export market. Harmon noted that technology is one of President Clinton's priorities, and that Ex-Im will work to facilitate more it exports. Mahajan said that India exports 75% of its software, but imports 75% of its hardware. Mahajan expressed interest in signing an MOU with Ex-Im Bank, as part of President Clinton's visit, to help the Ministry move forward on its goal of becoming a paperless office.

Meeting with Ambassador and Unocal CEO

Unocal expressed their anger with the bureaucracy and problems in the power sector in India. Because of many issues, including lack of progress on escrow arrangements, Unocal is giving serious consideration to withdrawing from the market. (Many of these frustrations were recurrent during the trip, in particular at the power sector round table in Chennai.)

Country Team Briefing

Briefings were held on the challenges in the power sector – e.g., reforms needed, GOI needing to honor commitments on escrow accounts, existence of subsidized power to farmers.

Opportunities for US companies await in power transmission and distribution. Regarding states, the economic team stated that in their belief no state in India was solvent, but 7 cities has domestic credit ratings (26 cities in India have over 1 million people). USAID's development credit authority (a \$20M guarantee) remains subject to sanctions in India. The GOI faces the high-cost of borrowing (budget deficit of 9% of GDP), which is a drag on the economy. Other areas of concern include: need for privatization, banking sector reforms (10% non-performing assets), high tariff regime (avg. 25%), and need for investment liberalization.

Meeting with Ranbaxy CEO Braer

Ranbaxy, India's leading pharmaceutical company, CEO Braer explained the changing structure of India's pharmaceutical industry with the leading companies switching from reverse engineering to investing in research and development. Ranbaxy has had a joint venture with Eli Lilly in India since 1992 and started U.S. subsidiary in 1998. Harmon expressed interest in supporting Ranbaxy's purchases from the U.S. Braer spoke about India's need for hospital equipment and chemistry lab equipment, plus hospital management technology. Ranbaxy's biggest financing needs are for venture capital, funding research or acquisition capital.

Meeting with Minister of Finance Sinha

Accompanied by Ambassador Celeste, Chairman Harmon briefed Finance Minister Sinha on the rupee loan program, the MOU to be signed with the power finance corporation, and the possibility of Ex-Im providing financing directly to states and municipalities. Sinha responded that, as an idea, the rupee loan program was good, especially for increasing trade exchange. He added that everyone involved needed to be clear, however, about the currency risks they would be taking and other issues. This will have to be worked out by the Reserve Bank of India, Sinha said, adding that there should be no problem in doing this. Sinha suggested that the Small Industries Development Bank of India (SIDBI) would be an appropriate partner in working with state-level corporations (so we scheduled a meeting with them in Mumbai later that week). Local banks are also spread across the country, and are well placed to identify the financing needs of small and medium enterprises.

On loans to municipalities, Sinha said some are doing very well and improving their services. They have to charge for the water and other services they supply that have often been free or almost free or they will not be able to repay their loans. Some municipalities have been able to issue their own bonds, and even the GOI has agreements and MOU's with the states to move them towards reforms. Sinha added that there is also great potential for Ex-Im in the corporatization of five of India's most important airports, as well as the major port modernization program. A massive road-building program, telecom upgrades, internet systems and of course power are also areas where Ex-Im could play a useful role, Sinha said.

Meeting with Minister of Power Kumaramangalam

The Minister first welcomed Ex-Im to his offices because he hasn't seen it for some time (a tongue-in-cheek reference to the impact of sanctions). The Chairman told Minister Kumaramangalam that Ex-Im has a long history of involvement in power projects and hasn't done enough yet in India. He also said that we know projects must go ahead in this area, and we are trying to catch up and see where we can help. Kumaramangalam said one of the major reform efforts in power would be reducing losses by mandating metering. If states want to buy meters from the U.S., Harmon said Ex-Im financing might in a small way help them move in the right direction. Harmon said the U.S. is breaking up its own utilities, with even such functions as metering now done by separate companies. Ex-Im's services are available in a variety of areas, but we only want to reward those states moving in the right direction. Kumaramangalam agreed that both products and services could be extremely useful. Another important area of focus for the Ministry is to determine how best to privatize distribution of power. Minister K. commented on the MOU with PFC as a good idea for Ex-Im to increase its financing in India.

Luncheon, MOU Signing Ceremony and Meeting with Power Finance Corporation Chairman Kohli

The Chairman signed a memorandum of understanding with the Power Finance Corporation of India (PFC) for up to \$500 million in Ex-Im Bank support for transactions involving U.S. exports of energy-related technologies, goods and services. PFC Chairman Kohli told Harmon PFC borrows from both the foreign and domestic capital markets and that it enjoys the highest Indian credit rating. Kohli also spoke of PFC's asset performance in glowing terms, i.e., 99% of their loans are paid on time, 1% delayed, and without any non-performing loans. PFC experiences growth of about 35% each year. Harmon suggested that Ex-Im might make loans through PFC for power projects, and said Ex-Im would welcome the opportunity to exchange goods and technical-level visits if this facilitates the process of getting deals done. Kohli agreed that this would be useful, adding that on-lending might be easier if Ex-Im became more comfortable with PFC's appraisal process. Clean energy projects including hydro and renewables are also possibilities. Also present in the first-half of the meeting were representatives of USAID and the US Energy Association who fund the Energy Partnership Program, of which the MOU was signed under the auspices.

Meeting with Civil Aviation Secretary Gupta

Chairman Harmon stated to Civil Aviation Secretary Ravindra Gupta that Ex-Im is well known in the aviation industry: half of its \$1.8 billion outstanding in India is with the airlines, and last year was Ex-Im's biggest for aircraft financing worldwide. Gupta said both Indian Airlines and Air India need to modernize their fleets, but with privatization now underway, this might not happen until next year. Gupta noted that, in the aftermath of the December 1999 Indian Airlines hijacking, there is a greater interest in security and bomb detection equipment. The cost of these items is very small compared to the cost of the aircraft, and they are in a different category since they concern basic safety, so Ex-Im should provide concessional financing for their purchase, Gupta said. Harmon promised to consider this, and urged Gupta to keep Ex-Im in mind as a source of financing support.

Chennai

Breakfast with State Officials and Consul General

Chairman Harmon talked about the challenges and opportunities with building infrastructure, particularly power in India. He also put forth the idea of providing financing for a state or municipality in which a state could serve as a role model of good governance. Chairman Harmon emphasized that Ex-Im Bank would be willing to take risk the private markets and other sources of capital might not be willing to take. Finally the Chairman also talked about the local currency facility, which he had announced in Delhi. All of these ideas were well received. Participants noted that Indian states in the south were some of the best managed in the Indian nation and might be best suited to serve as a model. Another suggestion was that Ex-Im consider using state sponsored financial institutions for the implementation of the local currency facility. There was also the recognition by the participants that India's power situation needs Indian government focus and attention, and that focus must come from the state level.

Round Table on Power Sector

This session allowed the Ex-Im delegation to listen to the problems, issues and constraints on the development of India's power sector. The session also included a very thorough presentation on

the current state of India's power sector. Generally all participants agree that India is in serious need of additional power capacity. India current has approximately 93,000 MW of installed power and if India wants to maintain a GDP growth rate of 7%, it needs to install 10% of additional power capacity per annum. This could become particularly critical given India's desire to become an IT powerhouse as this industry will need an uninterrupted power supply to truly flourish.

India's power distribution system is grossly inefficient. Many energy consumers receive power for free or at substantially subsidized rates. Further, virtually no metering system currently exists. The country's state electricity boards are beginning to make headway in tackling these issues, though given their nature are quite obviously politically sensitive. As noted earlier Unocal which had a representative in attendance remains quite unhappy with the current situation and is desirous of some resolution on the use of escrow accounts to capture a return on their investment. Finally, despite the seriousness of India's power situation virtually everyone in the round table agreed that it is much better that India solve its power distribution problem first and then build more capacity, rather than the other way around.

Meeting with the Chief Secretary of Tamil Nadu

The discussion centered on the environment, technology and infrastructure. Chairman Harmon highlighted his proposal on local currency lending as well as providing funding at the state or municipal level. The Chief Minister's finance secretary (who was present at the breakfast meeting) discussed (i) the idea of using a state government owned institution to implement Ex-Im Bank's local currency idea as a way to better reach small and medium size business, and (ii) the possibility of Ex-Im Bank financing to purchase capital equipment needed for upcoming road projects.

Speech Before Local Officials and Students at Indian Institute of Technology

Questions from students and faculty centered on the mechanics of Ex-Im Bank's \$1 billion local currency facility, the role of the Ex-Im Bank and the view of the US on opportunities in India. A presentation on the background and history of IIT was also made to the Chairman, highlighting the history and stature of this institution. Approximately 25% of this institution's student body comes to the US for further study or work in engineering related fields.

Meeting and Luncheon with Confederation of Indian Industries (CII)

The idea of a more robust US-Indo partnership was addressed. Several members of CII were interested in ways India could help American companies as well as the other way around. In addition, the question was asked whether the Ex-Im Bank could finance Indian exports to the US, which Chairman Harmon explained was not possible given Ex-Im Bank's charter and mandate.

Round Table on Information Technology

Chairman Harmon discussed how the Ex-Im Bank was looking for innovative ways to finance products in the technology sector. Few knew anything about the Ex-Im Bank, furthermore at least in an open forum seemed uninterested in Ex-Im Bank capital given the current abundant availability of resources available to the technology sector. However, after the session was over a number of the companies came up for private discussions to ascertain what type of funding they might be able to receive from the Ex-Im Bank. Many top tier US firms have created offices

in India and an increasing number of successful Indian Americans are returning to India to either fund or create start up technology ventures in India. Much of the funding sought for IT in India has been for seed/venture capital.

Mumbai

Jet Airways Tour

Upon arrival in Mumbai the Ex-Im Bank team was met by Mr. Naresh Goyal, Chairman of Jet Airways, and taken on a tour of Jet's central operations facilities. The team was able to see the ticketing and baggage areas, the central flight coordination facilities and the crew areas. In addition the team was able to meet several senior operational executives of Jet. In all respects the operations appeared professional and well-organized.

CII Breakfast

The Confederation of Indian Industries (CII) organized a breakfast with senior Indian business leaders. The Chairman was introduced by industrialist Jamshyd Godrej, former Chairman of CII. The Chairman outlined the basic goals of the trip, as well as the Ex-Im initiatives announced during the week. There were several questions from the audience – notably there was a statement about the hydro potential of Orissa, a request that we look at the bio technology industry and an inquiry about the Chairman's views on the pace of privatization in India.

Meeting with Reliance Industries

The team met with Mr. Mukesh Ambani, Vice-Chairman & Managing Director, of Reliance Industries Limited, and members of his finance team. Mr. Ambani noted that they have several projects that could be eligible for ECA support (including a \$6 billion petrochemical facility with \$2.5 billion of U.S. content), however they are very focused on (i) cost of capital, and (ii) speed of financing -- and Reliance had been of the view that our financing might not be attractive on either count. In response, the Ex-Im Bank team stated that we had improved our processing time and we have several products – notably CGF's and limited recourse project financing – that might be attractive to Reliance. Mr. Ambani further noted that they would be very interested in rupee-denominated financing and they thought it might have the effect of relieving some of the lending limit and other capital pressures to which Indian banks are subject.

Meeting with Ratan Tata

The team met with Mr. Tata, Chairman of the largest industrial conglomerate in India. Mr. Tata stated that the Indian economy was doing well, but that it was still fragile. As regards U.S. exports, Mr. Tata stated that the SE-Asia devaluations had the effect of making exports from that area much more competitive (with the Koreans, in particular, providing attractive financing packages for infrastructure projects). There was some discussion about the possibility of taking subsovereign risk. In addition, Mr. Tata mentioned that education, particularly distance learning, could be an important area in need of U.S. equipment.

Environment Speech Before the U.S.-Asia Environmental Partnership, ERC, and Chemtech Foundation

Chairman Harmon gave a luncheon address which touched upon Ex-Im Bank's role, our goals for our India trip, as well as our special incentives for environmentally friendly projects. His remarks were very well received and there were a number of questions, including questions from

state officials about the availability of our programs on a subsovereign basis.

Meeting with Governor of Reserve Bank of India Bimal Jalan

The team met with Governor Jalan and discussed a number of matters, notably Ex-Im's goals for the India and the Rupee guarantee program. Governor Jalan reaction to the Rupee guarantee idea was that, as initial matter, it sounded fine, however, they would study the question further. He also suggested that we draft an aid-memoire regarding the program and have it approved by the Ministry of Finance and, thereafter, sent to the Reserve Bank. Governor Jalan also discussed the state of the Indian banking sector and indicated that there was a continuing effort underway to improve service and bring the banks into compliance with international norms.

Meeting with A.P. Hinduja

The team met with Mr. A.P. Hinduja, who manages the Hinduja group's Indian operations. Mr. Hinduja and members of his senior staff outlined the group's operations in India – which include truck manufacture (Ashok-Leyland), power (4 projects in Tamil Nadu and 2 in Maharashtra), banking, telecom, IT, media and oil/gas. There was some discussion, in particular, as to whether the Hinduja bank in India could act as an intermediary lender for Ex-Im financing.

Bank of America Reception

Bank of America held a reception for the Chairman which was attended by a number of senior Indian business leaders, including representatives from existing customers and partners of Ex-Im (ICICI, Escotel and the Jindals). The Chairman briefly outlined the purposes and goals of Ex-Im's trip to India and gave credit to Bank of America for progress on the Rupee guarantee idea

Citibank Breakfast with Bankers

Citibank hosted a breakfast for the Ex-Im team which was attend by senior representatives of the western banking community in India (Bank of America, Chase Manhattan Bank, HSBC, Morgan Stanley, Societe Generale, BNP, American Express Bank and ABN Amro). There was much discussion about infrastructure needs and the impediments to financing. In addition, there was a lot of give and take regarding the possibility of subsovereign risk. Notably, a number of the bankers thought that there was no state or state agency that currently presented a "bankable credit", although there was some interest in the concept of picking out the "best" one and rewarding their reform efforts with financing. Gujarat, Karnataka and Andhra Pradesh were noted as states that have made a lot of progress.

Meeting with Jet Airway Chairman Naresh Goyal

The team met with Mr. Goyal and his senior finance team (as well as some members of Jet's Board of Directors). The Ex-Im team received a briefing on Jet's financial and market position. There was then a discussion about specifics of Jet's financing requests to Ex-Im. In particular, the Jet representatives stated that they had been loyal Boeing customers, despite strong efforts from Airbus, and that they were looking for support from Ex-Im Bank on several specific financing issues. The Chairman indicated that we would respond to Jet shortly on these issues and that, while he could give no indication as to Ex-Im's reaction to these specific matters, he had an overall favorable impression of Jet Airways.

Meeting with the Ex-Im Bank of India

The Ex-Im team met with Mr. Y.B. Desai, Managing Director of the Ex-Im Bank of India, and

members of his senior management team. The team was shown a video which describes Ex-Im India's operations. Chairman Harmon remarked that he was very favorably impressed by the scope of their operations, particularly the freedom they had to support a wide range of projects (including equity investments by Indian firms overseas). There was some discussion of ways in which the two institutions could cooperate on financing, including efforts to reach small and medium-sized businesses in India. Chairman Harmon and Mr. Desai also discussed the possibility of signing an MOU which would outline a framework for cofinancing and risk-sharing between the two institutions.

Luncheon with Indian Banks Hosted by the Ex-Im Bank of India

Ex-Im India hosted a luncheon for the Chairman with senior representatives of Indian financial institutions (ICICI, HDFC, IDFC, IDBI, SIDBI, State Bank of India, Bank of Baroda and the Export Credit Guarantee Corporation). There was significant discussion about the impediments to infrastructure finance, notably power and water development.

Meeting with Enron Executives

The Ex-Im Bank team met with Sanjay Bhatnagar, CEO of Enron India Pvt. Ltd., and senior members of Enron's India management team. There was a presentation about Enron's current activities in India (which include power, gas pipelines, telecom and energy consulting services). In addition, there was a detailed discussion of the current status of the Dabhol Power project. There was a discussion about ways in which Ex-Im could be supportive of Enron's projects. Mr. Bhatnagar did express some concern about Ex-Im's processing time on project finance cases and he was assured that there were no current problems in that regard.

Meeting with Uttam Steel

The Chairman met with Rajinder K. Miglani, Chairman of Uttam Steel Limited, regarding their financing application with Ex-Im. Mr. Miglani outlined his history in the steel business and the history of his company. He said that the company "runs at 100% and sells 100%", exporting up to 40% of its production. The company had some problems recently due to a recession in the Indian steel market, however, Mr. Miglani said that the worst was behind them and that the business was now doing well.

Meeting with Industrial Development Bank of India (IDBI) and Small Industries Development Bank of India (SIDBI)

The Chairman met with Mr. G.P. Gupta, Chairman and Managing Director of IDBI, and Mr. Shailender Narayan, Managing Director of SIDBI. IDBI is the largest of the domestic "development" banks, and SIDBI is a subsidiary geared toward meeting the financing needs of small industry (up to Rs. 10 Billion in machinery and other assets, outside of land and buildings). There was much discussion regarding how both IDBI and SIDBI could act as conduits for Ex-Im financing in India – particularly to new and small businesses. There was a proposal that Ex-Im enter into an MOU or other general arrangement with each institution in order to further this goal.

Dinner with the Piramals

The team attended a dinner hosted by Ajay and Swati Piramal, owners of a large textile and pharmaceutical firm. The dinner was attended by a number of significant industrialists, including representatives of the Godrej group of companies.

THE PRESIDENT HAS SEEN
3-13-00

THE WHITE HOUSE
WASHINGTON

cc
NLS

Street

can I come back to DC
night of 30th, leave 31st off
in DC but for Radio Room?

copied
Street
Podesta

How will be when —

Be

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David Good Friday night
for Easter — come back early
Mon. am —

or
pass RND this week if I just
go up for them 4/5, 4/18
5/6 RND at Blair, Fayetteville BZ

THE PRESIDENT HAS SEEN
3-13-00

FREDERICK & SUSAN M. WILMER
1900 BROWNING STREET
BALDWIN, NEW YORK 11510
H (516) 867-7728
W (516) 766-2240

Brown/Conner's Off

If true, this is
very disturbing -
you then have
been here for 10 years
Fri - As look with
if there's anything
can do -

March 11, 2000

President Bill Clinton
The White House
Washington, DC 20000

BZ
copy of
Nolan
Podesta

Re: THE DISAPPEARANCE OF JENNIFER WILMER
CASE # 9356740 (Trinity County, CA)

Dear Mr. President,

Along with my heartfelt gratitude for signing Jennifer's Law, I am also here to beg you for your assistance. Since January 1994, four months into Jennifer's case, I have persistently and consistently requested that the State of California take Jennifer's case away from the jurisdiction of the Trinity County's Sheriff's Department (TCSD). I knew then what has become clearer throughout the years, that either the TCSD were totally inept and incompetent or totally corrupt. After reading this letter I hope and pray action will be taken to correct a situation that is entirely unacceptable. Keep in mind our ultimate goal is to be able to bring our daughter home.

For six and a half years I have had to fight the good fight just to receive minimum investigation. My daughter was further victimized by the TCSD, themselves, when they attempted to vilify her. The then Congressman David Levy had to intervene to tell them to cease or face repercussions. They totally demoralized me by making me feel that Jennifer was not worth their time or effort. Even though I went through two years of anguish and tears over their handling of the case, I regained my strength. I will not go away.

I realize Jennifer is just one person. No one deserves the treatment she received at the hands of TCSD. She never did anything wrong. She was loved and she loved. She needs your help. Something happened to her on September 13, 1993. There are leads that have been ignored.

Recently we hired a new private investigator. Through his intervention and the services of a member of the U.S. Forest Service, the following information has been made available to us.

1. TCSD was aware of "fresh dirt" in the yard of Jennifer's residence immediately following her disappearance. They did not investigate this.

February 20, 2000

Page No.: 2

2. In July 1994, TCSD reported that potential witness, "could not remember anything". She has been located and her recollection of what she saw is still remarkably clear, nearly 7 years later. Either TCSD never interviewed her and made it all up or they intimidated her to silence.
3. Following a "jailhouse confession" almost two years ago, stating where Jennifer's body is buried and who murdered her, TCSD prepared an affidavit in support of a search warrant for the property in Blocksburg. But then Wayne Ford stepped forward as a previously unknown serial killer and all work on this "jailhouse confession" stopped. Even though I was immediately informed by the California Department of Justice Ford was not in the area during our time frame, a fact corroborated by Det. Juan Freeman of the Humboldt County Sheriff's Department, this information apparently never found its way to Trinity County. As of February 18, 2000, TCSD still feels that Wayne Ford may be responsible.
4. Since 1998, I have attempted, to no avail, to obtain Jennifer's file so as we could review it and see if there was anything in it that might trigger further information. TCSD has said they will not give up that file because "I would twist everything around and get them all in trouble." I do believe that according to CA GOV 6254(f) this is not a valid reason for refusing to hand over her file. What is in that file that they are afraid of? We will get a copy of that file.

Needless to say we are getting more and more upset by this botched investigation. In 1994 we asked Dan Lungren for and gained the assistance of the California Department of Justice and expected something to be done. Even though this department is always open to me, the State of California has not forced the TCSD to take necessary action. I feel they were never really concerned because they thought no one would care and want to listen to a story about a twenty-one old missing person. Every time I go the California, local law enforcement from surrounding areas volunteer war stories concerning the actions of Trinity County. They make a mockery of law enforcement. But the sad fact is not only was my daughter a victim of their deeds but they continue to victimize my family and myself by not allowing us to bring Jennifer home.

I, therefore, beg you for a Federal Inquiry into the handling of this case. In our petition to Dan Lungren in 1994, we asked for an agency better equipped to handle such a case. My request, six years later, is the same.

Sincerely,



Susan Wilmer

Attachments

**FREDERICK & SUSAN M. WILMER
1900 BROWNING STREET
BALDWIN, NEW YORK 11510
H (516) 867-7728
W (516) 766-2240**

September 27, 1999

Sheriff Paul Schmidt
Trinity County Sheriff's Department
P.O. Box 1228
Weaverville, CA 96093

**Re: THE DISAPPEARANCE OF JENNIFER WILMER
Date of Disappearance: September 13, 1993
CASE # 9356740 (Trinity County, CA)**

Dear Sheriff Schmidt,

We were deeply troubled that you were not available for our 10:30 AM appointment on Wednesday, July 28, 1999. We flew 3,000 miles and drove for approximately 8 hours to make that appointment. Our daughter is the most important thing to us. You didn't even have someone else available to meet with us. You could have called us to cancel. We had information for you such as, where Tro is living now. We also wanted to offer to pay for the search of the property where Jennifer is reported to be buried. Because you think our fight for justice might somehow prove you wrong, you continue with your very bad decisions.

During these past six years, both Fred and I have waged "the good fight" and played "the good game". We believed in our hearts that the system we have always stood up for would help us bring our Jennifer home.

What we witnessed in these six years was that both your department and the California Department of Justice have let California get away with murder. Your department made a decision that the one plausible lead received during these six years will not be pursued. This lead, if proven true, would solve Jennifer's murder and we would be able to bring Jennifer home. By not pursuing this lead it would show that you would rather let a family suffer and a murderer go free than admit that at least one other capital murder case was not diligently investigated and another was ignored.

The lead referred to involves Tro Patterson, one of Jennifer's housemates. As you know, a person incarcerated informed members of your department that this housemate murdered Jennifer on September 13, 1993 and buried her body on a piece of private property in southern Humboldt County, CA. I believe this information was received in March 1998. We became aware of it in August 1998 and have waged our "good fight" since then to have an adequate search of this property. The excuse given for not pursuing this lead is that it is hearsay information. Because your department made a decision to

September 27, 1999

Page No.: 2

minimize Jennifer's murder early on with the consequence of all leads drying up, hearsay information just might be the only information available and it was and is your duty to exhaust all leads.

Tro Patterson is of particular interest. His family knows the Klaas family. On October 4, 1993, the day after Polly Klaas was kidnapped from her bedroom (and three weeks after Jennifer's disappearance), I called Tranquilla to report this coincidence. I expected this information to be turned over to the proper authorities but for some unknown reason, the information was never given to the Petaluma, CA authorities. Two weeks before Richard Allen Davis' trial, I called Petaluma to discover that they never received this information. Davis' trial proceeded without this coincidence being investigated. Now, years later, evidence is received connecting Tro Patterson to Jennifer's murder and your department will not look for Jennifer. Had that one phone call been made on October 4, 1993, the F.B.I. would have been all over Tro, his father and everybody else and the questions posed today would be moot. Your department would have received all assistance available. But, as we all know, because Deputy Litts failed to report the calls made to him on September 16, 18, 21 and 22, 1993 (by Jennifer's housemates, myself and the Nassau County Police Department, NY) and his failure to keep on file Jennifer's picture Fedexed to him on September 20, 1993, a decision was made to minimize my daughter's murder from the beginning and an attempt was made to squash all leads. What was not figured in was my persistence.

After six years, we will no longer play the game. The truth regarding the coincidence of one family knowing two people that disappeared, three weeks apart, and that this information was totally ignored by you will not be kept quiet. My daughter will not be thrown away to cover-up your dereliction of duty.

Sincerely,

Susan M. Wilmer

See attached Addendum

cc. Janet Reno, Attorney General of the United States
Gray Davis, Governor of the State of California
Eliot Spitzer, Attorney General of the State of New York
Bill Lockyer, Attorney General of the State of California
Martin Ryan, Bureau Chief, California Department of Justice

ADDENDUM TO LETTER
TO Sheriff Schmidt:

At any moment in time you had the power to change the following scenario. But the decision was always made to cover up the ongoing wrongdoing. It was your choice.

To repeat, because Litts failed to report the calls made to him on September 16, 18, 21 and 22, 1993 (by Jennifer's housemates, myself and the Nassau County Police Department, NY) to report Jennifer's disappearance and failed to keep on file Jennifer's picture Fedexed to him on September 20, 1993, a decision was made to minimize my daughter's murder from the beginning and an attempt was made to squash all leads.

In an attempt to bury Litts' failure to comply with procedures, a decision was made to make Jennifer the "bad guy". Statements were made vilifying Jennifer and defamatory statements concerning her family were made to the media, making it into my local newspaper. This continued until a warning was given by Congressman Levy's office for you to cease and desist these statements. Litts was "punished", his job was excessed and he was gone by May 1994.

On October 4, 1993, your department made the decision that the coincidence connecting Jennifer to Polly Klaas was not important. This action could have skewed the hands of justice in a horrifying manner. The potential that two capital murder cases may have been affected by this decision is very real. Your department has recently written us concerning the gravity of withholding information. I am positive your department is held to a higher standard than we are.

During the first week following Jennifer's disappearance, a potential witness's call to your department was ignored. After becoming aware of this in May 1994 and expressing my displeasure, a member of your department intimidated this witness to silence.

In early 1994, an attempt was made to hurt the investigation, when a member of your department rode through 299 stopping at establishments and telling the proprietors Jennifer had been found. Posters were removed, thereby stopping possible information from emerging. Todd Lofgren warned us about this before he retired.

You were forced into questioning Tro, 6 months after Jennifer's disappearance, when thousands of petitions made it to Dan Lungren's desk. "Normal" police procedure would have dictated the questioning of all Jennifer's housemates immediately following the report to the police, preferably alone and in unfamiliar surroundings. As these interviews never occurred, we, as Jennifer's parents had to seek recourse. These petitions aggravated the situation but we had no choice. We, on this end, had to endure reprimands from members of your department, as if we were the criminals.

You were forced to search the house where Jennifer lived in Hawkin's Bar, 3 years after her disappearance, when Child Quest International offered to do it for us. "Normal" police procedure would have dictated this to be done immediately following the initial report to the police.

At what I thought would be the last recourse, I took my complaints before the Grand Jury. Through calls received from members of that panel, I discovered that they used all their human power to find a violation of law but fell short. Now you really were mad at us. We actually had the audacity to question your power.

I continued my fight until the information received last year. With your handling of this new information it became clear to me, something I felt from the start of your blunders, that your department does not want to find Jennifer. The discovery of her body would prove how wrong you have been.

And as I stated in the beginning of this addendum **at any moment in time you could change the situation** or you can continue to cover up your mistakes. The choice is yours. Also, remember, at any moment in time these cover-ups could become violation of law, if they haven't already become so.

Gove / P. M. M.

~~JP~~ has other
copy - we need these
proposals evaluated
A-Z-A-A —

for

THE PRESIDENT HAS SEEN
3-13-00

copied
Spurling
Reed
Podesta



MEMORANDUM FOR THE PRESIDENT

From: Secretary Bill Richardson
Subject: Proposals to Increase Domestic Energy Security

Today's increased focus on oil prices provides you with the opportunity to advance significant energy initiatives over the next several months. Each initiative I am proposing for your consideration would stand alone, but as a package would dramatically enhance our domestic energy security.

Northeast/New England Energy Supply

- **Regional Product Reserve**
 - ▶ Support a federally-funded and operated two million barrel product reserve at NY Harbor, available to entire region, with relatively high threshold for use
- **Regional Energy Diversification Project:** *60 day study*
 - ▶ Issue strong Administration statement in support of natural gas infrastructure expansion
 - ▶ Convert federal buildings in Northeast and New England to natural gas
 - ▶ Repeal the tax on Contributions in Aid of Construction, which adds 35% to 50% to the cost of natural gas hookups
 - ▶ provide other incentives for businesses and large users to switch to natural gas

Increased Energy Independence Through Energy Efficiency

- **Fuel Efficient and Alternative Fuel Vehicles:** issue an Executive Order on fuel efficient vehicles with a goal of a 20% reduction in federal transportation oil use by 2005
- In addition, we should:
 - ▶ increase mass transit subsidies for federal employees
 - ▶ reallocate federal funding to increase alternative fuel bus use
 - ▶ through your office, direct an inter-agency effort to develop a "green label" for vehicles to increase consumer product understanding*PNGV / SUV Initiative to make SUVs more fuel efficient*

Enhanced Domestic Oil Production

- **Support Tax Incentives** for domestic producers would increase producer's access to capital and add up to 300,000 barrels of oil to domestic capacity:
 - ▶ counter-cyclical marginal well tax credit (phased in at \$12-\$15 per barrel)
 - ▶ expensing of delayed rental payments & geological/geophysical costs
 - ▶ removal of net income limitations on depletion
- **Improve administration of oil and gas loan program** at Commerce Department

More Effective Management of the Strategic Petroleum Reserve

- **Manage the Reserve to Increase Energy Security:** *Once the current oil crisis subsides, institutionalize market-based, counter-cyclical SPR oil acquisition strategies -*
 - ▶ oil exchanges, leasing of unused storage capacity, more royalty-in-kind oil
 - ▶ will put more oil in Reserve and have new tools to fight market volatility

Industry/Public Communication

- Announce National Campaign for Energy Efficiency and Savings
 - ▶ Blue Ribbon Panel for Energy Efficiency
 - ▶ Fuel Economy Web Site/Consumer Campaign
- Convene White House Summit on Energy
- Meet with Oil CEOs

Next Steps - Oil Diplomacy

Proposed Presidential calls

Saudi Arabia

Kuwait

Mexico

Venezuela

Nigeria

Norway

Potential Richardson travel to

Nigeria

Algeria

Venezuela

Norway

IEA (Paris)

Gulf States ?

Indonesia

Prices Under Various OPEC 10 Scenarios

WTI Price	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Base	30.20	29.62	29.20	28.30	28.00	27.90	27.70	27.30	26.90
+1.5	30.20	29.10	28.20	26.90	26.20	25.70	25.20	24.70	24.30
+1.7	30.20	29.00	27.90	26.40	25.50	24.80	24.10	23.50	22.90
+2.0	30.20	28.70	27.30	25.60	24.50	23.50	22.60	21.70	20.80

Gasoline Price	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Base	1.57	1.56	1.55	1.51	1.49	1.46	1.42	1.39	1.37
+1.5	1.57	1.55	1.53	1.48	1.45	1.41	1.36	1.33	1.30
+1.7	1.57	1.55	1.52	1.47	1.43	1.39	1.33	1.30	1.27
+2.0	1.57	1.54	1.51	1.45	1.41	1.36	1.30	1.26	1.22

- EIA considered several scenarios related to actual increases in OPEC 10 crude oil production. The impact on the price of WTI and the U.S. average price for regular, unleaded gasoline under these scenarios is described above. In all scenarios, EIA made 3 basic assumptions:
 - Demand growth in 2000 is assumed to be 1.6% (1.2 million barrels per day)
 - Iraqi oil production increases from 2.3 million barrels per day in the 1st quarter to 2.6 million barrels per day in the 2nd quarter, 2.8 million barrels per day in the 3rd quarter, and 3.0 million barrels per day in the 4th quarter. These production levels will probably necessitate a quicker infusion of spare parts for the oil industry than is currently occurring.
 - Non-OPEC production (including Mexico and Norway) is forecasted to increase by 0.9 million barrels in 2000 from 1999 levels.

Enhancing Domestic Energy Security

Industry/Public Communication.....	TAB ONE
Northeast/New England Regional Energy Diversification Project.....	TAB TWO
Northeast/New England Regional Product Reserve.....	TAB THREE
Energy Efficiency.....	TAB FOUR
Domestic Oil Production Incentives.....	TAB FIVE
Management of the Strategic Petroleum Reserve.....	TAB SIX
International Oil Diplomacy.....	TAB SEVEN

Industry/Public Communications Strategies

to be worked out with White House/DOE

Staff

Northeast Regional Energy Diversification Project

Background

In the Northeast and New England, there has been a long-standing dependence on fuel oil to heat homes and power businesses. Historically, the principle reason for this dependence on oil (largely imported) was the lack of adequate interstate natural gas pipeline capacity.

During the last decade interstate natural gas pipeline capacity into the Northeast has increased by over 25 percent, from 10 billion cubic feet per day (Bcfd) to over 12.5 Bcfd. In addition, there are currently 27 proposed pipeline expansion projects in the Northeast that will enhance the movement of gas *within* the region. Currently, pipeline capacity appears to be adequate for heat but additional capacity will be needed for new gas-fired power generation facilities.

Nationwide, growing energy demand will require the construction of 1000 new power generating plants by 2020. EIA projects that almost all new generating capacity will be fueled with natural gas as it is efficient, abundant, cheap, and the most environmentally benign of the fossil fuels; 23% of all carbon emissions from fossil fuel combustion are from natural gas, compared to 34% from coal.

In the Northeast, demand for gas power generation is expected to grow by 250% by 2010. There are currently 51 applications for new power plants in New England alone. To meet this demand, there must be investment in natural gas production, as well as a corresponding investment in natural gas infrastructure. The Administration is supporting a 30 tcf market by 2010 (currently we are at approximately 22 tcf). Policies to encourage diversification of energy sources in the Northeast and New England are consistent with, and will underscore the Administration's support for natural gas as a cleaner, transition fuel.

On February 16th, President Clinton tasked the Department of Energy with undertaking a "60 day study on converting factories and major users from oil to other fuels [especially natural gas] which will help to free up future oil supplies for use in heating homes". The final results of the study are not yet known, but preliminary analysis suggests the following initiatives could help lead the way to diversification of energy sources in the Northeast/New England region:

Strong Administration Policy Statement is Key for Northeast Pipeline Construction

It is estimated that an investment of \$1.5 billion will be required to provide the infrastructure to meet natural gas demand in New England and the Northeast. Industry is not concerned about raising the capital to finance infrastructure construction because demand continues to grow. Instead, industry is concerned about the speed and nature of decisions by federal and state regulators -- that they are sufficiently slowing down the permitting process to endanger project deadlines and investment plans.

The Federal Energy Regulatory Commission (FERC) permits the construction of new pipelines. Industry has reported that it is having difficulty in getting timely permitting from FERC and believes that a clear, unambiguous statement of policy support for natural gas infrastructure expansion, particularly for the Northeast and New England, would be very helpful in dealing with federal, state and local regulators and elected officials. The policy statement should stress the importance of natural gas to regional and national energy security, the need for additional infrastructure, and the need to reduce our reliance on imported oil.

Provide Incentives for Natural Gas Hookups

The largest obstacle to quickly reducing fuel oil dependence is the cost of converting homes and businesses from fuel oil to natural gas and the cost of extending gas utility lines to new homes and businesses. Although both consumers and utilities will benefit from conversion over the long run, pay back could take many years.

Because of the high initial cost of conversion, modest federal and state incentives would make it possible for more homes and businesses to convert to natural gas. Such conversions would have positive regional and national benefits – environmental, economic and national energy security.

- **Convert federal buildings to natural gas or renewable fuels, consistent with the President's Executive Order 13123.**

Converting federal buildings to natural gas or renewable fuels would demonstrate the government's leadership and commitment to alleviating the pressure on fuel oil use by homeowners. For example, there are approximately 200 federal buildings in New York City alone that could be converted from fuel oil to natural gas. One of NYC's large natural gas utilities, Keystone, is proposing that the federal government partner with them to convert these facilities to natural gas. This single action, which is already within the authority of the federal government, would save 1.25 million gallons of fuel oil per year and could serve as a flagship demonstration project for diversifying energy sources in the region. Additionally, we should survey the entire region to determine other federal buildings that are suitable for conversion from heating oil to natural gas.

- **Repeal the Tax on Contributions in Aid of Construction (CIAC)**

The IRS imposes a tax on new connections to utility systems. This tax is an unnecessary barrier to new connections because it increases the cost of expanding natural gas systems and, at a minimum, should be repealed for federal buildings, military bases, government facilities, state and municipal buildings, new subdivisions, schools, hospitals and facilities owned by charitable and religious organizations.

Payments or contributions of property to a utility by a new customer to connect to the system are treated as taxable income by the utility. Many state utility

regulations require that connection costs paid by the customer be “grossed up” to include the utility’s income tax liability. The customer must pay both the cost of connection plus the utility’s tax burden. In other states, either the utility or ratepayers absorb the tax. This tax increases the cost of connections anywhere from 35 to 55 percent.

-- *Sensitivities*: there might be state opposition. Need to further research what interests, if any, the states have in this tax.

- **Customer Incentives**

- ▶ Tax Credits: a tax credit should be offered to encourage business customers to switch from heating oil to natural gas, fuel cells, combined heat and power systems, or renewable energy. The amount of the credit would be 20 percent of the cost of conversion, up to \$1000 (this is consistent with the Administration’s existing tax credit proposals for fuels cells and CHP).
- ▶ SBA loans: the current SBA loan program should be enhanced to encourage businesses to convert to natural gas or renewable fuels. Generally, SBA loan guarantees can be used for this purpose.

--*Sensitivities*: Petroleum Marketers (heating oil distributors and wholesalers) will strongly oppose these incentives and will likely oppose this effort in general.

Reduce Regulatory Impediments/ Increase Incentives for for Gas Fired Independent and Distributed Power Generation

Distributed generation refers to the placement of small-scale power-generation units at or near a site where the electricity will be used. These units can generate as little as 5 kilowatts of electricity (enough for a single family home) or as much as 50 kilowatts (enough for a factory). Natural gas is a particularly attractive fuel for distributed generation and currently powers most distributed generation technologies.

Compared to electricity generated at central power stations, distributed electricity generation produces fewer pollutants, is more energy-efficient and can be more reliable. A significant percentage of electricity is lost when power is transmitted from a central station to the end-user; this is not the case with on-site generation.

On the generating plant side, gas-fired combined-cycle technology is the overwhelming choice for new power stations. These plants offer extremely high efficiency – now approaching 60 percent compared to 34 percent for traditional boiler units – as well as lower construction costs, and shorter construction lead times.

- **Develop and pass federal interconnection standards:** federal interconnection standards would enable independent power producers of all sizes to connect to the grid to receive or sell power. The Administration's electricity restructuring bill would establish a federal interconnection standard; this is key to increasing competition and power options in a restructured electricity market.
 - *Sensitivities:* certain investor owned electric utilities and some states oppose federal interconnection standards.
- **Support increased research and development for natural gas/electricity infrastructure reliability.** Additional gas pipeline capacity is needed in the Northeast, largely for electric power generation. The need for increased power generation, fired by natural gas turbines, will provide additional ammunition as gas pipeline companies seek FERC permitting approvals for new pipelines. The Administration has included a \$36 million energy infrastructure reliability R&D initiative in its 2001 budget request to support the merging electricity/natural gas infrastructures.

Proposal for a Federally Funded Regional Product Reserve

This proposal would have the Federal Government provide the resources for the leasing and operation of one or more reserve facilities in the Northeast (or the construction if existing facilities were not suitable), the purchase of initial inventory, and the support for a regional Federal-State board of Reserve managers.

Step 1 – The Federal Government would provide technical assistance and appropriations through Congress for the exploration of the leasing and construction options for storage facilities that would be Federally owned. In addition, Congress would provide for the creation of a Northeastern Reserves Board who would direct the study of the lease/build decision, have oversight of the building or leasing decisions, have oversight for the fill contracts, and oversight for the operation of the reserve.

Step 2 – The Federal government would provide funds to acquire refined product to store in the reserve. This could be done through annual appropriations or through use of a revolving fund. If a revolving fund were used, the fund would be (at least partially) replenished if the product were sold at a profit. (Note: It may make sense to acquire and store diesel fuel in a refined product reserve, rather than heating oil, since the products are similar, but diesel fuel can be used directly as heating oil, and the diesel fuel market is larger, making it easier to sell the product without severely affecting prices in order to keep the supply “fresh”. This could be a decision left to the Board, however.)

Step 3 – The trigger operator.

Option A. The federal government could be given the authority to release product by the authorizing legislation. However, the authority should be different from the one now given for SPR release, which requires a national supply disruption.

Option B. the states could have authority over a proportion of the reserve, which they authorized for shipment to their state. The State of New York acknowledges that they do not have the expertise to make informed decisions about market needs.

Option C. A third options would be to have the previously mentioned Northeastern Reserves Board interpret a trigger authority or criterion. This would ensure some continued, moderating Federal role in deciding when to open a reserve while also giving States the majority role in deciding to open the reserve.

Cost of A Regional Reserve

Current legislation proposing a regional product reserve suggest a two million-barrel reserve based in the Northeast. In addition, industry is likely to support a reserve of this size.

According to a 1991 study carried out for the Department of Energy, the reserve would cost about \$7 and \$10 per barrel to operate annually for leased storage, assuming the product could be sold each year at cost. Also, based on work done in a 1998 study of regional reserves, we believe that a two million-barrel reserve would cost about \$85 million to site and construct. In order to ensure that the reserve was able to be fully constructed (if necessary) and set up for operation without delay, the project should be fully appropriated for a initial two year period for about \$125 million

Increased Energy Independence through Fuel Efficiency and Alternative Fuels

Background

At the same time the federal government focuses on supply factors that will help reduce oil imports, it is equally significant that improvements can be made by enhancing fuel efficiency, primarily in the transportation sector, and promoting the increased use of alternative fuels. These goals can be met through the following action items:

Issue Executive Order on Alternative Fuel and Fuel Efficient Vehicles

The Department of Energy and other agencies have been working with the White House Climate Change Task Force on several "Greening the Government" executive orders. One executive order currently being reviewed would set a goal of 20% reduction in oil use for transportation by Federal agencies by 2005. This executive order would require agencies to increase the use of alternative fuel vehicles and alternative fuels, and for the first time requires agencies to purchase more fuel efficient vehicles. This order would demonstrate that the government is leading the effort to reduce oil imports by example.

Enhance PNGV Through Increased SUV Fuel Economy

Overall transportation sector fuel economy has worsened due to the increasing popularity of sport utility vehicles (SUVs). The Administration is currently engaged in negotiations with the auto industry on the appropriate means of improving the fuel economy of SUVs through the government's Partnership for a New Generation of Vehicles (PNGV) initiative. The Secretary of Energy and other government leaders could become actively involved in the ongoing negotiations. The objective would be to reach agreement on addition of SUVs to the PNGV initiative, in time for the Vice President to announce at a March 30 PNGV event in Washington.

Green Energy Star Labeling for Vehicles

The President should direct an interagency effort to develop a "green label" for vehicles that will allow consumers to more easily make environmentally and fuel efficiency friendly purchase decisions. Green labeling of vehicles is designed to provide consumers with an easy to understand assessment of the environmental impacts of particular vehicles. Various non-government organizations, EPA, and DOE are all developing green labeling concepts. An interagency approach should be used to speed up the develop of one standard as a means of reducing oil imports and improving the environment.

Reduce Heavy Truck Engine Idling

The ubiquitous idling of heavy vehicle diesel engines across the U.S. needlessly consumes about 0.75% of all the fuel used in surface transport at considerable cost penalty to the trucker, the trucking company, and the Nation. Auxiliary cab heaters and coolers available commercially can achieve the desired cab comfort control and winter heating of the fuel, engine block, and lubricating oil at about one sixth the fuel consumption and cost, with far lower exhaust emissions and reduced wear and maintenance of the engine than by the continued idling of the truck engine. Only about 1% of U.S. heavy duty trucks utilize these devices compared to 70% in Germany. The President and trucking industry should announce a partnership to reduce truck idling through the use of small, fuel-saving, energy efficient heaters and coolers for heavy trucks.

Increasing Mass Transit Subsidy for Federal Employees

While several federal agencies, such as the Department of Energy, offer the full subsidy available under law for employees that use mass transit, other agencies do not. Expanding the transit subsidy to all federal employees would make a strong statement that the Federal Government supports transportation options that help reduce oil imports. Congressman Wolf (VA) has already requested the President to implement a draft DOT executive order for this effort.

Reallocate Federal Funding for Transit Buses to Encourage Purchase of Alternative Fuel Buses

Local transit districts need more funds to defray the incremental costs of alternative fuel buses. The Federal Transit Authority pays 80 percent of a capital project's eligible costs (the Federal share), and a recipient pays the remaining 20 percent (the local match or local share). Decreasing the local share on buses that run on natural gas or other alternative fuels to 10% or even 0% will increase the attractiveness of alternative fuel buses relative to diesel buses. The President should support changing the Federal Transit Administration funding formula to encourage increased purchase of alternative fuel transit buses.

Publicize Fuel Economy Web-Site and Driver Tips

The Department of Energy web-site offers information on the fuel economy of all MY 2000 vehicles. We have just added used car and truck information. Furthermore, the site is preparing new "tips for drivers" on how to reduce fuel use regardless of the kind of vehicle driven. Traffic on the site has doubled since gasoline prices have gone up, yet is still only 1000s per day. The Administration can help showcase the web-site to increase public awareness.

Support Legislative Incentives for Fuel Efficient Vehicles and Alternative Fuels

The Administration's tax package includes incentives for the purchase of fuel efficient vehicles. Automakers are now more supportive of this effort and the Administration has an opportunity to make this a high visibility debate. In addition, the automakers and natural gas stakeholders are promoting alternative fuel incentives. Senators Jeffords, Rockefeller, and Hatch and others are preparing legislation to promote the use of alternative fuel vehicles and Senator Daschle is working on legislation to promote alternative fuels. The Administration should reach out to members of Congress to develop legislation to promote the use of alternative fuels as a means of reducing oil imports.

Draw Attention to Need for Long-Term Investments

The Administration's budget requests for car and truck R&D, the Climate Change Technology Initiative, and the BioEnergy Initiative, need continued congressional support. Each offers the potential for important technology benefits that will reduce dependence on imported oil in the transportation and manufacturing sectors in the long-term. Coupled with short-term announcements and solutions, these investments ensure continued progress toward a less reliance on oil. By identifying the unfunded programs proposed by the Administration, we can disarm Congressional critics that say the Administration is not doing enough to solve today's oil price problem.

Enhanced Domestic Oil Production

Incentives to Reduce our Reliance on Imported Oil

Background

The current oil crisis has focused significant attention on oil imports and the availability of worldwide excess oil production capacity. The bottom line: of the available 5.5 million barrels per day excess production capacity in the world, 4.5 million of it is in OPEC countries. Increasing domestic production would enhance US productive capacity.

U.S. oil fields are generally mature, and exploration and production costs are higher than in most OPEC nations. Reducing exploration and production costs for domestic oil and gas production enables our producers to compete and increases domestic production.

The following tax credits would likely increase domestic production by approximately 300,000 barrels per day; this is roughly the equivalent to the excess productive capacity of Venezuela.

Marginal Well Tax Credits

Prior to the oil price crash of 1998, over 433,000 marginal wells produced almost a million barrel per day — roughly equivalent to the amount of oil we import from Venezuela. Small producers own approximately 70 percent of all marginal wells. When oil prices fell, over 30 percent of these wells were shut-in; the high cost of reopening these wells means much of this production is simply lost. In addition, many of these wells also produced associated natural gas; shut-in of wells has resulted in a corresponding loss of natural gas supply as well.

The Administration could design a marginal well tax credit with a variety of limitations to restrict its application. For instance, the tax credit could phase-in between particular prices (e.g. \$12-\$15 dollars per barrel, the minimum price above shut-in) and could be limited to small producers, to companies or individuals that derive at least a specified percentage of their income from oil-related activities, or be permitted to offset only taxes due on oil-related revenue.

The cost to the Treasury would depend on the limitations tied to the credit. Legislation introduced in Congress this session, which includes a sliding credit in the \$14-\$17 range, has an estimated cost of \$600 million over five years. Estimates of the benefits range from 75,000 to 150,000 barrels per day, the equivalent in additional production we are seeking from Norway in the current oil crisis.

Expensing of Geological and Geophysical (G&G) Costs

G&G costs represent the cost of exploring for and producing oil. They are an important and integral part of exploration and production for oil and natural gas. Under current tax law, G&G costs are treated differently, depending on the success of the venture. The cost of unsuccessful ventures can be deducted during the tax period they are incurred; successful activities must be capitalized, because for tax purposes costs that benefit *future* periods must be recovered over

such periods.

G&G costs are similar to research and development costs for other industries, which are allowed not only deductions, but tax credits for R&D costs. Allowing the deduction of G&G expenses would likely increase domestic production by around 126,000 barrels of oil per day and costs approximately \$430 million over five years.

Delayed Rental Payments

A delayed rental payment is an amount paid for the right to delay development on a currently-held lease. In September, 1997, the IRS issued an issue paper that such payments are "pre-production" costs which must be capitalized as opposed to expensed. This ruling effectively increased the cost of oil production by limiting the flexibility a producer has to make judgements on the timing of production. The Administration should allow deductions of delayed rental payments to reduce the costs of doing business.

Elimination of the Net Income Limitation for Small Producers on Percentage Depletion

The deduction for depletion is generally limited to 65% of the taxpayer's taxable income before the depletion allowance and is constructed to disadvantage small producers. The Administration should support the elimination of the 65 percent limit and permit small producers to carry back excess depletion for a period of time, perhaps ten years. This would permit producers to amend returns for prior years, thereby reducing their tax liability and enabling them to put capital back into current production.

In addition to tax credits which would directly encourage production, we would propose two credits that would enable us to enhance production at the same time they would mitigate environmental damage.

Tax Credit for Carbon Sequestration

The purpose of this tax credit (would require amending Section 43 of the Federal Tax Code) is to encourage the injection of carbon dioxide into petroleum reservoirs to gain environmental benefits from the safe disposal of carbon dioxide, and increase domestic production utilizing enhanced oil recovery techniques. The tax credit could be deactivated if oil went over a certain price e.g. \$28 per barrel. Benefits would go to both independent and major producers. Costs have not been estimated.

Tax Credit for Efficient Motors

For small producers, electricity represents up to 40 percent of the costs of oil production. Many motors are old and inefficient. A credit for motor replacement with motors that have been given efficiency ratings, would lower the cost of production and reduce emissions through energy efficiency.

More Effective Management of the Strategic Petroleum Reserve A Concept Paper

In Brief

This concept paper advances several strategies to use market-based mechanisms to more effectively manage the Strategic Petroleum Reserve, increase the nation's energy security, and decrease oil market volatility.

Following a prolonged, post-Gulf War period of stability in world oil markets, the recent history of oil prices has been one of extreme volatility -- from roughly \$10 per barrel a year ago to almost \$31 today. This volatility is a direct result of OPEC interventions in markets and is testimony to the problems associated with cartel-driven production levels -- where serious miscues in matching supply to demand and the need to maintain consensus among eleven nations have resulted in disastrous production strategies.

Excessive volatility is bad for U.S. energy security at both ends of the price spectrum. Extremely low prices discourage diversification of energy sources and encourage energy inefficiency. High prices contribute to inflation, slow economic growth, and artificially increase reliance on low-cost production areas in the Persian Gulf. Overall, volatility creates an uncertain energy investment environment and precludes rational business planning for those businesses in which energy represents a significant variable cost.

Stable oil prices are a desirable goal for both the U.S. and the world, for producing as well as consuming nations. How then does the federal government help achieve this objective in the face of continued OPEC market intervention, without either itself intervening in markets or becoming de facto partners of OPEC, as we continually seek rational production levels to serve the world's energy and economic needs?

We can meet this challenge by managing the Strategic Petroleum Reserve (SPR) in a manner that increases our energy security while maximizing the value of the Reserve to the American taxpayer and the public. The Reserve is a large stockpile (570 million barrels) of crude oil and has significant unused capacity. The Reserve's organic statute currently allows the Department of Energy (DOE) to engage in counter-cyclical oil acquisition strategies for the purposes of least-cost SPR oil acquisition.

These *market-based strategies* could enable the DOE to fulfill its mandate to increase the size of the Reserve utilizing available tools which would, as part of the process, enable the Department to increase demand for oil when prices are low, and add supply when prices are high. This paper will discuss how these acquisition strategies take advantage of high and low price market conditions, how they encourage more effective SPR management, and how they help to mitigate market volatility.

Assumptions

This paper assumes that the Government will not adopt oil price control regimes, but may tailor its SPR oil acquisition strategies to be counter-cyclical to the oil market. It also assumes that there is no political will to appropriate billions of dollars to buy oil when it is cheap, or to allow the Administration to sell oil just because of high prices. It assumes that there will be only minimal appropriations for the acquisition of oil and that all activities will be self financed.

Managing the SPR in a Backwardated Market

Situations of war, natural disaster, or the reluctance of OPEC to raise production despite high prices and low inventories, inevitably result in an oil market in which a *price premium is associated with near-term deliveries relative to deliveries at a later date*. On the New York Mercantile Exchange this condition is known as “backwardation”.

Backwardation sends a signal to owners of oil to draw down inventories for immediate refining and consumption. Inevitably, inventories drop. If this supply/demand imbalance is not rectified, the backwardation becomes steeper, more inventories are drawn down and spot shortages occur, sometimes accompanied by sudden and sharp price spikes. This situation occurred most recently in the January-February heating oil market in the Northeast.

This description of market backwardation is key to understanding the idea of a “time exchange” of oil from the SPR because *market conditions that create backwardation are ideal for an exchange of oil*. The Secretary of Energy is expressly authorized to “acquire petroleum [for the SPR] by purchase, *exchange* or otherwise.” When conditions are backwardated, companies can take high-priced oil today, sell it at high prices tomorrow, purchase lower-priced oil down the road, and ultimately return more oil to the SPR than the original contracted amount. All of this can be accomplished at no cost to the taxpayer and, over time, result in increased oil in the Reserve.

Whenever oil markets are seriously perturbed by short supply, the Reserve can and should offer to exchange oil now for more oil later. Again, at the completion of the exchange, the Reserve inventory will be greater, satisfying the energy security mandate of the Department to fill the Reserve. Also, an exchange would add to the Reserve without appropriated funds or cost to the Government, except for transaction costs.

Using SPR Storage Capacity When Oil Prices are in Contango

Several times in the last 20 years, the supply of oil has seriously exceeded demand; the most notable cases were in 1986 and 1998. Both times, oil prices dropped to the \$10 level for benchmark West Texas Intermediate oil, and even less for poor grade, high sulfur oils. When supply exceeds demand, despite very low near-term prices, oil traders put oil into inventory because the price for later delivery is sufficient to pay the cost of storage.

As storage capacity around the world fills, the options for adding to inventories become constrained, and prices fall to the point where some producers must stop production. That situation occurred in 1998, due to the Asian economic collapse. Although demand from Asia dried up, production continued unabated, leading to very low prices in the United States.

Since the Strategic Petroleum Reserve is the world's largest storage facility, it can take advantage of the value associated with its assets -- in this case storage capacity. The price conditions just described put a *premium on the price of oil that is delivered later rather than earlier*. If the future price is sufficiently high -- a condition referred to on the New York Mercantile Exchange as "contango" -- there is profit potential for a private company to buy cheap oil, store it in the Government's caverns, pay the Government a rental fee (in oil), and sell the oil for later delivery.

Using the Government storage facilities in this manner has multiple benefits: the SPR takes payment for storage "in-kind," adding to the Reserve; the domestic petroleum industry will get some relief from price volatility; and the contractor makes a profit. As in the case of an exchange, the Government does not spend any appropriated funds or incur costs other than the minimal operating expenses associated with moving oil through the Reserve.

At the end of year 2000, the Reserve will have 110 million barrels of unutilized capacity. By comparison, the change in U.S. crude inventories during 1999 that caused prices to double was 45 million barrels, and the worldwide inventory change was 300 million barrels. Clearly as an adjunct to commercial facilities, the SPR storage caverns would be a formidable asset.

Smoothing the Transitions Using Royalty-in-Kind Oil

In theory, the Government should buy oil when prices are low, but because of the great anxiety associated with potential oil shortages, the appropriation of funds for buying oil has always occurred at precisely the wrong time -- following oil price *increases*. In other words, the Government feels pressure to buy high, when it should be buying low.

The ideal situation would be for the Department of Energy to constantly be filling the Strategic Petroleum Reserve and to moderate the rate it takes oil out of the market according to price indicators. SPR activities are, however, episodic and attract a disproportionate amount of market attention.

This ongoing moderation could be accomplished by the institutionalization of the existing, one-time royalty-in-kind transfer program with the Department of the Interior. DOI is the recipient of very large volumes of oil from companies that have taken leases on Federal lands on the Outer Continental Shelf. The Minerals Leasing Act provides that Interior may transfer that oil to the Department of Energy.

Similarly the Energy Policy and Conservation Act that authorizes the Reserve provides that Energy may take Federal royalty oil for the Reserve. Furthermore, because the transfer is an administrative action, it has no budget impact, even though there is clearly a cost to the Treasury because oil transferred to the Reserve is not sold.

In February 1999, Energy and Interior agreed to conduct a 28 million barrel transfer that will continue through December 2000. DOE takes title to the oil at the legal transfer point but exchanges it for Reserve quality oil to be delivered to the Reserve sites. The cost to Energy is only the operating expense of injecting the oil; there is no cost to Interior.

One under-appreciated aspect of the royalty-in-kind program is that the Reserve can vary the rate at which oil is taken off the market according to market conditions. In early 1999, with very low prices, the delivery dates for royalty-in-kind exchange oil were set to occur as soon as the contractors took delivery of the royalty oil. However, during January 2000, with prices rising, it became clear that the Reserve could both increase the amount of oil it would receive in the exchange, and add oil to the current market to relieve supply pressure.

The Reserve contracting officer approached contractors that were scheduled to deliver 5 million barrels of oil between February and June, to renegotiate the contracts for a later delivery. The revised contracts changed the delivery date to December, 2000; in exchange for this renegotiated delivery date, the contractors agreed to deliver 13 percent more oil -- the Reserve acquired 600,000 extra barrels of oil at no cost, and five million barrel of oil were kept on the market when oil supplies were very low.

In order to make the Reserve actions in the marketplace less abrupt, the royalty-in-kind transfer program could be made permanent at a modest base rate, around 50,000 barrels per day. The rate could be varied to respond to market conditions. When prices are relatively high, deliveries would be negotiated for later dates when prices were lower. When prices are too low, Interior would increase the rate of transfer to Energy, removing some supply from the market without actually reducing production.

Summary

By using the Strategic Petroleum Reserve's oil and storage capacity in a counter-cyclical manner, the Federal Government could add to the Nation's energy security by a continuous addition of oil inventory, and be a moderating influence in oil price cycles without regulating or spending appropriated funds. The counter-cyclical acquisition strategies outlined in this paper -- exchanges, storage and royalty-in-kind oil -- could be institutionalized as market-based mechanisms to increase energy security by filling the Strategic Petroleum Reserve, at the same time they serve as tools to address the problems associated with oil market volatility.

Energy Diplomacy

As a result of Secretary Richardson's visit to oil-producing countries in late February, most OPEC governments now support production increases in April. The goal of the diplomatic strategy at this stage should be to ensure that the level of increase is adequate to replenish depleted oil stocks. In addition to dealing directly with OPEC governments, we should urge key consuming nations to also weigh in with these governments.

With OPEC, we need to maintain pressure for a 2-2.5 million barrel per day increase in production in April. The most important player remains **Saudi Arabia**. We need to engage Saudi Arabia directly at the highest levels and specifically ask for the level of increase we need. **Venezuela** is currently in the lead on developing OPEC consensus. We need to stay in close contact with them and push their other customers to reach out to them. So far, Energy Minister Rodriguez appears to welcome this. **Kuwait** has reversed its previous rejection of production increases, leaving **Algeria** as the last "friendly" holdout. We need to underscore for Algeria that it will be hurt politically to be alone with Libya in opposing increased production (even Iran is now acquiescing to increases), and that it will help them financially to support such increases. **Indonesia** and **Nigeria** have not been vocal about their position. Nigeria is the more important player, because it has excess capacity and because its Petroleum Minister is the Secretary General of OPEC. We need to encourage them to vocally support significant increases in production. We should stay in touch with both **Qatar** and **UAE**, both of whom appear to support increases. We cannot talk to **Iran**, **Iraq** and **Libya**, but should find surrogates to approach Iran and Libya.

The only **non-OPEC member countries** with excess capacity are **Mexico** and **Norway**. Both support increasing production. We should continue our close contact with them to underscore the importance of their increasing production on April 1 whatever OPEC does.

Of the **consuming nations**, **Japan** is the biggest and most influential (after the US). Japan can weigh in with Iran, Kuwait and Saudi Arabia. We should focus considerable efforts to get them to do this. **South Korea** is another key market for Gulf oil. We should ask them to support our position with OPEC nations. We should continue discussions with the **UK**, **Canada**, **France**, **the Netherlands**, **Germany** and **Italy** to weigh in with their own suppliers and to push for a joint EU demarche to OPEC governments. In addition, developing countries that are large customers or who have influence in the G-77, should be asked to lobby their suppliers and express concerns about the effect of high prices on developing economies. We have been successful with **India** and **Egypt**. Now we should also approach **South Africa** and **Ghana**. Finally, other large producers, such as **Brazil** and **Angola**, should be pressed to call for stable markets and increased production.

As a supplement to these key efforts, we should consider a general message to embassies explaining our position. We can also work some of the regional economic groups, such as **IEA** and the **Organization of African Unity**.

Oil Diplomacy

Proposed Presidential calls

Saudi Arabia

Kuwait

Mexico

Venezuela

Nigeria

Norway

Potential Richardson travel to

Nigeria

Algeria

Venezuela

Indonesia

IEA (Paris)

Secretary of State will see

UK

Germany

Italy

France

Richardson calls/meets in Washington with

Qatar

Kuwait

Mexico

Japan

UAE

Others travel to

Japan

South Korea

Contact through Embassies

Brazil

Angola

Canada

S. Africa

Ghana

OAU

Remaining IEA/OECD countries

Draft Talking points for Crown Prince Abdullah of Saudi Arabia

- Saudi Arabia is a valued strategic partner of the U.S. Our security and economic relationships are of great importance to us. We want to maintain these close ties.
- We appreciate your statement March 9 that Saudi Arabia will work to have OPEC restore stability to the market.
- We further appreciate your support of increased OPEC production levels in April. As you know, we believe that significant increases will be important to meet demand and replenish depleted stocks.
- Our analysis shows that the increase needed is 2-2.5 million barrels per day beginning in April. A smaller increase – or one spread out over a long period – will not be enough.
- I understand that you want to calibrate production increases so that the price of oil not drop precipitously. None of us wants to see prices fall as they did in 1998.
- However, we believe that demand for crude oil in the second quarter will remain strong and that prices will not fall too fast if production is raised by 2-2.5 million barrels per day.
- Will Saudi Arabia advocate for an increase of at least 2 million barrels per day?
- We greatly appreciate your willingness to work with us on this.

Draft Talking points for Prime Minister of Norway

- I appreciate the responsible position that you are taking with respect to the current situation in the oil market.
- As you know, our analysis shows that world oil stocks are at their lowest level in two decades and that we need significant increases in production in April if we are to have any chance of replenishing these stocks.
- Our experts say there needs to be an increase of 2- 2.5 million barrels per day. Is that consistent with your analysis?
- I am very concerned that several OPEC countries may only supporting small increases in April. To reach consensus within OPEC, they may even agree to an increase as small as 1 million barrels a day.
- We do not believe this would provide adequate supply and would certainly not reduce the current high prices, which will hurt, not only our economy, but the economies of Asia and the developing world.
- That is why I would urge you to keep the pressure on OPEC governments to increase production in the second quarter.
- I would also urge that, if OPEC's increases are under 2 million barrels per day, Norway increase its own production. I believe that Mexico may do the same.
- I appreciate and support your efforts. Let me know if there is any way in which we can help you.

Draft Talking points for Venezuelan President Chavez

- We appreciate how well our two countries have been able to work on the issue of oil supply.
- We appreciate the news we are hearing that Venezuela supports increases in OPEC oil production in April.
- We understand the need to build consensus in OPEC prior to the March 27 meeting and are pleased that Venezuela is taking the lead in this effort.
- Our analysis shows that the increase needed is 2-2.5 million barrels per day beginning in April. A smaller increase – or one spread out over a long period – will not be enough.
- I understand that you want to calibrate production increases so that the price of oil not drop precipitously. None of us wants to see prices fall as they did in 1998.
- However, we believe that demand for crude oil in the second quarter will remain strong and that prices will not fall too fast if production is raised by 2-2.5 million barrels per day.
- This is a view that is shared by most of the world's oil consuming nations. France, India, IEA and the EU have all made statements expressing this concern.
- Will you advocate for at least a 2 million barrels per day increase?
- We greatly appreciate your willingness to work with us on this. I will send Secretary Richardson to Venezuela next week to follow up on this conversation.

Draft Talking points for the Emir of Kuwait

- Kuwait is an important friend and ally of the United States.
- We greatly value our strong relationship.
- I need to raise with you an issue of great importance that will affect the continued health of the U.S. economy.
- I know your government is currently considering its support increased oil production at the OPEC meeting on March 27.
- I understand and appreciate that none of us want to see prices as low as they were a year ago, when the Kuwaiti economy was devastated.
- However, our analysis shows that world oil stocks are at their lowest level in over a decade and that we need significant increases in production in April if we are to have any chance of replenishing these stocks.
- This is a view that is shared by most of the world's oil consuming nations. France, India, the IEA and the EU have all made statements expressing this concern.
- Our analysts say that to avoid damage to the world economy, there needs to be an increase of at least 2-2.5 million barrels per day.
- Can I count on you to support an increase of at least 2 million barrels per day?
- I appreciate your willingness to work with us on this. Secretary Richardson will be in contact with Minister Sheikh Saud next week to follow up on this.

Talking points for Zedillo

- I appreciate all the work that Mexico has done with respect to the current situation in the oil market. You are supporting the right decision – a 2.5 million barrel per day increase in production in April.
- You and Secretary Tellez should be commended for your leadership. I know that domestically and internationally you have received criticism, but you are doing the right thing.
- I am very concerned, however, that Saudi Arabia and Venezuela may support only small increases in April. To reach an OPEC consensus, they may even agree to an increase as small as 1 million barrels a day.
- As your own analysis shows, this increase will not be enough to replenish depleted world stocks, which are now at their lowest levels in over a decade. And continued high prices – or even higher prices – are bad for the global economy.
- That is why I would urge you to keep the pressure on OPEC governments to increase production in the second quarter.
- I would also urge that Mexico, with Norway if possible, increase its own production if OPEC's increases are too small. I know that you have already had discussions along these lines with the Norwegians.
- I also want to share with you the latest information from our oil experts. Our analysts predict that the United States will not have enough crude oil **this month** to meet gasoline demands in April and May. As a result, US gasoline prices may continue to rise.
- For this reason, I am asking that you increase your own production as soon as you can. I understand that you may be compelled to keep production down this month, but I would urge you to increase supply to U.S. markets as soon as you are able.
- I appreciate and support your efforts. Let me know if there is any way in which we can help you.

Talking points for Obasanjo

- Today, I need to discuss with you our concern over the level of crude oil supplies on the world market.
- I know your government is currently considering whether to support increased oil production at the OPEC meeting on March 27.
- Our own analysis shows that world oil stocks are at their lowest level in over a decade and that we need significant increases in production in April if we are to have any chance of replenishing these stocks.
- We believe that production needs to be raised by 2-2.5 million barrels per day. A smaller increase – or one spread out over a long period – will not be enough. Is that consistent with your analysis?
- I appreciate that you do not want the price of oil not drop precipitously. None of us wants to see prices fall as they did in 1998. I know low prices were devastating for your economy.
- However, we believe that demand for crude oil in the second quarter will remain strong and that prices will not fall too fast if production is raised by 2-2.5 million barrels per day.
- This is a view that is shared by most of the world's oil consuming nations. France, India, the IEA and the EU have all made statements expressing this concern.
- Can I count on you to support an increase of at least 2 million barrels per day?
- I appreciate your willingness to work with us on this. I am sending Secretary Richardson to see you next week to discuss this further.

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President of The United States
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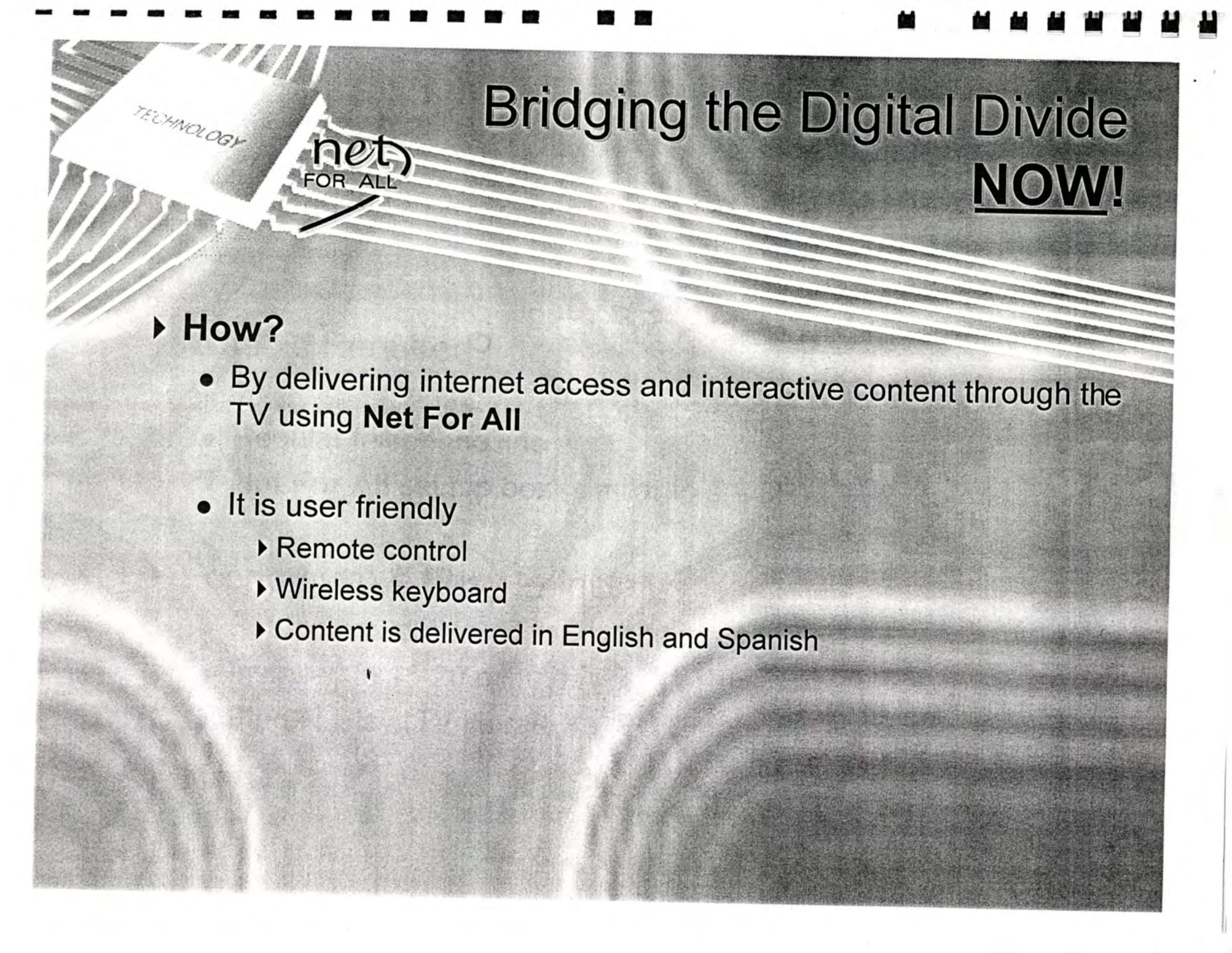
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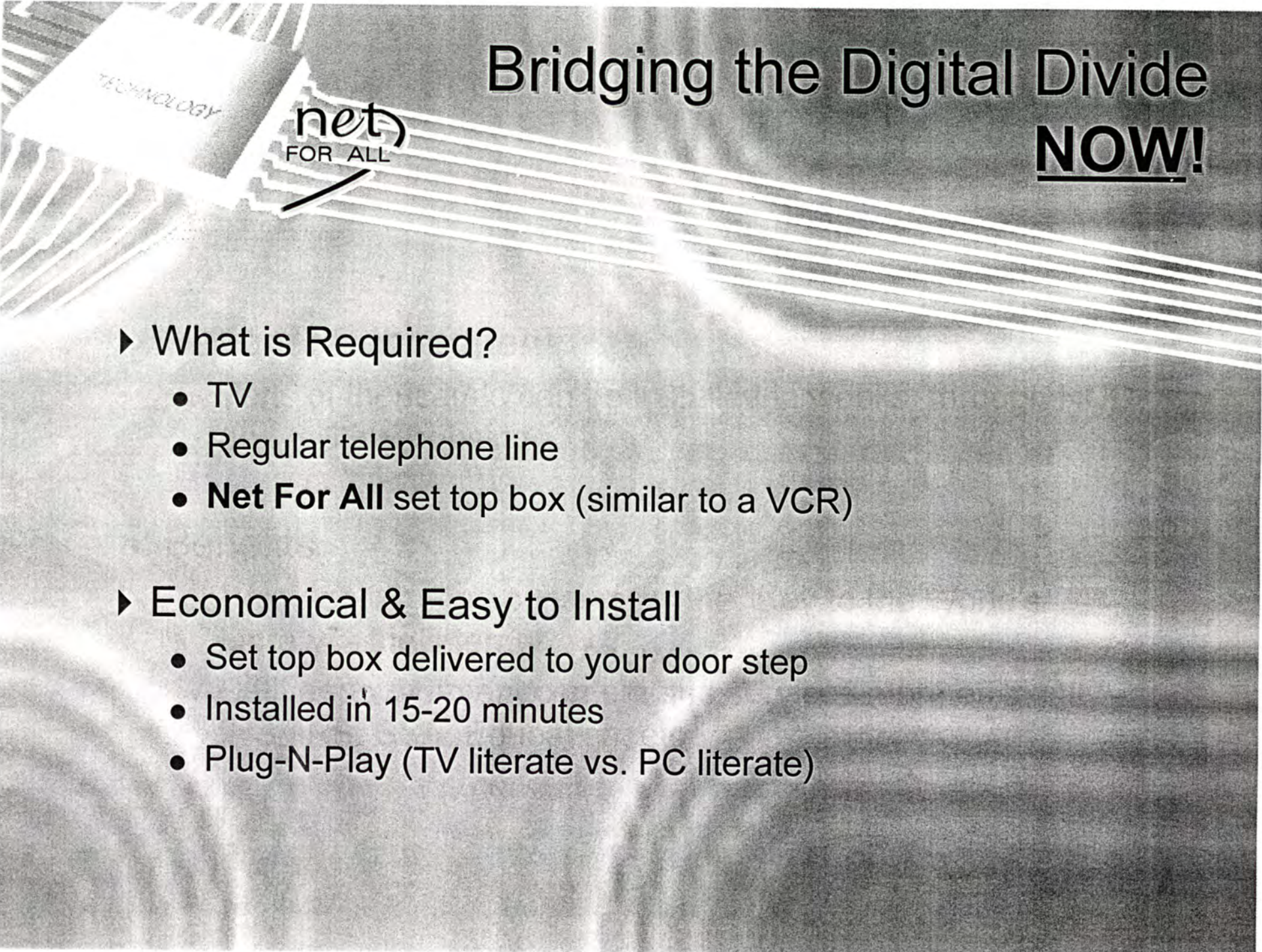
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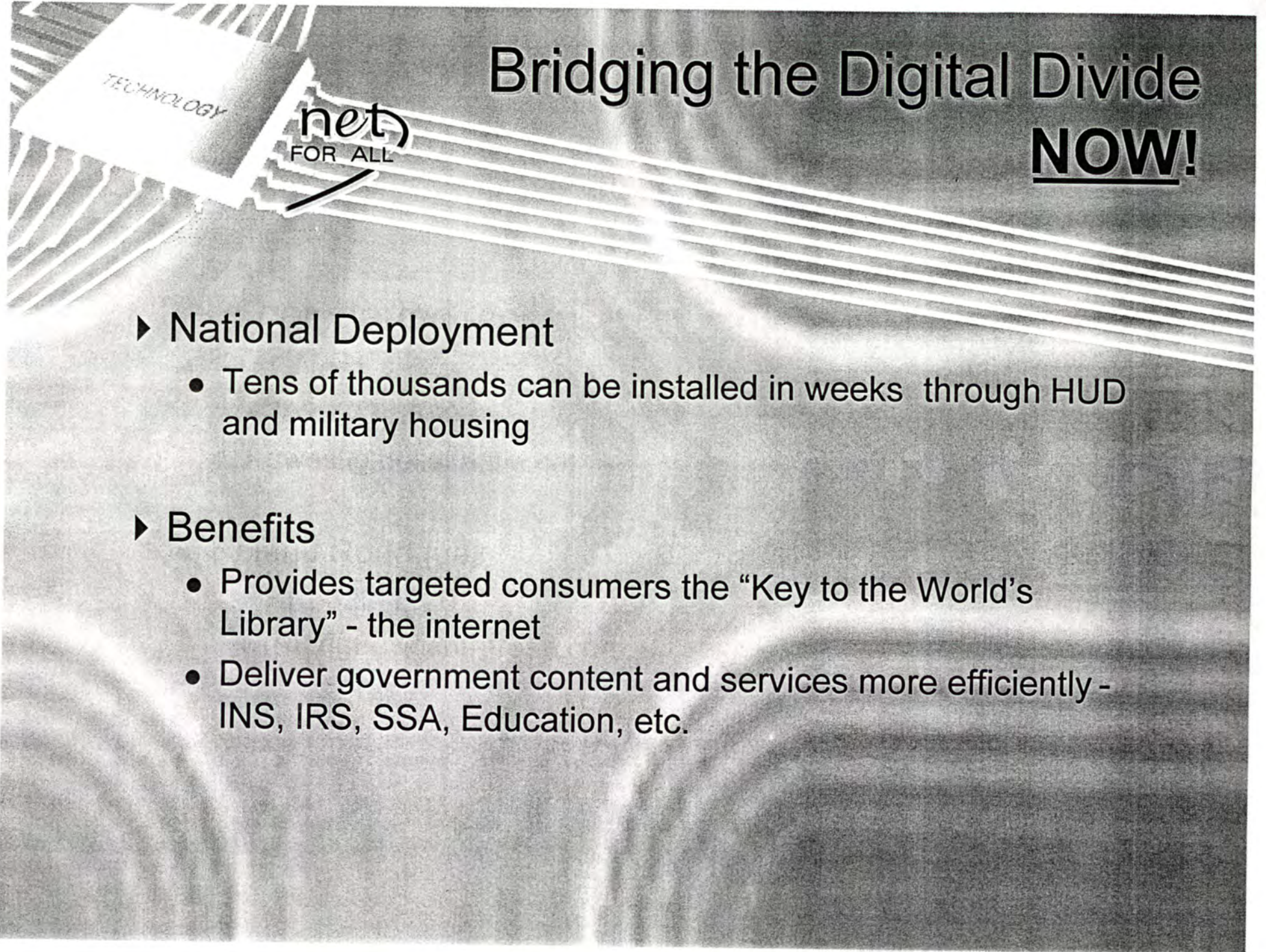
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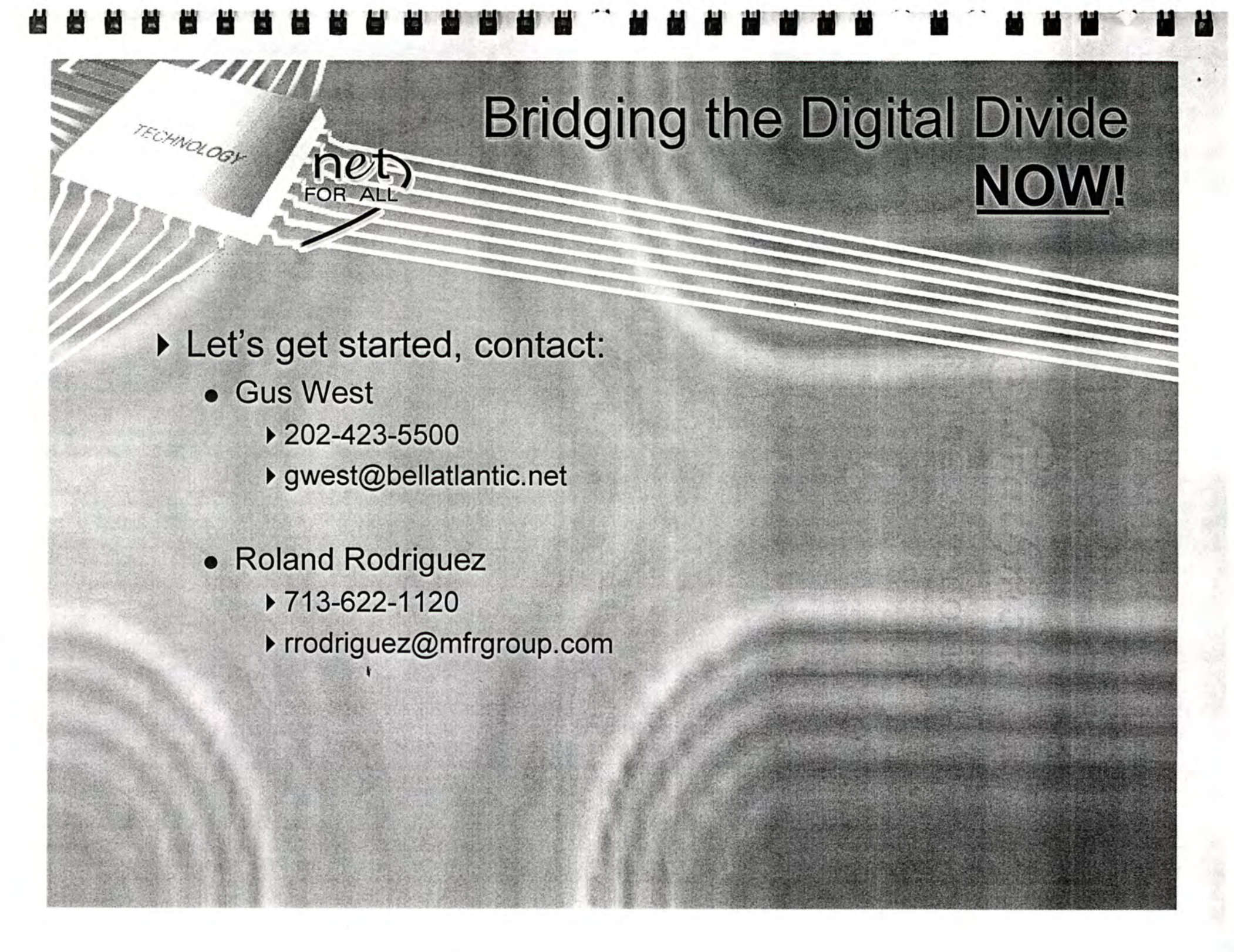
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- Roland Rodriguez

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Blue Clutter

3/18/00

9 March 2000

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making history! — you
might get a kick out of
this recent find of mine.

It's a piece of stationery
from President Truman's
Air Force One, known
then as "the Flying
White House" before the
code name gained
currency. This piece
was purloined from the
secret stash, apparently,
of President Truman's pilot

With compliments and
best regards —

Jeff Shesol

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Shesol (original)
Podesta

THE PRESIDENT HAS SEEN

3-13-00


Cipri
Podesta

JP
Can we do
anything about
this? / know
better

IX

Genome Decoding Plan Is Derailed by Conflicts

Distrust Leads to a Breakdown of Talks

By NICHOLAS WADE

With the race to decode the human genome nearing completion and the stocks of genome companies soaring, a last-minute merger negotiation between the public and private competitors has foundered in a clash of principles and egos. In an exchange of letters over the last week and a half, each side sought to blame the other for the breakdown and for failing to negotiate in good faith.

Although a long history of disagreement between the principals on each side probably did not help matters, a basic obstacle was an impasse between the public consortium's desire to make the information in the genome freely available to all researchers and the need of the private company, Celera, for enough proprietary safeguards to make a profit.

The decoding of the human genome is expected to mark a new era in medicine in which diseases will be analyzed and treated in terms of the genes that cause or influence them.

Identifying the sequence of the 3 billion chemical units of DNA that make up the human genome has been a 10-year project of a public consortium of university centers, financed largely by the National Institutes of Health and the Wellcome Trust of London.

But in May 1998, the newly formed Celera Corporation of Rockville, Md., leapt into the fray with the surprise announcement that it would sequence the genome from scratch with a novel approach and finish several years ahead of the public consortium's target date. Both Celera and the public consortium have said they will finish decoding the most important parts of the genome sometime this spring, a deadline that for both seems to be slipping into summer.

When Celera's approach seemed to be succeeding, despite predictions from some scientists that it could never work, observers in both camps realized that they were pursuing the same end with complementary means. Celera had a top-down method for sequencing the genome, the public consortium a bottom-up approach. If the two data sets were combined, the genome might be sequenced much sooner.

Most of the DNA sequencing on the public consortium's side has been carried out under Dr. John Sulston at the Sanger Center in Britain and Dr.

After preliminary talks, a meeting was held between the principals on Dec. 29. On the public consortium's side were Dr. Waterston, Dr. Francis Collins, head of the National Human Genome Research Institute, and Dr. Harold Varmus, then director of the National Institutes of Health. Dr. Venter was joined by Tony White, president of Celera's parent company, the PE Corporation.

But Dr. Lander and other doves were absent, resulting in a meeting of hawks without a mediator. The meeting broke up in mutual feelings of distrust. After two months silence, Dr. Collins and Dr. Varmus wrote on Feb. 28 to Celera that they would assume the idea of cooperation was dead unless they heard from Celera by March 6. The two officials included a proposed statement of shared principles, including that "the current antagonism and excessive competition should be replaced with a more collaborative spirit."

On Tuesday, a day after the institutes' deadline, Dr. Venter replied that Celera was still interested in collaboration and that the institutes' letter had "dramatically misstated" the company's position on its needs for intellectual property protection.

The stark disagreement is in one sense surprising because the two sides recently joined forces in successfully sequencing the genome of the laboratory fruit fly, used by Celera as a critical pilot project for its human genome strategy.

But fruit fly genes are of no direct medical value, and the two sides were able to share credit and make their data public without acrimony.

With the human genome data, there are much higher stakes in terms of intellectual credit for a landmark achievement and the prospect of a huge commercial payoff.

At the Dec. 29 meeting, the institutes' side insisted that the merged data set should be freely used by everyone, including Celera's commercial competitors, like Incyte Pharmaceuticals. Mr. White indicated he could not agree to that.

"The meeting went far astray when Waterston started defending Incyte's right to sell the Celera data," Dr. Venter said.

According to Dr. Collins, Mr. White declared that Celera "wanted to gain a monopoly on the human genome as a database," and that "it would be difficult for a publicly supported enterprise to become a competitor in

afford to give away everything they have," said Dr. Gerald Rubin, the University of California biologist who led the public consortium's side of the fruit fly genome project.

Dr. Rubin said Celera and Dr. Venter had "completely honored the letter and spirit of their agreements." He said he was puzzled at the pressure on Celera to release its data when it had already made public far more than any of its competitors.

Although the human genome is a gold mine in principle, it is unclear exactly where the commercial payoff will come. The genome itself is just a mystifying string of the same four chemical letters, with no evident punctuation, annotation or chapter headings. Interpreting and making use of it will be the work of decades.

Dr. Norton Zinder of Rockefeller University, a member of Celera's scientific advisory board who had favored collaboration, attributed the breakdown in talks partly to the difficulty of predicting the course of the genome's commercial development.

"There is no paradigm for how you value the information in the human genome sequence in itself," Dr. Zinder said. "When you do other things to the information, it is priceless — but that value comes after-

A plan for cooperation falls victim to clashing interests and egos.

ward and you don't know at what stage of this later work it will be found."

Dr. Venter said he still intended to make Celera's human genome sequence available to academic researchers without restriction on commercial uses they might develop from it.

Disagreements seem certain to continue even if the two sides go their separate ways. In an asymmetry caused by the public consortium's open access policy, Celera can use its rival's data, which is made public in a computer database known as GenBank. Dr. Venter plans to publish a human genome sequence based on both Celera's and the public consortium's data. But the N.I.H. officials in their letter called this plan "a breach of scientific ethics" because it involved publishing other scientists' primary data.

Dr. Venter termed the position ridiculous because the posting of data in GenBank constituted a publication, he said.

He said the differences with the

stocks of genome companies soaring, a last-minute merger negotiation between the public and private competitors has foundered in a clash of principles and egos. In an exchange of letters over the last week and a half, each side sought to blame the other for the breakdown and for failing to negotiate in good faith.

Although a long history of disagreement between the principals on each side probably did not help matters, a basic obstacle was an impasse between the public consortium's desire to make the information in the genome freely available to all researchers and the need of the private company, Celera, for enough proprietary safeguards to make a profit.

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Most of the DNA sequencing on the public consortium's side has been carried out under Dr. John Sulston at the Sanger Center in Britain and Dr. Robert Waterston at Washington University in St. Louis. Both strongly support the idea of placing all human DNA immediately in the public domain, and have reservations about dealing with Celera.

It was another member of the public consortium, Dr. Eric Lander of the Massachusetts Institute of Technology, who approached Dr. J. Craig Venter, the president of Celera, with the idea of a collaboration.

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On Tuesday, a day after the institutes' deadline, Dr. Venter replied that Celera was still interested in collaboration and that the institutes' letter had "dramatically misstated" the company's position on its needs for intellectual property protection.

The stark disagreement is in one sense surprising because the two sides recently joined forces in successfully sequencing the genome of the laboratory fruit fly, used by Celera as a critical pilot project for its human genome strategy.

But fruit fly genes are of no direct medical value, and the two sides were able to share credit and make their data public without acrimony.

With the human genome data, there are much higher stakes in terms of intellectual credit for a landmark achievement and the prospect of a huge commercial payoff.

At the Dec. 29 meeting, the institutes' side insisted that the merged data set should be freely used by everyone, including Celera's commercial competitors, like Incyte Pharmaceuticals. Mr. White indicated he could not agree to that.

"The meeting went far astray when Waterston started defending Incyte's right to sell the Celera data," Dr. Venter said.

According to Dr. Collins, Mr. White declared that Celera "wanted to gain a monopoly on the human genome as a database," and that "it would be difficult for a publicly supported enterprise to become complicit in that." As for Celera's wish to prevent competitors from selling its data,

"That is taking a whack at the entire sector that seeks to take this sequence and provide it in a usable form," Dr. Collins said.

But in refusing to allow Celera proprietary safeguards, N.I.H. officials may have pushed the company too hard. "I don't think the director of a publicly traded company can

off will come. The genome itself is just a mystifying string of the same four chemical letters, with no evident punctuation, annotation or chapter headings. Interpreting and making use of it will be the work of decades.

Dr. Norton Zinder of Rockefeller University, a member of Celera's scientific advisory board who had favored collaboration, attributed the breakdown in talks partly to the difficulty of predicting the course of the genome's commercial development.

"There is no paradigm for how you value the information in the human genome sequence in itself," Dr. Zinder said. "When you do other things to the information, it is priceless — but that value comes after

A plan for cooperation falls victim to clashing interests and egos.

ward and you don't know at what stage of this later work it will be found."

Dr. Venter said he still intended to make Celera's human genome sequence available to academic researchers without restriction on commercial uses they might develop from it.

Disagreements seem certain to continue even if the two sides go their separate ways. In an asymmetry caused by the public consortium's open access policy, Celera can use its rival's data, which is made public in a computer database known as GenBank. Dr. Venter plans to publish a human genome sequence based on both Celera's and the public consortium's data. But the N.I.H. officials in their letter called this plan "a breach of scientific ethics" because it involved publishing other scientists' primary data.

Dr. Venter termed the position ridiculous because the posting of data in GenBank constituted a publication, he said.

He said the differences with the public consortium began at a May 1998 meeting when Dr. Collins of the N.I.H., under pressure from his English colleagues, first decided against collaborating with Celera.

The New York Times

THURSDAY, MARCH 9, 2000

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Who Should Own Your Genes?

AS THE RACE to map the human genome nears completion, companies are hurrying to patent as many chunks of it as possible in hopes of deriving lucrative medical treatments later on. Often they apply for patents on gene sequences about whose functions they know little or nothing. Anyone wanting to do further research on these genes—research crucial to figuring out how they actually work—would have to pay licensing fees and royalties to the companies that hold the patents. Depending on what kind of fees or conditions companies choose to set, this could slow research or complicate doctors' use of tests for genetic disorders.

The government's Human Genome Project, which puts genes into the public domain as it finds them, claims to be within a few months of sequencing all 100,000 genes. But as many as 70,000 of those could already be under patent application by one of the companies racing with the government to complete the map. How the U.S. Patent Office handles those applications will determine the level of public access to the genome for years to come.

There is a strong public interest in keeping the genome as freely accessible as possible, not only because it is an unparalleled scientific resource but because, as the underpinning of human life, it belongs in a certain sense to humanity. More pragmatically, it belongs to the public because public funds have been the foundation of the genome mapping effort.

Patent law has traditionally treated organic substances—even genes—as chemicals like

any other, which qualify as "inventions" if someone isolates them and shows they can be used for a specific purpose. But for gene patent applications, examiners have deemed it enough to show knowledge of a gene's structure rather than offering conclusive evidence of what it does. The patent office granted a patent to Rockville-based Human Genome Sciences Inc., for example, for a gene that was later discovered—by scientists unaffiliated with the company—to play a key role in transmitting the AIDS virus.

Last year, after much outcry, the patent office issued revised guidelines—open for public comment until March 22—that require a somewhat more specific showing of "utility." But many scientists say the guidelines don't go far enough, since they still allow for patents based on "theoretical utility," which could mean as little as an apparent resemblance between the new sequence and other sequences previously discovered.

This is wrong, even if it reflects common practice for patenting other substances. The patent office should tighten its rules on the genome to the point where the vast majority of the basic sequence will end up in public, not private, hands. If that proves impossible under current law, Congress should carve out an exception in the patent law to recognize the public's unique claim on the genome. And companies that already hold gene patents should be obliged—by Congress if necessary—to make them available on reasonable licensing terms to researchers and doctors.

The Washington Post
THURSDAY, MARCH 9, 2000

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Disease spreading across flooded land

'You will see lots of people die, especially the children,' doctor says in Mozambique

By Vivienne Walt
Special for USA TODAY

CHEAQUELANE, Mozambique — The malaria epidemic that health workers have been dreading has arrived in Mozambique's flood areas.

Less than two weeks after calamity struck, lakes of flood water appear to have bred disease-carrying mosquitoes in the tropical heat, spawning thousands of malaria cases.

"You will see lots of people die, for sure, especially the children," Claudio Marra, an Italian physician working for UNICEF, said Wednesday. "Usually, the rate increases around this time of year. But the floods have created a natural breeding ground for mosquitoes."

A government health worker's handwritten log tells the chilling story. By Wednesday, his neat columns listed 3,214 malaria cases among about 39,000 flood refugees who have converged on this village searching for food and clean water.

President Joaquim Chissano told reporters Wednesday that 212 flood victims have been found dead. Health workers have warned that



By Jockel Finck, AP

No shelter: Young flood refugees sit through a rainstorm Wednesday at an encampment for an estimated 39,000 people at Cheaquelane, Mozambique.

hundreds, perhaps thousands, more could die in the aftermath of the floods and a cyclone that hit southern Mozambique in late February.

In this village, two small tents serve as the health center for the sprawling encampment. Since setting up the tents 11 days ago, two health workers have treated about 500 patients a day. Of those, two-thirds have malaria, many in a form so severe that recovery is unlikely.

Rahel Uzebe, 6, doubled over outside the health tent in her red-and-

white dress. She was vomiting, her forehead searingly hot. She had just been diagnosed with malaria. "We have been waiting for help for hours," said her mother, Florentina Uzebe, 27, who showed the anti-malaria tablets she had been given.

A huge influx of relief has poured into Mozambique since Friday. The capital, Maputo, is a staging area for a major operation involving six military forces: American, Spanish, German, French, British and Libyan. They have unloaded medicines, food

and equipment to repair battered roads and bridges. Helicopters drop supplies to isolated communities.

Much of Mozambique's malaria is resistant to drugs. A lack of water and shelter in temperatures reaching into the 90s has also brought the threat of dehydration. As a result, Cheaquelane's health workers have treated hundreds of diarrhea cases.

About 250,000 people have been uprooted and have lost their possessions. Many homes have been washed away, and crops and an estimated 80% of the nation's livestock may have been wiped out.

In Chokwe, a nearby town of 15,000 people that has been without electricity, food or pumped water for 11 days, health workers are struggling to dispose of corpses. Since floodwaters receded last weekend, the bodies of about 60 flood victims have been found by volunteers with the group Doctors Without Borders.

"We cannot bury them, because it will contaminate the whole town's water supply," Marra said. "The safest would be to burn them. But people do not believe in cremation here."

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Greenspan, Through the Looking Glass

By Lawrence Kudlow

Alan Greenspan's harsh warnings that only substantially higher interest rates can slow down the economy are like an out-of-range cellular telephone call. They are disconnected from the reality of the new Internet economy.

Mr. Greenspan, the chairman of the Federal Reserve, has repeatedly warned that we are at risk of inflation and that "excess demand" must be curbed by a tighter credit policy. Trouble is, the superb performance of the economy disproves these fears. Over the past five years, rapid technological advances have generated 4 percent yearly growth while inflation has been at a minuscule 1½ percent. A virtually perfect scenario.

Yet Mr. Greenspan persists in conjuring up arguments that fly in the face of both actual evidence and established economic theory. Lately he has been seeing harm in the productivity gains that policymakers have sought for three decades. Over-

First, rising stocks were bad. Now rising productivity is a problem, too.

all productivity has grown an average of 3 percent annually in the United States; the industrial sector has increased productivity by more than 5 percent per year. All schools of economic thought — Keynesian, supply-side, even socialist — agree that productivity increases are always desirable.

The Fed chairman, however, now asserts that rising productivity is doing bad things, fueling corporate profits and higher stock market prices. This, he warns, poses the threat of inflation caused by increased consumer spending.

So, in this tortured Alice-in-Wonderland logic, all that appears to be good is really bad. Real world statistical evidence, however, runs counter to this view. Despite the

Lawrence Kudlow is the chief economist at Schroder & Company, an investment firm.

soaring stock market, consumer spending over the past five years increased by 35 percent, less than the increase in wages and salaries, which rose by 38 percent. The stock market then, has not induced consumers to spend above their means.

Also, a recent study by the Federal Reserve itself suggests that many investors in the bull market are actually saving more and spending less in order to reap greater retirement benefits. Indeed, it was during the 1970's, when inflation was

high, that consumption went up faster than wealth. During the 1980's and 1990's, when inflation was low, wealth rose faster than consumption. And this wealth led to a spectacular surge in investment, providing more factories, equipment and services that can keep up with demand.

Indeed, the very success of Mr. Greenspan's own anti-inflation policies has fostered the productivity-driven prosperity that he is now in danger of curbing. Declining inflation puts more money in the pockets of workers, investors and entrepreneurs. As a result, the efficiency of employers and employees has improved markedly. The entire economy has been retooled for global competitiveness.

Most vexing, however, is Mr. Greenspan's apparent refusal to acknowledge that inflation really is caused by too much money chasing too few goods. In speech after speech — warning of potential inflation threats — the central banker never,

ever mentions the word money.

If the money supply were excessive, the dollar's exchange rate would decline, gold prices would increase and long-term interest rates would rise — all market signals of future inflation. But today, the dollar is strong, gold is weak and long-term Treasury rates are falling, telling us that the Internet is more important than the Fed.

Technology has fought inflation much more successfully than the Fed ever could. Let's look at recent

technological breakthroughs: computer chips that break the gigahertz speed barrier of one billion cycles per second, new molecular electronic chip-making systems, new open access to broadband cable transmission systems, and new business-to-business auction websites for low-cost manufacturing supplies and parts.

They all promote faster economic growth at lower prices without any help from the Fed.

But Alan Greenspan doesn't seem to appreciate these developments. And in this sense, the Fed is stuck in the old era — it thinks we still have a smokestack economy as opposed to the new Internet economy.

The Fed keeps trying to pour old wine into new bottles. This won't work, and it might do considerable harm. If it goes too far, and raises interest rates too high, that will surely undermine this prosperity.

Here's a better idea for Greenspan and Company: If it ain't broke, don't fix it. □



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mother and 10 others drowned when a smuggler's boat sailing from Cardenas, Cuba, to south Florida capsized in the Florida Strait. In the 100 days since his rescue, the boy has become an icon for many Cuban exiles who oppose the communist regime of Fidel Castro.

In January, U.S. Attorney General Janet Reno ratified an Immigration and Naturalization Service ruling that the boy should be returned to Cuba at the request of his father.

Deputy U.S. Solicitor General Edwin S. Kneedler said Elian is not entitled to an asylum hearing because he was only paroled into the United States to live temporarily with his great-uncle and not formally admitted into the country.

Furthermore, Kneedler said, the INS interviewed Juan Miguel Gonzales in Cuba and found "a close relationship" that gives the father the sole right to speak on the boy's behalf.

Attorneys for Lazaro Gonzalez are pressing for an asylum hearing in which they would be able to present evidence that Elian would face a life of persecution and harm if he were returned to the island.

In court papers filed last week, government lawyers ridiculed the notion that Lazaro Gonzalez's lawsuit reflected Elian's fear of returning to Cuba. "No 6-year-old could have asked a state court (as these plaintiffs have) to find that his father is unfit simply because he wants his son to grow up with him in Cuba," wrote Justice Department lawyers. "And no 6-year-old would have retained five law firms to press these claims."

If the judge orders the INS to conduct an asylum hearing, it would be held within 60 days, attorneys for the family said.

Attorney General's Aide Kills Self Over Money Scandal **By Mary Beth Sheridan**

Los Angeles Times

MEXICO CITY A top aide to the attorney general is found slumped over the wheel of his car, dead of a self-inflicted gunshot wound. His corruption-busting boss is forced to admit that his right-hand man had secretly stashed away a \$700,000 fortune. In a suicide note, the aide acknowledges that the money "is difficult to explain."

The suicide of Juan Manuel Izabal on Wednesday shocked even Mexicans accustomed to the frequent drug-payoff scandals that have rocked the Justice Ministry. It was especially damaging to Attorney General Jorge Madrazo Cuellar, one of the most trusted figures of U.S. anti-narcotics officials, who has tried to implement broad anti-corruption programs.

Initial investigations Thursday suggested that Izabal's fortune came from unscrupulous deals, not narcotics. But commentators said the scandal showed that corruption is so profound in Mexico that it frustrated even top officials in the government of President Ernesto Zedillo who are dedicated to combating it.

"The president has had the will to combat corruption. But at the end of his six years (in office), you see he hasn't been able to," said Francisco Molina, a former top drug official who is now a senator for the opposition National Action Party, or PAN.

Izabal, the top administrative official in the Justice Ministry, was found dead early Wednesday morning, just a few blocks from his home in southern Mexico City.

At first, the sensational death of such a prominent figure

"The administrative officer (Izabal) knew about this," Madrazo said.

The next morning, Izabal's body was discovered, shot once in the head, with a .38-caliber Beretta pistol in his hand.

Hours later, the bankers revealed what had driven Izabal to desperation.

Recently, the bank had sent Izabal three notices asking him to claim his safe-deposit box from a Citibank branch that was scheduled to close, the officials said, according to Madrazo. When he didn't respond, the officials opened the box.

Inside, they found a fortune: \$700,000 in U.S. and Mexican money, Madrazo said.

On Tuesday morning, Izabal finally turned up at the bank to claim the box, Madrazo said. But it was too late: Bank officials told him they had decided to inform the Justice Ministry about the contents.

In the suicide note to his wife, Izabal said: "You are going to learn about things you don't know that will disappoint you. Forgive me. The safe-deposit boxes don't just have documents, as I told you; there is also money that is difficult to explain. It's the result of business deals that I have done, but that would not be understood, given my position as a civil servant. It's not from narcotics or anything like that, but I didn't declare it, and the circumstances have me against the wall."

Authorities said Thursday they still didn't know where Izabal had obtained his fortune. Madrazo said he "could not rule out" that the money was from traffickers but suggested that was unlikely. Other officials noted the dead aide didn't handle narcotics investigations. Instead, he was responsible for a wide range of administrative matters, ranging from purchases of equipment to the custodianship of money and property seized from traffickers.

Madrazo immediately ordered an investigation of Izabal and other senior officers.

Spy Leaked Details of NATO Bombing to Yugoslavs, BBC Reports

By Marjorie Miller and John-Thor Dahlburg
Los Angeles Times

LONDON A spy within NATO leaked details of allied bombing raids to the Yugoslav government during the first two weeks of last year's military campaign against President Slobodan Milosevic, a British Broadcasting Corp. television documentary reports, citing a U.S. Air Force investigation.

NATO, U.S. and British officials immediately denied the report, a preview of which appeared in Thursday's edition of the Guardian newspaper and on the BBC Web site, <http://www.bbc.co.uk>.

The documentary, which will air Sunday on the BBC, asserts that an Air Force investigation found that the Yugoslav government was given highly sensitive "air tasking orders," including the targets to be hit, flight paths and the timing of surveillance flights and bombing sorties.

When the alliance's military commander, U.S. Gen. Wesley K. Clark, ordered that the number of people allowed to see the air tasking orders be reduced from about 600 to around 100 to impact on the Serbs' knowledge "was immediate," the Air Force reportedly learned.

Clark didn't comment directly about the alleged

investigation. In the documentary, viewed by the Los Angeles Times, he said, "In some cases, we had some indication maybe they did have some information about specific things that were being targeted."

"We looked for all indicators that the Serbs might have known what we were doing, and we worked these back into what else we could do to tighten operational security."

In the Guardian story, co-written by the reporter for the BBC documentary, Clark is quoted as saying there was "absolutely not" a spy at NATO headquarters in Brussels, Belgium. Asked, however, if there was a spy "in NATO," he said, "I don't think so."

Those responses didn't appear in the documentary about the bombing campaign, which NATO launched after Milosevic's crackdown on ethnic Albanians in the separatist province of Kosovo.

If the leaks did take place, it means that the Serbs would have been able to move into and around Kosovo without detection by reconnaissance planes avoiding the aircraft's paths and could have moved soldiers and equipment out of harm's way when they knew air attacks were imminent.

A high-ranking European diplomat at NATO said that, if there had been a leak, it would not have been from alliance headquarters in Brussels but from the alliance members' military commands because information about the strike targets "never got to Brussels."

U.S. and European officials at NATO said they were unaware of an Air Force investigation, and NATO spokesman Jamie Shea called the BBC report "a bit flimsy," although he did acknowledge that NATO had changed its procedures two weeks after the war began March 24 to restrict access to information about operations.

"Would the Pentagon have a top-secret report on a mole or spy in NATO, sit on it for a year and then tell the BBC about it instead of NATO or the member governments?" Shea said. "The air campaign has been over for a year. If there was such a compromise of NATO operations, how come the head of security here who is an American, incidentally has never heard of it?"

Shea nonetheless acknowledged that "two weeks into the campaign the target access list was cut back from 600 to 100. These kinds of things were not done because anyone had evidence of a spy. It was through ordinary prudence, ordinary care."

But reports of a previous leak turned out to be true. In November 1998 almost five months before the air war started a senior French officer, Pierre-Henri Bunel, admitted that he had slipped NATO's overall target plans to a Yugoslav diplomat based in Brussels.

Albright Praises Leadership of Serb-Run Half of Bosnia By Norman Kempster Los Angeles Times

BANJA LUKA, Bosnia-Herzegovina In a striking change from Washington's wartime sympathies, U.S. Secretary of State Madeleine Albright praised the leadership of the Serb-run half of Bosnia on Thursday, pronouncing it ahead of the rest of the country on both political and economic reform.

With Bosnian Serb Prime Minister Milorad Dodik at her side, Albright said moderate forces in Republika Srpska, as the Serbian entity is known, "have been fighting the good fight. ... They have distanced themselves from (Yugoslav President

and hampered by corruption. But he vowed to stamp out graft and make the economic reform process understandable and open to all.

Dodik also assured Albright that Milosevic is no longer calling the shots in the Bosnian Serb entity, as he clearly was during the war. Although Milosevic continues to control some minority political parties, Dodik said his overall influence "is almost insignificant."

He said Bosnian Serbs "are ready to help all democratic efforts to achieve change" in Serbia, the dominant Yugoslav republic. But he didn't list any specific steps his government is planning to take.

Later, in a meeting with a selected group of Bosnian Serb journalists, Albright expressed frustration at the internal disputes that have sapped the strength of the democratic opposition to Milosevic in Serbia.

"It is important to have an opposition leader not four of them that disagree with each other," Albright said.

Nevertheless, she said, she had expected the Serbian public to rise up against Milosevic before this. "The hardest thing for us to understand is why the Serb people put up with it. ... I don't know where the young people are; maybe they've emigrated. ... Where is the military? Usually, the military is with the people."

Albright acknowledged that the Clinton administration had expected ordinary Serbs to blame Milosevic for the hardships they endured this winter when international sanctions limited imports of heating oil and other fuel.

"I know they are mad at us," she said. "I know people don't like me. But they should blame Milosevic."

Albright also pledged \$2 million in U.S. aid to rebuild 200 unoccupied houses in Republika Srpska and Croatia to provide shelter to returning refugees. She offered the help after the Bosnian Serb government and Croatia, a former Yugoslav republic neighboring Bosnia, issued a new refugee policy intended to facilitate the return home of hundreds of thousands of people who remain displaced more than four years after Bosnia's war ended.

The declaration gives the prewar owners of a house the right to reclaim it even if it is being occupied by someone else. It also allows refugees who prefer to remain where they are now to do so.

The policy primarily affects ethnic Serbs displaced from the Krajina region of Croatia who are now in Republika Srpska and ethnic Croats driven out of towns and villages in the Bosnian Serb entity who are now in Croatia.

Two photos and one map (TPN) available at www.latwp.com By Dexter Filkins Los Angeles Times

ARASADITHIVU, Sri Lanka In a land where women are prized for their quiet passivity, one of the world's most ruthless guerrilla groups is riding toward victory on the strength of its female fighters.

The women of the Liberation Tigers of Tamil Eelam, rebels waging a war for an independent homeland in this island nation, are emerging as the movement's most important weapon after thousands of men have died in battle.

With vials of cyanide hanging from their necks, women Tigers are shooting their way into government bunkers and police stations. They are hacking to death men, women and babies. Women Tigers are wrapping their bodies with explosives and

have moved soldiers and equipment out of harm's way when they knew air attacks were imminent.

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Albright said Dodik's government, which has supported the 1995 Bosnian peace accords, deserves economic and political support from the United States and the rest of the international community. As a token, she said, Washington will give the regime \$7 million to help finance its budget.

"The trend toward privatization is stronger here than elsewhere in the country," Albright said during a day of meetings in this town, which serves as headquarters for the Bosnian Serb entity.

To be sure, that is faint praise since the Muslim-Croat Federation that governs the other half of Bosnia-Herzegovina has done almost nothing to dismantle the state-controlled economy the country inherited from the former Yugoslav federation. But Albright's comments show how much Washington's attitude has changed from the war years, when the Bosnian Serbs under far different leadership were considered the aggressor.

Dodik acknowledged that Republika Srpska's privatization effort has been marked by "successes and failures,"

public to rise up against Milosevic before this. "The hardest thing for us to understand is why the Serb people put up with it. ... I don't know where the young people are; maybe they've emigrated. ... Where is the military? Usually, the military is with the people."

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With vials of cyanide hanging from their necks, women Tigers are shooting their way into government bunkers and police stations. They are hacking to death men, women and babies. Women Tigers are wrapping their bodies with explosives and killing dozens in suicide attacks. As the men fall, the women fighters are stepping into the upper ranks of a guerrilla army once reserved exclusively for men.

Seetha, a 22-year-old leader of 1,500 women fighters, stands just over 5 feet tall, wears her hair neatly trimmed and says she might one day like to have a family. Dressed in camouflage fatigues and toting a machine gun, she talks with the cool confidence of a battle-hardened commander.

"It's difficult to say how many people I've killed," said Seetha, who gave up her real name when she became a Tiger. "Sometimes after a battle, there might be 50 or 75 bodies lying around. It's hard to say how many of them were mine."

Seetha is one of thousands of Sri Lankan women who have joined the Tigers, changing not only the face of the notorious rebel army but also challenging long-held views of their gender in this traditional society.

The Tigers' ranks were filled only with men in 1983, when the predominantly Hindu Tamil rebels launched their struggle

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Election spending is record \$250M

By Jim Drinkard
USA TODAY

WASHINGTON — Presidential candidates have spent a record-shattering quarter of a billion dollars in the primary election season, and it isn't over yet.

The result of all that spending: The race is back where it began as the anointed choice of the Republican Party faces the standard-bearer of the Democratic establishment.

- Bush on Gore, Interview, 15A
- Bradley, McCain to quit, 15A

With their treasuries all but depleted and their nominations all but locked up after Super Tuesday balloting in 16 states, Vice President Gore and Texas Gov. George W. Bush can breathe a little easier, retool their campaigns for a financially leaner spring and summer and begin raising more money.

More primaries and caucuses are yet to come, but with their opposition on the verge of dropping out, spending rates will be far lower than during the battles of the last two months.

They leave behind a trail of spending records. Candidates spent \$211 million by Jan. 31 and tens of million more in February and March. In 1996, a candidate field of similar size had spent \$183 million by the time nominees were selected in March.

By far the biggest spender has been Bush. He has raised \$73 million and spent nearly all of it fending off challenger John McCain, who aides say is planning "a major announcement" today regarding his campaign.

The tally for McCain and the two Democrats, Gore and former senator Bill Bradley, is close to the \$40.5 million limit each because they accepted federal matching money. Bush was able to spend more because he decided not to take matching funds and thus was not subject to the spending limits.

The largest single item in the political expense column is TV and radio ads, direct mail and telephone calls. Bush and McCain, for example, together poured more than \$9 million into TV ads during the two weeks leading up to this Tuesday's primaries and caucuses.

Report says harassment of military's gays doubles

By Andrea Stone
USA TODAY

WASHINGTON — Despite renewed Pentagon vows to enforce its "don't ask, don't tell, don't pursue, don't harass" policy, cases of anti-gay harassment more than doubled in the military last year, a report out today says.

Nine hundred sixty-eight cases of anti-gay harassment were reported to the Servicemembers Legal Defense Network in the 12 months beginning in February 1999, up from 400 the year before.

The incidents ranged from verbal taunts and death threats to assaults and the murder in July of Pfc. Barry Winchell, a gay soldier at Fort Campbell, Ky. Other findings:

► A small but definite trend in commanders who buck the policy and quietly refuse to discharge openly gay troops.

► There were 665 cases in which troops were asked about their sex lives or investigated, a 30% increase over last year.

► Women made up a record 31% of gay discharges, although they make up only 14% of the force. "Women are at the nexus of homophobia and sexism," says Michelle Bencke, the group's co-director.

The "don't ask" policy allows gays to serve in the military if they keep quiet about their sex lives, and commanders are not to ask about troops' sexual orientation. Since Winchell's murder, Defense Secretary William Cohen has ordered anti-harassment training.

Pentagon spokesman Kenneth Bacon said he had not seen the report and could not comment on its findings.

► Ignoring the policy, 4A

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How the government failed to stop the world's worst Internet attack

By M.J. Zuckerman
USA TODAY

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Susan Levy Haskell arrived at her office at the University of Minnesota as usual before 8 a.m. on Monday, Aug. 16, 1999, where she watched at first curiously, then later in horror, as the university computer system came under attack from a massive yet anonymous Internet adversary.

Haskell, the university's computer security coordinator, says that as hours passed the volume of incoming malicious traffic rose from a mere annoyance to an all-consuming electronic dissonance. The Internet connection grew ever less responsive, degrading steadily until the university was cut off from the world.

"It became pretty terrifying to realize how many machines had to be involved. It seemed like hundreds."

Investigators later determined that 2,200 computer systems, including those at more than 30 universities in the United States, had become unwitting "zombies," serving a still unidentified master computer, which directed the attacks and forced the university off the Internet for two days.

In a matter of weeks after the Minnesota incident, academics and elite computer security firms began spreading the word to clients and colleagues that this newly enhanced "denial of service" (DoS) attack was a clear and immediate danger to the Internet.

But it would take more than a month before federal officials at the National Infrastructure Protection Center (NIPC), which is responsible for national computer security matters, to learn of the incident and three more months for them to conclude that it was a threat worthy of a warning to the public.

It is now apparent that throughout the end of 1999, cybervandals were infecting large, insufficiently secured computer systems as zombies and laying the groundwork for a series of attacks last month that rocked e-commerce.

The delayed response and limited distribution of threat information is one of several criticisms being leveled at the NIPC and its sister agencies as the investigation into the attacks progresses slowly, according to recent congressional testimony.

"It was not enough," says Jamie Gorelick, the former deputy attorney general, who from 1994 to 1997 directed the administration's creation of the current electronic defense policy.

She and others say the protection center failed, leaving many e-commerce firms unprepared for the attacks Feb. 8-11 that slowed the global Internet by 20% and shut down the world's most popular commercial Web sites and the FBI's home page.

"There needs to be some agile operational capacity in the government, an ability to move quickly to provide warnings," she says. "This doesn't sound at all like what we had in mind."

Michael Vatis, director of the NIPC, an interagency fusion of federal, local and international organizations based at the FBI, defends his agency's response. It says it permitted the private sector to prepare for the worst while avoiding public hysteria.

"Three years ago we wouldn't have been able to respond at all," Vatis says. "Today we have an effective resource" for investigating crimes and issuing threat alerts.

Critics say the protection center and its sister agencies have fallen short of the vision President Clinton had two years ago when he issued a plan to "create a genuine public-private partnership to protect America in the 21st century" from devastating cyberattacks. The plan called for the private sector, which owns and operates both the Internet and the infrastructure that supports it — electricity, banking and communications — to create secure information-sharing centers in which companies could anonymously share threat information, new vulnerabilities and crises data. It also created a Commerce Department coordinating center to work with those industry clearinghouses and the NIPC.

But as the administration seeks \$37 million in new spending for cybersecurity, the NIPC and its sister agencies are troubled by confusion within their own ranks as well as a lack of cooperation from companies and other government agencies.

► Other government agencies are refusing to work with the NIPC, privately pointing to the FBI's longstanding reputation for not sharing well with others. "That's something we're still working on," Vatis says.

The Pentagon is the only Cabinet-level agency represented at the NIPC. The Secret Service, Transportation Department and Treasury Department, each of which is designated to have

"There needs to be some agile operational capacity in the government, an ability to move quickly to provide warnings. This (last incident) doesn't sound at all like what we had in mind."

— Jamie Gorelick, former deputy attorney general

representation at the protection center, refuse to take part. The Department of Energy, which is supposed to play a major role at the center, is not represented. The CIA, which has four slots at the center, has filled one.

► Friction and turf battles between the new cybersecurity agencies may be hampering operations. The National Coordinator for infrastructure protection and counterterrorism is Richard Clarke, a White House official, who must get clearance on a case-by-case basis before the NIPC will brief him about investigations.

Vatis says Justice Department guidelines bar the FBI from briefing anyone outside the department about ongoing cases unless the attorney general grants a waiver.

► The Internet communi-

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ty is demanding broader distribution of more timely threat information, beyond the security professionals with whom the NIPC typically deals. "If you are only spreading the word to specialists, then you are not getting threat information out across the board to small universities or e-tailers," says Harris Miller of the Information Technology Association of America, a leading trade association representing 11,000 corporations.

► Though some companies are warming to the idea of sharing information with the government, many complain that they remain uneasy about government efforts to police the Internet.

"Where (the federal government) is completely failing is to be a place people trust" with delicate information, says Alan Pallar of the SANS Institute, an education facility for computer system administrators that claims 100,000 members. "Ninety-eight percent of the time they won't share with the FBI because they fear having their (computers) confiscated, that their troubles will become public knowledge and that the agents will scare (clients) to death."

► The president's plan has created so many entities gathering data on Internet vulnerabilities that it is causing confusion. "Imagine living in a community where there are seven different numbers to call for 911 services," says Mark Rasch, chief counsel to Global Integrity, a leading cybersecurity firm that hosts the financial industry's information sharing center. "You need to have one number, one place, that everyone trusts."

Adds Tom Noonan, CEO of Internet Security Systems, probably the fastest-growing firm in its field and a major booster of the NIPC: "Quite frankly, I'm confused by all these different government groups."

Word spreads slowly

In the days after the University of Minnesota attack, Haskell says her 911 instinct was to notify academic colleagues or other trusted computer professionals.

One of those she contacted was David Dittrich, director of software engineering at the University of Washington in Seattle. He became the first person to track down and unlock the codes that make the attacks operate.

It was a matter of days before he realized the new attack technique required immediate action. But the wheels of government turn slowly.

Dittrich first alerted CERT, the Computer Emergency Response Team at Carnegie-Mellon University, the nation's premier clearinghouse for data on computer vulnerability. By early September, it began organizing an unprecedented international conference to examine the emerging threat.

Based on CERT's letters of invitation to the conference, a handful of high-end security firms learned of the attack technique, and in October and November the firms quietly briefed clients about the impending threat.

Though the NIPC is a sponsor of CERT and has a liaison for the emergency response team on its staff, it received its first substantial report from CERT in late October. The response team has declined to comment on the apparent delay.

The three-day CERT conference in early November adjourned with this determination: "There is essentially nothing a site can do with currently available technology to prevent becoming a victim" of a denial-of-service attack.

The only prevention, the conferees said, was for system operators to update their security precautions to prevent vandals from exploiting known system weaknesses to gain control of

their computers as attack "zombies."

On Dec. 8, the NIPC sent a note briefing FBI Director Louis Freeh for the first time. On Dec. 17, Vatis personally briefed Attorney General Janet Reno as part of an overview of preparations being made for Y2K.

By that point, several DoS attacks already had occurred, but "people weren't getting the message," Dittrich says. "CERT and NIPC were really worried. They had obviously been hearing about a lot more intrusions. They went back and recategorized a whole bunch of incident reports going back to April-May time frame, and they started telling me that this is a really big thing."

But not until the NIPC, working with Dittrich and Mitre Corp., developed a tool for identifying zombies in a system did the protection center decide to warn the public Dec. 30 and post the tool for anyone to download.

By that time, Vatis says, "someone was setting the groundwork for an attack, and that is when we decided to make a public announcement."

Electronic 'night of the living dead'

The NIPC was convinced that New Year's Eve "could be a day for people to start sending marching orders to these zombies. We were afraid that Dec. 31 might become the night of the living dead," he says.

"Thanks for giving us plenty of time to prepare," says a sarcastic Vinton Cerf, an MCI WorldCom executive who is widely regarded as a founder of the Internet. "The timing of this all was singularly unfortunate."

But the protection center gets high praise from many security firms for being the first to provide an effective tool to locate and remove the zombie infections. Vatis says far more damage would have occurred in February otherwise.

"You know, I'm sensing a little bit of doublespeak here," Vatis says. "Business is saying, 'We don't want the government telling us what to do; we can fix this ourselves.' And I agree. But then I hear people saying, 'Gosh, government didn't warn us loud enough.'"

"People have been saying for a long time that it's going to take an electronic Pearl Harbor for people to take security seriously," he says. "There's a kernel of truth there because we live in an event-driven society."

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Patently Absurd

Once the province of a nuts-and-bolts world,
patents are now being applied
to thoughts and ideas in cyberspace. It's a ridiculous
phenomenon, and it could kill e-commerce.

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Speaking

By James Gleick

WHEN 21ST-CENTURY HISTORIANS look back at the breakdown of the United States patent system, they will see a turning point in the case of Jeff Bezos and Amazon.com and their special invention: "The patented One Click® feature," Bezos calls it.

Not everyone who knows Bezos as the newly minted billionaire founder of the world's leading Internet retailer knows that he's also an inventor, but he is. It says so on U.S. Patent No. 5,960,411, "Method and system for placing a purchase order via a communications network." Every good invention needs a story, and Jeff Bezos has one for one-click ordering. He's laying it out in federal court, where, at the height of the holiday shopping season, he won an injunction forcing his chief competitor, Barnesandnoble.com, to add deliberate complication to its ordering process.

In ways that could not have been predicted even a few years ago, the patent system is in crisis. A series of unplanned mutations have transformed patents into a positive threat to the digital economy. The patent office has grown entangled in philosophical confusion of its own making; it has become a ferocious generator of litigation; and many technologists believe that it has begun to choke the very innovation it was meant to nourish.

The one-click story starts like this: A young man founds a company called Amazon.com in the obligatory garage, with a bit of money raised from his family. Soon his tiny crew begins selling books online. Customers use a "shopping cart," and when they click on it with the mouse after they've finished making their choices they get a list of items they've selected for purchase. From there, they can enter instructions for payment, shipping, gift wrapping and so on.

But Bezos knows (he's not the first to use the shopping cart method) that many carts are abandoned in their virtual aisles by customers who decide they just don't have time for all this. So Bezos decides ("sometime prior to May of 1997," he says with the help of his lawyers) to offer a shortcut: letting customers choose an item with just one muscle twitch, one click of the mouse button, and use a shipping address and credit card number on file from a previous purchase. He orders his software developers to "make it happen." And

so they do. Amazon applies to the government for a trademark on the name "One Click" and a patent on the... well, on what, exactly? Not the idea, because pure abstractions may not be patented. Not the program code, because copyright law protects this.

Last September Amazon received its patent, and instantly sued Barnes & Noble over its similar Express Lane. In December Amazon won an injunction forcing its competitor to insert a superfluous mouse click. ("Please be sure to click this button," Barnes & Noble begs plaintively. "If you don't, we won't get your order!")

The one-click injunction capped a burst of skirmishing in 1999 — the start of what promises to become furious, wide-ranging courtroom warfare — over who will control electronic commerce. As the year 2000 begins, few of America's e-commerce leaders are not targets of patent litigation. The battles will determine whether the essential tools and building blocks will continue to spread rapidly through the community of software designers and Internet pioneers, or whether they will be cordoned off as the private property of particular companies. Amazon just got a new patent for a system of letting Web sites refer customers in exchange for commissions — its "affiliate" program. Sure enough, Barnes & Noble has a nearly identical affiliate program. So do thousands of other online merchants, now feverishly calling their lawyers yet again. Can Amazon really own this? For better or worse, the struggle will redefine our understanding of what an invention is in our complex, technocratic age.

PATENTS HAVE LONG SERVED AS A FUNDAMENTAL COG IN THE American machine, cherished in our national soul. We are the land of Thomas Edison and the Wright Brothers and Alexander Graham Bell, where Congress is empowered by the Constitution "to Promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries." Hence the patent office, charged with the enforcement of a Faustian bargain: inventors give up their secrets, publishing them for all to see and absorb, and in exchange they get 20-year government-sanctioned monopolies on their technologies.

This arrangement fueled industrial progress in the early United

Illustration by Dugald Stermer

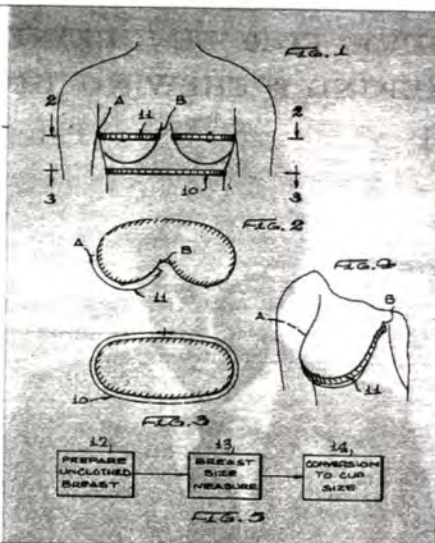
States, but during the short span of the Internet revolution the system has begun to disintegrate — by growing out of control. The United States is issuing patents at a torrential pace, establishing new records each year, and it is expanding the universe of things that can be patented. Patents began in a world of machines and chemical processes — a substantial, tangible, nuts-and-bolts world — but now they have spread across a crucial boundary, into the realm of thought and abstraction. Software and algorithms used to be unpatentable. Recent court decisions and patent-office rule-making have made software the fastest growing patent category, and companies are rushing to patent the most basic methods of doing business. "This is a disaster," says Lawrence Lessig, a Harvard law professor and cyberspace expert. "This is a major change that occurred without anybody thinking through the consequences. In my view, it is the single greatest threat to innovation in cyberspace, and I'm extremely skeptical that anybody's going to get it in time."

The litigation is spreading fast. Multi-Tech Systems is suing the three leading PC makers, Compaq, Dell and Gateway, over patents on transmitting voice and data. A St. Louis patent broker is suing Yahoo over a "method of effecting commerce in a networked computer environment in a computerized system" — that is, shopping online. Another start-up, Priceline.com, has patented its Internet version of an ancient auction technique, the name-your-price "reverse" auction, and is suing Microsoft's Expedia.com travel service. Microsoft, meanwhile, has infuriated much of the Internet community by patenting a well-known "style sheet" technology just as it was being adopted as standard by the World Wide Web Consortium.

Sightsound.com is suing at least one music retailer and demanding royalties from others over a patent on selling audio and video recordings online. A California software company is suing eBay over database technology. Two professors at the Massachusetts Institute of Technology are suing the Ask Jeeves search site over two patents on handling questions in natural language. A Boeing software engineer has patented a basic method of correcting the century in dates stored in databases and sent a threatening form letter to 700 of the nation's largest corporations (including The New York Times), demanding one-fourth of a percent of their total revenues, on the assumption that they probably have used the same method.

This is just the beginning. Patents marking off broad swaths of electronic commerce will soon be pouring from the patent office, unwelcome surprises to whole categories of new entrepre-

James Gleick (www.around.com) is the author, most recently, of "Faster: The Acceleration of Just About Everything."



U.S. PATENT NO. 5,965,809

No padding: "Method of bra size determination" (by direct measurement). Issued: 1999. Inventor: Edward Pechter.

neers. In the last few months, companies have gotten patents for keeping calendars on the World Wide Web, for downloading Web pages at regular intervals, for storing documents in databases, for "real-time shopping," for auctioning cars, for creating profiles of users; for search engines, for payment systems and for variations of every other fundamental gear and lever in the theoretical machinery of online business.

For that matter, the most trivial slices of offline life are winning patent protection: for example, a technique for measuring a breast with a tape, to determine bra size; and one for executing a tennis stroke while wearing a kneepad (U.S. 5,993,366: "The tennis racket is swung toward a tennis ball so as to hit the tennis ball with the racket. . .") Many of these patents are harmless. Most are narrower, when read carefully, than they sound at first. Others are multimillion-dollar lawsuits in embryo.

Each of these patents is a tiny masterpiece of logic and disputation. Each represents, by definition, a restraint on trade, a layer of regulation, expensive overhead in the free-market economy. The exclusive rights conveyed by a patent translate into higher prices for consumers. The Supreme Court saw the downside more than 100 years ago. "It creates a class of speculative schemers who make it their business to watch the advancing wave of improvement, and gather its foam in the form of patented monopolies, which enable them to lay a heavy tax upon the industry of the country," the court wrote. "It embarrasses the honest pursuit of business."

Patent lawyers and officials argue that each represents a good idea and that good ideas deserve to be rewarded; but does every good

idea deserve a 20-year government-sponsored monopoly?

"We like to say right to exploit," the commissioner of Patents and Trademarks, Q. Todd Dickinson, says cheerfully.

PATENTS LEGENDARILY PROTECT THE LONE inventor, the pioneering genius in a garage, against the predation of big companies. In reality the opposite has usually been true. As basic industries like electricity, telephony and broadcasting developed in the 20th century, the great corporations learned to create arsenals of interrelated patents to use as sword and shield. "The wise people, with good patent lawyers, patent a whole system," says Thomas P. Hughes, a historian of technology. Although small companies can get patents, the big companies can afford to litigate — "when it comes into court, guess who's going to win?" Absurd patents can be fought and overthrown, but to challenge a patent costs, on average, more than \$1 million.

"Even under traditional patent rules, many of these software patents will turn out to be bad patents," says Lessig at Harvard, "but in the meantime they create these little mafia monopoly holders who can go around demanding, with a federal court behind them, that you pay up or we'll shut you down."

Patent battles have become a strong catalyst for mergers, reducing competition in various domains. The largest corporations, with gigantic patent portfolios, routinely enter into cross-licensing agreements with their largest competitors. Companies without portfolios of their own have to pay cash, representing a hidden tax within the high-tech economy, and the costs are skyrocketing: revenues in the United States for patent licenses were about \$15 billion in 1990; eight years later they had soared to more than \$100 billion. I.B.M. alone took in well over \$1 billion from licensing last year and received a record 2,756 new patents.

Those lone inventors are out there nonetheless, dreaming of the patent that will make them rich, and they are a familiar species of fraud victim. An entire industry of invention promoters promises to help inventors get patents, usually charging thousands of dollars in fees that are virtually never recouped.

AT FIRST, THE AWARDING OF A PATENT was special — a profound and unusual act. Under the original patent law of 1790, the examiners who met to consider each invention were none other than the secretary of State, the secretary of War and the attorney general: Thomas Jefferson, Henry Knox and Edmund Jennings Randolph awarded the first, on July 31 of that year, for a process of making potash, for fertilizer. They issued two more that year. Gradually the patent system grew and became associated with the American

'In my view, it is the single greatest threat to innovation in cyberspace, and I'm extremely skeptical that anybody's going to get it in time.'

inventive spirit. Patents created an unparalleled storehouse of how-to data about technology and a pipeline for sharing that information.

They also became a source of prestige and distinction; after all, to be an inventor was to be a patent holder, and vice versa. "The patent system added the fuel of interest to the fire of genius," said Abraham Lincoln, himself the proud holder of U.S. Patent 6,469 ("Device for Buoying Vessels Over Shoals"). Even so, it took 46 years of growing bureaucracy and accelerating output to produce a total of 10,000 American patents. Now the patent office issues that many patents every three weeks.

A single examiner can approve a patent, without review from supervisors or the commissioner. "If an examiner allows a case," one examiner says, "not even the president of the United States can force him to change his mind. Then there's the Supreme Court, and they're kind of busy." Each examiner is a specialist, meant to be familiar with the landscape and the "prior art" background for particular types of technology.

But for the ethereal new realms of software and business methods, especially, the system has broken down. Through most of the young history of software engineering, the state of the art has been carried around in the heads of programmers working late nights in offices strewn with soda cans and pizza boxes, not in academic journals suitable for indexing and perusal by patent examiners. Examiners give most weight to their own database, anyway, treating the six million existing U.S. patents as a sort of filing cabinet of all human knowledge.

"The U.S. Patent Office is just not competent to examine software patents," says Gregory Aharonian, a consultant and publisher of a widely read patent newsletter. "Eighty percent of software patents effectively cite nothing from the computing literature. To me it's a kind of contempt." He contends that the patent office has neither the time nor the expertise needed to distinguish good patents from bad. "It's a cold war," he says. "It's just people playing legal games."

The patent office has become a place where the essential politics — the checks from contending interests — are out of balance. The voices heard daily at the patent office belong to people who like patents, want patents and rely on patents for their living; their creed is, *the more the better*. Officials measure their own performance in terms of their output. It's as if they were a manufacturing company turning out product.

Meanwhile, the dollars-and-cents reality of running the American patent office has also encouraged the patent explosion. In 1991, the patent office was cut off from general tax revenues and required to subsist entirely on fees for its operating budget. The political argument was that customers should pay for government services. Thus, officials think of their fee-paying patent applicants as their customers: *the more the better*, again. Examiners know that their year-end bonuses depend on productivity. Each morning, as Commissioner Dickinson arrives at his Crystal City office, he walks past a framed poster bearing the motto "Our Patent Mission: To Help Our Customers Get Patents."

It's virtually forgotten that government's customers also include the rest of the nation, the citizenry at large, whose fortunes depend on the agency's judgments and policies.

WITH THE ADVENT OF COMPUTING, HUMAN invention crossed a threshold into a world different from everything that came before. The computer is the universal machine almost by definition, machine-of-all-trades, capable of accomplishing or simulating just about any task that can be logically defined. Even more so with cyberspace — everybody's computers, connected — the universal machine to the *n*th degree. Take any real-world procedure or activity; transfer it to cyberspace; and now we have an activity that seems both new and technological.

But patents played no role in the early history of personal-computer software. Microsoft, founded in 1975, received its first patent in 1986 — for a sort of hinged box. Another two years passed before it got its first computer-related patent. I.B.M. and some other companies were patenting software, but they had to engage in a careful sophistry to do it: making sure to say that a program was an *apparatus* or a *system* and that it was "embodied on a computer-readable medium." Applicants and examiners employed a mutually understood pretense that machinery was still involved.

The biggest battles over intellectual property in the software business focused on copyright. Apple sued Microsoft in 1988 for copying the "desktop metaphor" and other main elements of Windows, and Lotus sued Borland in 1990 for copying menus and discover-command sequences in its spreadsheet software. Both defendants had clearly copied *something*, but it was not the actual code; it was something vague, in

the nature of "look and feel," and ultimately the courts ruled in favor of the defendants.

For books, copyright law protects actual text, not ideas or plot; the law had to figure out what that meant for this new form of expression, software. Some software authors in the 1980's tried to extend their copyright protection beyond the literal code, to elements at higher levels of abstraction: a common phrase was "structure, sequence and organization." Ultimately the courts held that copyright law did not cover these broad elements. The computer industry itself was divided; so was the Supreme Court, which split 4-4 in refusing to overturn the *Lotus v. Borland* ruling.

Patent officials like to suggest now that those cases might have ended differently if Apple and Lotus had patented their innovations. The decisions "tilted the system away from copyright," Dickinson says. "People shifted and started to use the patent system."

As the software industry began flooding the office with applications, the system came around to a view of software programs as machines. They *are* machines, in a way. "Anything that can be done in hardware can be done in software," says one examiner. "We're not using gears; we're using some other mechanism, some other means." But they are machines without substance — incorporeal machines, machines made of imagination and "logic" and "bits." The patent office used to require an exact model of every invention it considered. Edison's original light bulb is sitting in Commissioner Dickinson's office. The models accumulated until the government ran out of storage space and abandoned the requirement. No one will be building models of these new phantasms of bits.

One more crucial court decision came in July 1998: the *State Street Bank* appeal. *State Street* had been sued for infringing a 1993 patent for an intricate computerized strategy of managing a multitiered portfolio of mutual funds. A federal court in Massachusetts found that the real subject of the patent was not a "machine" but a business method in data-processing garb, and declared the patent invalid. Did Einstein invent his formula, $E=mc^2$, or was it there all along, waiting to be discovered? He couldn't have patented it, the Supreme Court has stated: such laws are "manifestations of nature, free to all men and reserved exclusively to none." Judge Patti B. Saris cited that principle in the lower-court *State Bank* decision, noting some other key precedents: "Mental processes, and abstract intellec-

The one-click injunction capped a burst of skirmishing in 1999 — the start of what promises to become furious, wide-ranging courtroom warfare — over who will control electronic commerce.

tual concepts, are not patentable, as they are the basic tools of scientific and technological work."

Saris decided that the so-called invention was no more than a way of calculating: "The same functions could be performed, albeit less efficiently, by an accountant armed with pencil, paper, calculator and a filing system." The patent gives its owner a monopoly, she pointed out: "patenting an accounting system necessary to carry on a certain type of business is tantamount to a patent on the business itself."

But the Court of Appeals reversed that ruling in 1998 and reinstated the patent, finding that software — even if it merely manipulates numbers, juggling them and transforming them into other numbers — produces something tangible. A powerful conclusion, in a digital age, and it opened the floodgates.

There is a sense of infinite regress to the argument, a feeling of abstraction upon abstraction, words like "algorithm" and "formula" and "process" and "method" defined and redefined circuitously, if not circularly. Judges and lawyers have devoted millions of words to the nuances. Maybe the trajectories of culture, economics and technology have reached a point where a distinction between idea and machine can no longer be sustained; where no bulwark of logic, but only the mist of undecidability, separates $E=mc^2$ from the light bulb.

BY THE TIME OF THE STATE STREET DECISION, Amazon's application had been working its way through the patent office for nearly a year. Barnes & Noble, late to the Internet business and lagging far behind Amazon, had redesigned its site yet again. Its new Express Lane looked to Bezos like a clone of his one-click system. Indeed, anyone examining the faces these sites present to the world might conclude that Barnes & Noble has copied a lot more than just one-click ordering. Both sites let customers post reviews of books; both display an average of the customer ratings in the form of one to five stars. They both list books that "customers who bought this book also bought." In October 1998 Amazon filed a "petition to make special," asserting that an "infringing product" was already on the market. Barnes & Noble didn't know that at the time; pending patent applications are kept secret.

In Crystal City, the examiner, Demetra Smith, was studying a small selection of prior art — a few earlier patents and articles from the computer trade press — trying to make sure she understood the difference between Amazon's invention and earlier shopping-cart systems. The key to the one-click system is actually quite simple. If a customer has shopped at Amazon before, credit-card and other information is stored in the company's computers, and meanwhile the customer's Web browser has stored a special file called a "cookie." That's how the browser knows, when the customer returns to Amazon's site, to display a personalized message: "Hello, Todd Dickinson! (If you're not Todd Dickinson, click here.)" Cookies were already widespread in e-commerce, and the examiner had among her papers a 1996 description of how Netscape's software implemented them.

As far as the examiner could see in the papers before her, no one had talked about using cookies to let customers skip past the whole shopping-cart checkout process, so in a sense Amazon's idea was, in fact, new. Still, she could see the basic elements in a patent that Lucent Technologies filed just a few months before Amazon, describing "user identifiers" sent back and forth on a network. She noticed a comment that the identifiers help a company "to recognize a returning user and, possibly, provide personalized service." Just what Amazon does! The next step seemed obvious — in the patent office's technical sense of the word. "It would have been obvious to one having ordinary skill in the art at the time the invention was made," she ruled tentatively, "to include various command mechanisms for a single user action in order to execute the user's request."

Obviousness is the key problem. Every patent examiner's work is about making fine distinctions: between two new applications on the same theme; between an old patent and a new refinement. Is that "ergonomic topographic toothbrush" novel enough to merit a new patent of its own? These are delicate enough questions when the subject is real stuff. Patent examiners can sink their teeth into concrete details like a "detachable and replaceable bristle head." With software, where the nuts and bolts are vaporous and intangible, questions of what's *obvious* and what's *novel* begin to float in the wind.

In any event, the burden of proof is on the examiner to show that an application must be rejected. Her subjective judgment is not allowed — only actual references in published literature. "People send in some really strange stuff for patents, and I have no choice but to issue it," says one examiner. "I can't say, 'Gee, that's obvious to me.'" Evidence of obviousness "has to be out there and public and in the same detail."

Amazon's lawyers argued and negotiated, agreeing to drop some claims in their application and amend others, and they followed the examiner's directions for reworking their drawings (margins incorrect, numbers too small, lines too irregular), and in the end, like most patent applications, this one was approved. After all, examiners are motivated to issue patents, not to hinder them. U.S. 5,960,411 grants Amazon exclusive rights to its method of placing an order "in response to only a single action." Also, "wherein the single action is clicking a button." And "the single action is speaking of a sound." And wherein a user "does not need to explicitly identify themselves." And "the single action is selection using a television remote control" or "a pointing device" or "depressing a key on a key pad." Amazon has itself pretty well covered.

Then again, hundreds of new e-commerce patents will be issued in the coming month, just about all to Amazon's largest and toughest potential competitors. Until they are issued, neither Amazon nor anyone else will know whether it is infringing them — perhaps with an innocent and obvious bit of homegrown programming.

Amazon claims that it spent thousands of programmer-hours on its one-click method, but the patent system doesn't care about that. In determining what may and may not be patented, the law does not distinguish between inventions that require expensive research and inventions that amount to a momentary flash of insight. A new drug that costs 10 years and millions of dollars of research gets the same protection as a bit of programming that comes to a lone hacker in a dream. In purely economic terms, this is inequitable and perhaps even dangerous.

"We're not talking about Thomas Edison inventing the light bulb," says Lessig. "We're not talking about Monsanto spending tons of money on some chemical whatever. We're talk-

ing about people taking ways of doing business and, because they put it into software, they say, 'This is now mine.'

AMAZON WON'T SAY HOW MANY PATENTS it has pending. The one-click patent isn't its first, as it happens; Jeff Bezos got one in February 1998 for "a method and system for securely indicating to a customer one or more credit card numbers that a merchant has on file for the customer when communicating with the customer over a non-secure network." The method is this: show the customer only the last few digits of each credit card number. Many companies use this very method, of course.

All around, hopeful entrepreneurs are treasuring new patents like geese ready to lay golden eggs. Stephen D. Messer, for example, is building an Internet business called LinkShare around a patent he got in November on managing referral fees for traffic between affiliated Web sites. His sister, Heidi Messer, a lawyer who is now LinkShare's president, encouraged him to apply for the patent on his idea. "When he told it to me, I thought it was profound," she says.

He's a believer in patents now. "Without the patent system, I never would have done what I did," he says. "Without the patent system you create a world where pirates have the advantage and pioneers are penalized."

As for one-click ordering, a final verdict could be years away, and in the meantime, online merchants will have to be careful. Mothernature.com already has one-click remedy packs. Safe Harbor has one-click ordering of digital video products. Are they patent infringers?

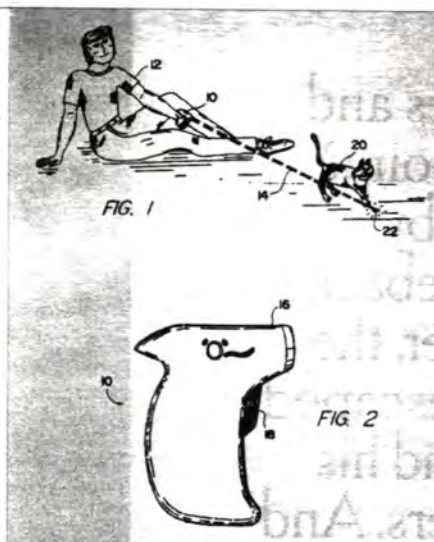
"I think the beauty of the patent law is, it encourages innovation, because it says, look, we challenge you to come up with a better way," says Heidi Messer.

"Somebody out there," says Stephen, "I guarantee you, probably sitting in a garage right now, has an idea that does zero-click."

Heidi laughs. "Telekinetic!"

Telekinesis would be worth patenting. Meanwhile, much of the value of the patent system lies in the disclosure of technologies that might otherwise be hoarded as trade secrets. But when Barnes & Noble decided to implement one-click ordering, its programmers did not need to see Amazon's patent. The software techniques are transparent. Any Internet company with a decent programmer at hand could imitate Amazon's system without breaking a sweat and without copying its actual code.

This isn't rocket science, in other words. I say as much to Commissioner Dickinson. He is unruffled; evidently he has heard it before. "We don't patent only rocket science," he says. "We patent football-helmet mailboxes." And indeed they do. Sportsbox Inc., a couple of guys in Richmond, Ky., owns the patent for mailboxes



U.S. PATENT NO. 5,443,036

No yarn: "Method of exercising a cat" (using a laser). Issued: 1995. Inventors: Kevin T. Amis, Martin H. Abbott.

built in the shape of football helmets; before you make one, you'd better get their permission.

Dickinson, who practiced as a corporate intellectual property lawyer for 25 years before taking over the patent office, says the law prohibits him from discussing any particular patent. (The patent office forbids its examiners to speak to the press at all, and the examiners who did talk about their work for this article insisted that their names be withheld.) Still, he can't resist revealing some pride in the progress of the Amazon case so far. "It's interesting because it's one of the first Internet patents to come to at least one conclusory stage of the litigation process," he says. "A federal judge found that the patent was sufficiently valid to issue a preliminary injunction, which is a rather extraordinary thing, right in the face of the Christmas holiday season. I thought that was kind of amazing, to be honest, and tends to suggest that the patent has validity."

In making her preliminary finding that Barnes & Noble infringed the Amazon patent, Judge Marsha J. Peckman in Seattle did not have to examine the underlying software code. Just how Barnes & Noble implemented one-click ordering doesn't matter. Any single-action ordering system violates Amazon's exclusive rights, she found. She also expressed a public-interest argument: "Innovation will be discouraged if competitors are permitted a free ride on each other's patented inventions," she declared.

The commissioner agrees. "The patent system has done its job for two centuries of protecting and nurturing and rewarding innovation. The system has worked."

But the digital revolution worked without patents. The great bursts of technological innova-

tion of the past two decades, the rise of personal-computer software and the spread of the Internet, took place in a freewheeling and competitive climate, with ideas bouncing at light speed from one place to another. A little head start in this world goes a long way; in the digital economy, "first movers" gain a tremendous and possibly long-lasting advantage, without extra government fortification. The greatest successes, like Microsoft and America Online, had nothing to do with patent protection. Amazon did not need patents to grow from Jeff Bezos' garage to its current pre-eminence.

Only Congress can now return the patent system to its time-honored role as a catalyst for innovation, rather than a concentrator of economic power. "For limited times," the Constitution says — and the generations of technology pass much more quickly now than they did in 1790. We want to reward inventors with a head start, not a lifetime entitlement. "Perhaps on the Internet, patents should last one 'Internet lifetime,' which is about two years," says Greg E. Blonder, a longtime researcher and vice president at Bell Labs and now "entrepreneur in residence" at AT&T Ventures.

This is a crowded and densely packed world; when a software engineer at I.B.M. comes up with a new idea, it's usually safe to bet that hundreds of software engineers in cubbyholes around the world are thinking along the same lines. Blonder himself has more than 60 patents to his name: toys, consumer electronics, software and business methods. He often gathers technologists for daylong brainstorming sessions; typically, these groups produce hundreds of useful "ideas," of which perhaps one in 10 turns out to be truly novel. "Problem is," Blonder says, "had I gathered together a different group of a dozen people, they'd come up with practically the same list. Arguably, any idea generated so easily and frequently is both obvious and a dubious candidate for a 20-year government-sanctioned monopoly."

Patents should be the exception, not the rule, he says. "As to my own business-process patents, well, as long as everyone in town is carrying a gun, I have to be armed as well. But I'd be glad to see the system change."

One thing is certain: the modern Internet entrepreneur is not a species in need of extra government incentives. If one-click ordering had not been patentable, surely Jeff Bezos would have invented it anyway in May 1997, put it to work in September 1998 and seen it copied in subsequent years by Barnes & Noble and thousands of other Internet merchants, all learning from his success, to the benefit of consumers. Surely he would have become a very rich man; and his future success would depend on his ability to continue outperforming his competitors, and to continue innovating. ■

THE PRESIDENT HAS SEEN

3-13-00

THE WHITE HOUSE

WASHINGTON

Copied
Streett
Davis
Emrich
Podesta

March 10, 2000

I think someone
of the security staff
can be found out
what happened?

MEMORANDUM TO THE PRESIDENT

FROM: STEPHANIE STREETT
HEATHER DAVIS
TIMOTHY EMRICH

CC: STEVE RICCHETTI

SUBJECT: CLEVELAND/CHICAGO TRIP

OVERVIEW:

CLEVELAND

You will depart the White House via motorcade (All helicopter packages are in South Asia) at 10:15 am and arrive Cleveland/Hopkins International Airport at 12:00pm. You will participate in a DCCC Lunch at the Playhouse Square Center before proceeding to the City Public Library to participate in a Prescription Drugs event with Democratic leadership. You then depart Cleveland at 4:40pm (EST), arriving Chicago O'Hare International Airport at 4:45pm (CST).

CHICAGO

Upon arrival, you will attend a library meeting at the Chicago O'Hare Hilton. You will then participate in DNC fundraisers at Phil Stefani's restaurant and Mike Cherry's residence. You will depart Chicago at 10:35pm and arrive the White House at 1:45am.

DOWN TIME:

Due to the need to include as many Members of Congress on the speaking program at the Prescription Drugs Unity event and longer drive times to Andrews and in both cities, your schedule no longer allows for down time. Subsequent to our conversation with you, we also learned that Parma Perogies is no longer in business.

LIBRARY MEETING:

Since there are no helicopter packages available for this trip, we have relocated the library meeting to the Chicago O'Hare Hilton to minimize the impact on rush hour traffic in Chicago. This decision was made after consultations with both Mayor Daley and Terry McAuliffe.

Monday, March 13, 2000

**SCHEDULE OF THE PRESIDENT
FOR
MONDAY, MARCH 13, 2000**

Final Schedule

SCHEDULING DIRECTOR:

STEPHANIE STREETT

HOME: 202-332-5651

OFFICE: 202-456-2823

WHCA PAGER: 4824

PRESS DESK:

HELEN LANGAN

HOME: 202-363-8346

OFFICE: 202-456-7465

WHCA PAGER: 4617

**TRIP COORDINATOR:
(CLEVELAND, OHIO)**

HEATHER DAVIS

HOME: 202-887-5457

OFFICE: 202-456-2811

WHCA PAGER: 4736

**TRIP COORDINATOR:
(CHICAGO, ILLINOIS)**

TIMOTHY EMRICH

HOME: 202-265-2332

OFFICE: 202-456-5306

WHCA PAGER: 4161

**ADVANCE LEAD:
(CLEVELAND, OHIO)**

AVERYL BAILEY

CELL PHONE: 202-757-8511

STAFF OFFICE: 29-220

WHCA PAGER: 5700

**ADVANCE LEAD:
(CHICAGO, ILLINOIS)**

AL RUTHERFORD

CELL PHONE: 202-607-6207

STAFF OFFICE: 44-220

WHCA PAGER: 4556

WEATHER:

WASHINGTON, D.C.

Overcast with a light rain/snow mix. Winds east at 12 to 18 knots. Low 35°F. High 45°F.

CLEVELAND, OHIO

Cloudy with rain changing to snow. A chance for freezing rain. Winds southwest at 15 to 25 knots. Low 30°F. High 42°F.

CHICAGO, ILLINOIS

Partly cloudy, becoming mostly cloudy with isolated snow in the late evening. Winds north at 10 to 15 knots. Low 32°F. High 47°F.

March 10, 2000 (7:37 PM)

Monday, March 13, 2000

**SCHEDULE OF THE PRESIDENT
FOR
MONDAY, MARCH 13, 2000
*Final Schedule***

8:00 am- **HOLD**
10:00 am

10:00 am- **PHOTO OPPORTUNITY**
10:10 am DIPLOMATIC RECEPTION ROOM
Staff Contact: Nancy Hernreich

Note: There will be approximately 60 guests in attendance.

10:15 am **THE PRESIDENT** departs The White House via motorcade en route
Andrews Air Force Base
[flight time: 25 minutes]

10:40 am **THE PRESIDENT** arrives Andrews Air Force Base

10:55 am **THE PRESIDENT** departs Andrews Air Force Base via Air Force One en
route Cleveland/Hopkins International Airport, Cleveland, Ohio
[flight time: 1 hour, 5 minutes]

March 10, 2000 (7:37 PM)

Monday, March 13, 2000

12:00 pm

THE PRESIDENT arrives Cleveland/Hopkins International Airport

Greeters: House Minority Leader Jack Ford
Assistant House Minority Leader Barbara C. Pringle
State Senator Daniel Brady
Mayor Michael R. White
City Council President Michael D. Polensek
City Council Member Robert J. White, III
City Council Member Kenneth L. Johnson
City Council Member Bill W. Patmon
City Council Member Craig E. Willis
City Council Member Nelson Cintron, Jr.
City Council Member Merle R. Gordon
City Council Member Patricia J. Britt
City Council Member Michael A. Dolan
City Council Member Frank G. Jackson
City Council Member Jay Westbrook
City Council Member Martin J. Sweeney
City Council Member Edward W. Rybka
City Council Member Timothy J. Melena
County Commission President Jane Campbell
County Commissioner Tim McCormack
County Commissioner Jimmy Dimora
10 City Year volunteers

12:15 pm

THE PRESIDENT departs Cleveland/Hopkins International Airport via motorcade en route Playhouse Square Center
[drive time: 25 minutes]

12:40 pm

THE PRESIDENT arrives Playhouse Square Center

Greeters: Bob Bellamy
Representative Stephanie Tubbs Jones
Andrew Tubbs
Mervin Tubbs

12:45 pm-
1:05 pm

PHOTO RECEIVING LINE
VIP LOUNGE
Playhouse Square Center
Staff Contact: Minyon Moore
Event Coordinator: Heather Davis
CLOSED PRESS

Note: There will be approximately 45 guests in attendance.

March 10, 2000 (7:37 PM)

Monday, March 13, 2000

1:10 pm-
1:55 pm

DCCC LUNCH
PALACE THEATER LOBBY
Playhouse Square Center
Remarks: Josh Gottheimer
Staff Contact: Minyon Moore
Event Coordinator: Heather Davis
POOL PRESS

Note: There will be approximately 80 guests in attendance.

- **The President**, accompanied by Representative Richard Gephardt, Representative Patrick Kennedy, and Representative Stephanie Tubbs Jones, is announced into the room and proceeds to his seat.
- Representative Stephanie Tubbs Jones makes brief remarks and introduces Representative Patrick Kennedy.
- Representative Patrick Kennedy makes brief remarks and introduces Representative Richard Gephardt.
- Representative Richard Gephardt makes brief remarks and introduces **the President**.
- **The President** makes remarks, works a ropeline, and departs.

2:00 pm

THE PRESIDENT departs Playhouse Square Center via motorcade en route City Public Library
[drive time: 10 minutes]

2:10 pm

THE PRESIDENT arrives City Public Library

Greeters: Andrew Venable, Jr., Director, City Public Library
Former-Representative Louis Stokes

March 10, 2000 (7:37 PM)

Monday, March 13, 2000

2:15 pm-
3:30 pm

PRESCRIPTION DRUG EVENT
LOUIS STOKES WING
City Public Library
Remarks: Lowell Weiss
Staff Contact: Bruce Reed
Event Coordinator: Heather Davis
OPEN PRESS

Note: There will be approximately 200 guests in attendance.

- Off-stage announcement of Secretary Donna Shalala, Edna Shalala, Representative Sherrod Brown, Andrew Venable, Jr., Director, City Public Library, and Alice Katchianes.
- Off-stage announcement of **the President**, accompanied by Representative Richard Gephardt, Representative Dennis Kucinich, Representative Stephanie Tubbs Jones, and Wanda Golias.
- Andrew Venable, Jr., makes brief remarks and introduces Secretary Donna Shalala and Edna Shalala.
- Secretary Donna Shalala and Edna Shalala make brief remarks and introduce Representative Richard Gephardt.
- Representative Richard Gephardt makes brief remarks and introduces Wanda Golias.
- Wanda Golias makes brief remarks and introduces **the President**.
- **The President** makes remarks.
- Representative Stephanie Tubbs Jones makes brief remarks and introduces Representative Dennis Kucinich.
- Representative Dennis Kucinich makes brief remarks.
- **The President** departs.

3:35 pm-
3:50 pm

MEET AND GREET
AUDIOVISUAL ROOM
City Public Library
Staff Contact: Bruce Reed
Event Coordinator: Heather Davis
CLOSED PRESS

Note: There will be approximately 20 guests in attendance.

March 10, 2000 (7:37 PM)

Monday, March 13, 2000

3:55	pm-	POLICE/DRIVER PHOTOGRAPHS
4:00	pm	HALLWAY Playhouse Square Center
4:05	pm	THE PRESIDENT departs City Public Library via motorcade en route Cleveland/Hopkins International Airport [drive time: 20 minutes]
4:25	pm	THE PRESIDENT arrives Cleveland/Hopkins International Airport Greeters: Steve Ricchetti's Family
4:40	pm (EST)	THE PRESIDENT departs Cleveland/Hopkins International Airport via Air Force One en route Chicago O'Hare International Airport, Chicago, Illinois [flight time: 1 hour, 5 minutes] [time change: -1 hour]
4:45	pm (CST)	THE PRESIDENT arrives Chicago O'Hare International Airport Greeters: Juan Andrade, President, U.S. Hispanic Leadership Institute Alfred Galvan, Illinois State Chair, American GI Forum Juan Rangel, United Neighborhood Organization Iris Martinez Marty Castro Adrian Garibay Genaro Trejo Theresa Munoz David Lomellin Carmen Lomellin Kevin O'Keefe Marc Schulman, President, The Eli's Cheesecake Company Maureen Schulman Kori Schulman Elana Schulman
Note: The President will also be greeted by 15 AmeriCorps members.		
5:00	pm	THE PRESIDENT departs Chicago O'Hare International Airport via motorcade en route O'Hare Hilton Hotel [drive time: 10 minutes]
5:10	pm	THE PRESIDENT arrives O'Hare Hilton Hotel

March 10, 2000 (7:37 PM)

Monday, March 13, 2000

5:15 pm-
6:30 pm
OFFICIAL MEETING
VIP SUITE
O'Hare Hilton Hotel
Staff Contact: Minyon Moore
CLOSED PRESS

Note: There will be approximately 10 guests in attendance.

6:35 pm-
6:40 pm
POLICE/DRIVER PHOTOGRAPHS
HALLWAY
O'Hare Hilton Hotel

Note: The President will also be greeted by White House Staff families at this time.

6:45 pm
THE PRESIDENT departs O'Hare Hilton Hotel via motorcade en route Stefani's Restaurant
[drive time: 20 minutes]

7:05 pm
THE PRESIDENT arrives Stefani's Restaurant

Greeters:
(kitchen)
Senator Richard Durbin
Representative Jan Schakowsky
Representative Rod Blagojevich
Mayor Edward Rendell, General Chairman, Democratic
National Committee
Joe Cari, Finance Chair, Democratic National
Committee

Greeters:
(outside dining room)
Phil Stefani
Karen Stefani
Anthony Stefani
Gina Stefani

7:10 pm-
7:30 pm
PHOTO RECEIVING LINE
FIRST FLOOR DINING ROOM
Stefani's Restaurant
Staff Contact: Minyon Moore
Event Coordinator: Timothy Emrich
CLOSED PRESS

Note: There will be approximately 55 guests in attendance.

March 10, 2000 (7:40 PM)

Monday, March 13, 2000

7:35 pm-
8:10 pm
WLF/SAXOPHONE CLUB RECEPTION
SECOND FLOOR DINING ROOM
Stefani's Restaurant
Remarks: Josh Gottheimer
Staff Contact: Minyon Moore
Event Coordinator: Timothy Emrich
POOL PRESS

Note: There will be approximately 325 guests in attendance.

- Off-stage announcement of **the President**, accompanied by Mayor Edward Rendell, Senator Richard Durbin, Representative Jan Schakowsky, and Representative Rod Blagojevich.
- Mayor Edward Rendell makes brief remarks and introduces Representative Jan Schakowsky.
- Representative Jan Schakowsky makes brief remarks and introduces **the President**.
- **The President** makes remarks, works a ropeline, and departs.

8:15 pm
THE PRESIDENT departs Stefani's Restaurant via motorcade en route Private Residence
[drive time: 15 minutes]

8:30 pm
THE PRESIDENT arrives Private Residence

Greeters: Mike Cherry, Event Host
Pat Cherry, Event Host
Shaynon Cherry
Jacob Cherry
Jessica Cherry

8:35 pm-
9:05 pm
PHOTO RECEIVING LINE
LIVING ROOM
Private Residence
Staff Contact: Minyon Moore
Event Coordinator: Timothy Emrich
CLOSED PRESS

Note: There will be approximately 90 guests in attendance.

March 10, 2000 (7:37 PM)

Monday, March 13, 2000

9:10 pm-
9:55 pm

DNC DINNER

TENT

Private Residence

Remarks: Josh Gottheimer

Staff Contact: Minyon Moore

Event Coordinator: Timothy Emrich

PRINT REPORTER ONLY (REMARKS ONLY)

Note: There will be approximately 90 guests in attendance.

- **The President**, accompanied by Mayor Edward Rendell and Mike Cherry, proceeds to stage.
- Mayor Edward Rendell makes brief welcoming remarks and introduces Mike Cherry.
- Mike Cherry makes brief remarks and introduces **the President**.
- **The President** makes remarks.
- Mike Cherry moderates question and answer session (3-4 questions).
CLOSED PRESS
- Upon conclusion of question and answer session, Mike Cherry makes jersey and gift presentation.
- **The President** departs.

10:00 pm

THE PRESIDENT departs Private Residence via motorcade en route Chicago O'Hare International Airport
[drive time: 20 minutes]

10:20 pm

THE PRESIDENT arrives Chicago O'Hare International Airport

10:35 pm
(CST)

THE PRESIDENT departs Chicago O'Hare International Airport via Air Force One en route Andrews Air Force Base
[flight time: 1 hour, 30 minutes]
[time change: +1 hour]

1:05 am
(EST)

THE PRESIDENT arrives Andrews Air Force Base

March 10, 2000 (7:37 PM)

Monday, March 13, 2000

1:20 am **THE PRESIDENT** departs Andrews Air Force Base via motorcade en route The White House
[drive time: 25 minutes]

1:45 am **THE PRESIDENT** arrives The White House

BC RON **THE WHITE HOUSE**
WASHINGTON, D.C.

HRC RON **PRIVATE RESIDENCE**
CHAPPAQUA, NEW YORK

March 10, 2000 (7:37 PM)



NYUMBANI Orphanage

c/o Rev. William L. George, S.J.
Georgetown University
302 Healy Hall
Washington, D.C. 20057
(202) 955-1360

Rev. Angelo D'Agostino, S.J., M.D.
Founder and Medical Director
P.O. Box 21399
Nairobi Kenya AFRICA
E-Mail: nyumbani@africaonline.co.ke

Board of Directors

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George L.J. Dalferes

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Nyumbani Orphanage is a project of The Children of God Relief Fund, Inc., a 501(c)(3) tax-exempt organization registered in the State of New York as a not-for-profit corporation. Employer Identification Number: 13.3615655. Contributions are tax deductible to the extent allowed by law.

March 7, 2000

William J. Clinton
The President of the United State
The White House
Washington, DC

Dear Mr. President,

Since our last meeting in the Oval Office, we have been blessed in being able to open a second NYUMBANI in Tanzania.

The carving accompanying this note has a story:

It was presented to me by the Regional Director (Dar es Salaam) of the ruling party (CCM) of Tanzania at the launching of the "Bill Clinton House" at the Nyumbani -Tanzania orphanage in Dar es Salaam (14 February 2000).

At the presentation of the wood carving, I was charged with the responsibility of giving it to the President of the United States as a sign of affection and esteem. It is meant to be a donkey in honor of his Democrat alliance and not just an ordinary donkey, but a "rampant", charging donkey. One quite capable of defeating any elephant! The presenter was very eloquent.

Wishing you much success in the years ahead as you undertake yet daunting challenges.

Sincerely,

Father Angelo D'Agostino, SJ, MD

PS: After I return to Africa on March 11th, I can be reached at PO Box 21399, Nairobi, Kenya.

3-13-00
Send to Eugene?
Yes ☒
No ☐

10

ca

Historic

Natchez



on the Mississippi

Larry L. 'Butch' Brown

Mayor

P.O. BOX 1185
NATCHEZ, MS 38901

Natchez

Phone: 601-445-7555

Fax: 601-442-2536

mayor@bkbk.com

Cities

00 MAR 13 AM 8:09

Officials

Carolyn -

3/13/00

TO DAN B

COORDINATE

W/ IGA

REPLY/CONGRATS

IF APPROPRIATE

1996 - First Place

Woodlawn Historic District - Restoration Project

1997 - Second Place

Developing & Promoting Black Tourism in Natchez

2000 - First Place

Main Street Marketplace - Farmer's Market

- AWARD GIVEN ANNUALLY - ONLY BLACK Elected officials ALLOWED to vote
- AWARD will be presented to Mayor BUTCH BROWN - SUNDAY MARCH 12 (9:30 AM)
- ALL AWARDS GIVEN HAVE HAD "PARTNERSHIPS" WITH LOCAL, STATE, FEDERAL, UNIVERSITY, AND "Public/Private" AGENCIES, etc.
- * PLEASE REFER ATTACHED SUMMARIES -

①

**1996 National Black Caucus of Local Elected Officials
City Cultural Diversity Awards Program
Application Form**
Page Two

Executive Summary

Use this page and the next page to highlight your city's program.

Across the nation cities are struggling with a common problem of how to enrich our urban environment by directing attention to blighted and neglected areas. Natchez is no different. Through the designation of the Woodlawn Historic District, Natchez is working toward the goal of restoring an older and blighted community through the physical preservation of its historic buildings and other infrastructure needs. The designation is only a part of a multi-phase revitalization plan to restore the quality of life for Woodlawn residents. Twenty-five homes in the Woodlawn district will receive federal, state and local funding, as well as private assistance for substantial renovations.

In Natchez we have found that designating historic districts is a well established tool for preserving buildings and areas of historical and architectural importance in the City of Natchez. The first National Register Historic District in Natchez was designated in 1979. Until 1995 there were only five historic districts. This year two have been added to the National Register, both of which identify historical and architectural resources in areas that are historically low-income and predominantly African American.

The most recent designated historic district, the Woodlawn Historic District, has remained an African American community since the late nineteenth century. The Woodlawn neighborhood is located in the old northern suburbs of Natchez and was developed from lands associated with pre-Civil War mansion estates. The houses, built by former slaves and their descendants, are small frame cottages with full-width porches fronting the street, shotgun houses of both brick and frame construction, and substantial frame dwellings in the Queen Anne, Colonial Revival, and California Bungalow styles. Many of the houses have cultural and historical significance. The cottage at 23 Garden Street (See Photo Exhibit), for example was built for Aaron Jackson, a former slave who enlisted in the Union Army after Natchez was occupied by federal troops in the summer of 1863. His descendants still own the house and have the original deed, a mortgage payment book for the Colored Building and Loan Association, and Jackson's pension papers from his service in the Union Army. In addition, 20 Woodlawn Avenue (See Photo Exhibit) was the boyhood home to Richard Wright, noted author of "Black Boy" and "Native Son." The National Register Historic District nomination encompasses over 520 structures, seventy-five percent of which are classified as "contributing" to the architectural importance of the neighborhood. The Woodlawn neighborhood has remained relatively intact and is highly worthy of historic district status on the National Register.

In 1994, the City of Natchez contracted with the Historic Natchez Foundation, a local historic preservation organization, to prepare the National Register nomination of the Woodlawn neighborhood. The designation itself has served to identify one of the most architecturally and historically significant African American neighborhoods in Mississippi, and in addition, will provide an opportunity for property owners to take advantage of historic rehabilitation tax credits. The residents of Woodlawn were involved in the designation process from the beginning. Their full support was vital for the City to continue to facilitate efforts for improvement. A total of four public meetings were held at a neighborhood church to discuss the nomination of the area to the National Register and its implications, and two more to discuss the selection process and accept applications for available funding. Attendance at these meetings was exceptional.

The designation has served as a catalyst to attract positive interest and investment to improve the quality of life for the residents of Woodlawn. One of the city's investment strategies for the neighborhood has been securing Department of Housing and Urban Development's HOME funds and CDBG funds for the rehabilitation of twenty-five owner-occupied homes. Over \$1.5 million will be used in the Woodlawn Historic District Revitalization Project: \$350,000 for the renovation of twenty-five historic homes, \$350,000 for infrastructure improvements, \$90,000 from the City of Natchez engineering, planning and other services, and \$780,000 from a private housing developer for more renovations at a later phase. The Southwest Mississippi Planning and Development District, a state-sponsored regional planning consultants, worked with the City to secure the funding.

1996 National Black Caucus of Local Elected Officials
City Cultural Diversity Awards Program
Application Form
Page Three

2

Executive Summary

Use this as the second page to highlight your city's program.

The first phase of the project will address three major areas in rehabilitating the twenty-five homes: 1) health and safety hazards; 2) exterior improvements; and 3) structural integrity. Each homeowner is required to contribute up to twenty percent of their total project cost, depending on the age of the individual homeowner. To assist homeowners with this match requirement, the City's Planning Department and the Southwest Mississippi Planning and Development District coordinated with four local banks and have devised a low-interest loan program to homeowners participating in this program. The Adams County Bar Association was instrumental in assisting homeowners in clearing titles to properties and establishing eligibility for the loan program.

Interest from the residents was overwhelming. Over 100 people applied for the available funding. The twenty-five participants were selected based demonstrated status that the homes are owner occupied. In addition their home must be classified as architecturally "contributing" to the neighborhood. "Contributing" means that the structure has, through the years, maintained the majority of its original architectural integrity which is a major factor in the survey process for National Register designation. The majority of participants in the program are senior citizens on a fixed income. All are African American and all are moderate to low income. Fourteen of the twenty-five households are very low income. The average number of years a homeowner has owned his or her home in Woodlawn is twenty-nine years.

The Woodlawn Historic District Rehabilitation Program is in its early stages. The first phase is scheduled for completion by late 1996. It is the largest home-rehabilitation project in the city's history. It has been singled out by Henry Cisneros, Secretary of the Department of Housing and Urban Development, as a model for communities around the country. The project is the first major collaborative effort of the City, the Federal Government, private and public organizations, and the residents themselves to restore a predominantly African American neighborhood in Natchez. It is the hope of many that this project will have a positive effect on the neighborhood and the residents. Increased tourism in the neighborhood will work to foster neighborhood pride and bolster private initiative in the revitalization effort. Other aspects of the comprehensive revitalization plan include the formation of a Woodlawn neighborhood organization and the publication of an historical informational brochure about the neighborhood.

Woodlawn is the quintessential example of how preservation can work for a community on the path of fast deterioration. In the past, low-income neighborhoods in Natchez have received little or no attention and, in many instances, historic houses that were allowed to deteriorate have been demolished. The focus the City is giving this African American neighborhood is long overdue. The project demonstrates commitment by the City and, more importantly, by the residents of their willingness to invest in themselves. The project is worthy of recognition for its excellence in commitment and sustenance, economic sense and social savvy, aesthetic artistry and innovation. These twenty-five homes demonstrate an incontrovertible fact that historic preservation can be an effective tool for rebuilding low-income communities and enriching the urban environment. The overall project will allow the City to assist the residents of the Woodlawn Historic District to increase and enhance the quality of life in the district which will have an indelible impact on the overall quality of life in the entire City.

1997 NATIONAL BLACK CAUCUS OF LOCAL ELECTED OFFICIALS
CITY CULTURAL DIVERSITY AWARDS PROGRAM
PAGE TWO

①

EXECUTIVE SUMMARY

USE THIS PAGE AND THE NEXT TO HIGHLIGHT YOUR CITY'S PROGRAM.

Describe in detail the program in any policy area developed by your city in the last three years. Your summary may range from that of a broad description of a comprehensive effort to a specific component of the program (maximum two pages).

As the oldest settlement on the Mississippi River, Natchez is a town famous for its pre-Civil War mansions built by rich cotton planters whose wealth derived from an agricultural economy dependent upon slave labor. For many years, Natchez promoted itself as the city "where the Old South still lives." This promotion included visual and written images of white-columned mansions and flowering magnolias. Shrouded by the illusion of a romantic Old South of white architecture and white flowers is the reality of black Mississippi.

Today, Natchez is recognized by historians as one of America's most significant historical southern cities. Natchez has a diverse cultural background that is well documented through various entities throughout the city. Although Natchez has a diverse cultural background, and an ideal racially balanced population, the interpretation of African-American culture has not been balanced. Natchez's cultural diversity was limited to the annual Pilgrimage interpretation of the antebellum south. In order to strengthen ethnic tourism in Natchez, the city has embarked upon an effort to promote Natchez, although a small community, as the number one destination for African-American History in the south. This effort can be heard in tour guide stories about the history of antebellum architecture and hanging moss. Tour guides have revised their stories to include history on African-Americans and their contributions to the existence of the antebellum south. For example, the white-columned mansion, Dunleith, symbolizes the strength of the African-American in the life of John Lynch, who fanned dinner guests in Dunleith's dining room as a young slave and emerged from the Civil War as one of the most influential African-American politician of nineteenth-century America. Why is it so important to attract black tourists to confront a troubled history? "Such a sidelight may conjure up the Confederacy a bit too vividly for some vacationers. Certainly, it tends to undermine the grandeur of the antebellum architecture and those massive, sheltering oaks. Why bring it up, then? Because one dare not deny the black experience-not when thousands of black travelers want to walk the roads, stand in the rooms and pray in the churches where the freedom struggle transpired." ("An American Mecca." *Newsweek*, 1991, Leerhsen and Smith)

Natchez has devised a list of important black historic sites. In addition, local citizens have established a museum where the African experience in Mississippi, especially in Natchez, could be interpreted. The support of the local officials for the museum has been admirable. One of the biggest obstacles facing the museum was a finding a home. The Mayor and City Council solved this problem by donating a building that was centrally located and adequate to house the museum's collections. Over the years the citizens of Natchez have given from their private collections, artifacts and family heirlooms, which has resulted in the need for additional space. The Mayor and City Council responded again by transferring a now vacant downtown Post Office Building to the museum. The new space is much larger and has a commanding presence on Main Street, in the heart of the Downtown Historic District.

The National Park Service is contributing to African American tourism by renovating the William Johnson House. William Johnson, who was a Natchez barber, earned his place in American history by keeping a diary, which today represents the most thorough account of the life of a free

1997 NATIONAL BLACK CAUCUS OF LOCAL ELECTED OFFICIALS
CITY CULTURAL DIVERSITY AWARDS PROGRAM

PAGE THREE

2

EXECUTIVE SUMMARY (CONTINUED)

USE THIS AS THE SECOND PAGE TO HIGHLIGHT YOUR CITY'S PROGRAM.

African-American in the pre-Civil War South. Johnson was a member of a free African-American aristocracy, who entered into business deals with white landowners, had marriages officially recorded, and owned between five and twenty slaves. However, they could not vote, sit on juries or testify in court against whites. Johnson served as his own contractor in construction of his 1841 two-and-one-half story brick townhouse. Today, the house has been donated and is being renovated by the National Park Service to be interpreted as part of the Natchez National Historical Park.

Currently, most of the money generated by minority tourism goes to white-owned businesses. The Natchez Convention & Visitor Bureau (NCVB) hired the first Ethnic Tourism Director to promote programs that help black businesses to take advantage of black tourist dollars. NCVB was the first Convention & Visitor Bureau in Mississippi to have this position. This position expands minority participation in tourism and helps bring more minority tourists into Natchez; expand the number of Black Historic sites to enhance ethnic tourism opportunities in Natchez; raise awareness of Natchez's Black History by offering programs to schools churches and community groups during Black History Month, and promote local publicity on ethnic tourism events, attractions, and activities, through newspapers, radio, and television.

In 1995, the city added to its list of black historic sites, the Woodlawn Historic District, an African-American community placed on the National Register of Historic Places. The designation itself has served to identify one of the most architecturally and historically significant African-American neighborhoods in Mississippi. The Woodlawn neighborhood is located in the old northern suburbs of Natchez which was developed from and associated with pre-Civil War mansion estates. The houses, built by former slaves and their descendants, are small vernacular frame cottages. Many houses have cultural and historical significance. The cottage at 23 Garden Street, for example, was built for Aaron Jackson, a former slave who enlisted in the Union Army after Natchez was occupied by federal troops in the summer of 1863. In addition, 20 East Woodlawn was the boyhood home to Richard Wright, noted author of "Black Boy" and "Native Son." The designation was also part of a multi-phase revitalization plan to restore the quality of life for Woodlawn residents. The area received federal, state and local funding, and private assistance for substantial renovations in the neighborhood.

The Woodlawn Historic District will play an important role in tourism. The project supports cultural diversity by recognizing and promoting a neighborhood for its African-American heritage. Recording the history of the neighborhood will be a valuable resource for future generations; while preserving the buildings will strengthen community pride and sense of identity.

As one can see, Natchez is serious about becoming the number one tourist destination for African-American History. As reporter Vernon Smith noted in Newsweek, "Natchez is among this nation's most important settings for immersing oneself in African-American history." Preserving those important settings is a priority of Natchez to celebrate and educate people of the role African-Americans played in the development of the South.

National Black Caucus of Local Elected Officials
2000 City Cultural Diversity Awards Program
(page two)

1

DESCRIPTIVE SENTENCES

This information, about your program, will be used in our press releases.

Please describe your program in no more than two sentences in the spaces provided below, keeping in mind the aspects of "who, what, where, when, how and why" about the program.

The Main Street Marketplace is a farmer's and craft market funded by a grant from the United States Department of Agriculture in downtown Natchez, Mississippi through a cooperative partnership between the City of Natchez and Alcorn State University. The Marketplace opened in October of 1999 to assist local farmers and crafts people in selling their products and to provide support services through the Cooperative Extension Program at Alcorn State University in an effort to improve the lives of local farmers and crafts people.

EXECUTIVE SUMMARY

Use this page and the next page to highlight your city's program.

Describe in detail the program in any municipal or public policy area developed by your city in the last eighteen months or more. Your summary should present a broad description of the program.

The Main Street Marketplace project began in 1997 with the City of Natchez and Alcorn State University partnering to develop a farmer's market in Natchez to serve a five county area in southwest Mississippi. Partnering together was a logical choice for the two organizations because of the location of the City of Natchez as an urban center for the southwest region of Mississippi and the strong agricultural program at Alcorn State University located 40 miles north of Natchez. Alcorn State University was founded in 1871 and has the distinction of being the first historically black land-grant institution and first state supported institution for the higher education of blacks in the United States.

In April of 1997 the City of Natchez and Alcorn State together submitted a Rural Business Enterprise Grant to the United State Department of Agriculture. The grant requested monies to develop a farmer's and craft market in downtown Natchez with both organizations providing matching funds. Alcorn State agreed to manage the market through its Cooperative Extension Program.

The site for the market in downtown Natchez is in the center of commercial activity and takes advantage of the tremendous tourism market in Natchez. The site chosen on Main Street included a circa 1940 grocery store in two buildings that had been joined by a common facade. The store had been abandoned for many years and was an eyesore to the community. The land and building are owned by St. Marys Basilica across the street so the City entered into a lease agreement with the church for the property. Plans called for the razing of one of the grocery store buildings and renovation of the other. Renovation began in April of 1999 with removal of the eastern building to make way for a landscaped grass plaza for the new market. After demolition of the one building was

National Black Caucus of Local Elected Officials
2000 City Cultural Diversity Awards Program
(page three)

2

EXECUTIVE SUMMARY *(continued)*

Use this as the second page to highlight your city's program (if you need additional space).

complete the renovation of the remaining building began. The renovation was completed in October of 1999. The farmer's market was named Main Street Marketplace and opened that same month with space for 40 vendors, bathrooms, a conference room, an office and area behind the conference room for development into a demonstration and storage area. Large openings were cut in the sides of the building and the front plate glass windows were removed to make the building an inviting open air market.

Alcorn's major role in the Marketplace is the management of the market and providing assistance programs for the vendors. The market is managed by a full time manager who is an employee of Alcorn State University. The Marketplace is open five days a week from seven in the morning to seven at night. Vendor spaces rent for as little as three dollars a day for long term rentals and all vendor profits remain with the vendor. The manager is responsible for renting vendor spaces, assisting vendors with displays, coordinating vendor activities, and monitoring the maintenance of the building. The assistance programs are provided through the Cooperative Extension Program at Alcorn State. The Extension Program works with local farmers in developing ways to improve: crop yields, insect control, farming techniques, and even marketing produce and goods. The manager of the Marketplace can also refer individual vendors to different Extension Agents as necessary to meet individual vendor needs. Alcorn students are also able to learn through the Extension Program agricultural production and marketing using the Marketplace as a living classroom. In addition to providing services to local vendors the Marketplace also participates in the WIC/Farmer's Market Nutrition program which gives vouchers to those who participate in the Women, Infant and Child program to buy fresh fruits and vegetables thus improving nutrition for low-income people.

The Marketplace also serves as a center for activity in downtown Natchez for festivals and events throughout the year. In November of 1999 the Natchez Children's Home held a Chili Cookoff on the grass plaza to raise money for the orphanage. During the Bluesfest in April of 2000 the Natchez Downtown Development Association is planning a Treasure Market in the parking lot of the Marketplace. The Marketplace is also organizing festivals around the seasonal produce such as the Watermelon Fest, the Strawberry Festival as well as a Pumpkin Celebration. All of these events help to bring the community together as well as enhancing the tourist activities in Natchez all while improving the sales of vendors in the Marketplace.

Alcorn State is completing the requirements to receive a \$50,000 grant for a Walk-in-Cooler, Reach-in Cooler, washing sinks, and a stove. The equipment would be used for demonstration events and to keep surplus produce fresh while waiting to be sold. Additionally special tables were constructed for the display of produce and goods to keep the Marketplace looking uniform and so farmers would not have to bring display tables. Vendors also have access to water hoses and garbage facilities.

The estimated cost of the Marketplace project was \$268,000. The USDA Rural Development Enterprise Grant furnished \$165,000 for the project, the City of Natchez provided \$76,300 and Alcorn State University put in \$26,700. Alcorn State pays the salary of the Marketplace manager.

The Main Street Marketplace is truly a creative endeavor combining two distinct organizations, the City of Natchez and Alcorn State University in a project to help local farmers and crafters prosper and to bring the community closer together through interaction at the Marketplace.

3-13-00
Foundation for

"HISTORIC NEW AMSTERDAM"

A historical park on Governors Island recalling the themes of the birth of 17th century colonial New York City
A place of educational significance to the nation and a showcase of NY's and NJ's earliest architectural and material culture

139 East 79th Street, 15th Floor, New York, N.Y. 10021, U.S.A.

Telephone (212) 737 3216 Facsimile (212) 988 6457

Education and History

Dr. Charles T. Gehring Director, New Nether- land Project, NYS Library Albany, New York	Dr. Oliver Rink, Author Chairman, History Dept. California State University Bakersfield, California	Dr. Patricia Bonomi Author, Chairman Emeritus, History Dept. New York University	D P Q N
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Fabend ning author Historian mtclair, NJ	Dr. Joyce D. Goodfriend Author Prof. History Department University of Denver, CO
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President William Jefferson Clinton
The White House
Washington D.C. 20500

February 16, 2000

Dear President Clinton,

As an ideal legacy to your presidency, this is to petition you, *directly*, to help with extending the commending theme of tolerance to the nation. The theme of tolerance belonged uniquely to the Middle Colonies' earliest history among other authoritative themes such as freedom of conscience, freedom of expression and religion, popular sovereignty and natural rights.

Specifically, I am requesting that you will positively consider, use your influence and help effectuate, proactively, the donating of the lower 1/3rd portion of Governors Island to a trust, set up for the specific purpose of creating a "Historic New Amsterdam" park **to serve as a permanent educational opportunity and most of all as a symbol of tolerance to all the workers of this great nation.**

My petition to you is in the spirit of a similar one, in 1649, when some ordinary settlers in New Amsterdam (now New York) availed themselves of their legal right to petition, *directly*, the highest level of their government for a redress of grievances (the States General of their fatherland). It was the first time in the entire Americas that this legal right was exercised. It resulted in major changes for the American province.

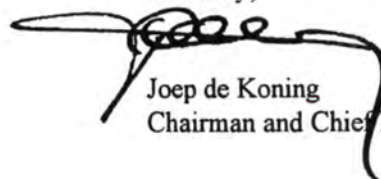
That particular legal right, available to all those colonists who resided in what are now referred to as the "Middle Colonies" (Delaware, Pennsylvania, New Jersey and New York, as well as part of Connecticut), was finally extended to the thirteen United States of America, 140 years later. It had found its way into the American Constitution via Amendment I of the 1789 Bill of Rights that incorporated various freedoms then insisted upon by the New York delegation under Governor George Clinton.

Of the many historic colonial messages of the Middle Colonies, **the symbol of tolerance** on Governors Island, next to **the symbol of liberty** on Liberty Island would be a timely reminder that in today's America there is no place for the forces of intolerance.

Please peruse the enclosed letters to Senator Moynihan, Governor Pataki and Mayor Giuliani as they describe the themes of and concept for the Historic New Amsterdam park. As you represent the interest of the nation, rather than regional or local interests, you may be able to endorse a historic message that is still meaningful and pertinent to the successful functioning of American society and more so in the future.

Doubtless, your efforts will be essential in helping realize a Historic New Amsterdam park on Governors Island for the benefit of the nation. **Like George Clinton, may you also want to insist** and leave a legacy.

Sincerely,


Joep de Koning
Chairman and Chief Executive

cc: Middle Colonies Senators and Members of Congress

IT HAS BEEN
3-13-00



STATE OF NEW YORK
OFFICE OF THE ATTORNEY GENERAL
THE CAPITOL
ALBANY, NY 12224

ELIOT SPITZER
Attorney General

Blue / *cc JD/Burke*

*Summit
This is disturbing
of how bad has been
good ideas for future*

(518) 474-7330

March 6, 2000

B

copied

*Podesta
Ricchetti
Reed*

BY TELEFAX

Mr. Bruce Reed
Director
Domestic Policy Council
The White House
1600 Pennsylvania Ave.
Washington, D.C. 20500

Dear Bruce:

As you know, at the end of last year and the beginning of this one, certain cities and states were negotiating with members of the gun industry to settle filed or anticipated lawsuits. The objective of the lawsuits -- and, of course, of the settlement negotiations -- was to save lives by having the gun companies adopt commercial measures to keep guns out of criminals' hands and incorporate safety devices to prevent gun accidents.

Through a series of press announcements, the administration invited itself into the negotiations, only to have the gun manufacturers refuse to meet with you. The administration had, they said, unduly politicized the process. But even as they were refusing to meet with you, the manufacturers were urging that we go forward with our long-scheduled January negotiating session, telling us that they saw a possible consensus beginning to emerge. This was a striking moment. After decades of intractability, the gun industry was telling city and state plaintiffs that a possibility of meaningful reform was at hand.

You did not ask us to listen to the industry's counter-proposals to see whether progress was truly possible. Instead, you insisted that if you were unwelcome, then the cities and states should not go. We did not.

Now I learn that, in secret, you have reopened talks with a subset of the industry and -- for reasons I cannot fathom -- excluded the cities and states whose process you halted. It was exceedingly unwise to exclude those with expertise who established the framework for the

settlement, and thus it is not surprising that, as one of your staff members told us on Friday, your current settlement efforts "are going nowhere".

Despite the foregoing, the White House potentially brings to the table resources and national regulatory power unavailable elsewhere. As things now stand, I can participate only from afar. The *only* goal should be saving lives by changing conduct within the gun industry. To that end, I set forth below: (1) how we got to the current stalemate; (2) where the emerging consensus was before your entrance; and (3) how the powers at the disposal of the federal government can recapture the momentum that has been lost.

1. How we got to the current stalemate

As you know, the federal government used the press to invite itself into the ongoing negotiations between the gun manufacturers and the cities and states. Speaking on behalf of New York State, I welcomed your participation.

In anticipation of the next negotiating session, my staff and I expended a great deal of time and effort educating members of the administration on the history and status of our proposals and negotiations -- negotiations that began in the summer of 1999 when New York reached out first to the industry and then to a widening circle of litigants. Due to your late entrance, we met (on an accelerated schedule) with the administration repeatedly both in New York and Washington. You asked us to provide you with our legal theories, settlement outlines, and negotiating drafts, all of which we did gladly.

Shortly before the January meeting, however, the gun industry refused to have the White House at the table. They feared, they said, that your presence would politicize what were already difficult talks. In response, you urged that no city or state attend the January session if you were unwelcome, and exhorted us all to stick together. We acceded, and canceled the negotiations, despite the industry's request that we continue without you. As a result, we never heard the industry's scheduled response to our proposals regarding downstream distribution.

Now it seems that solidarity is a one way street. In secret, with select manufacturers, the Departments of Treasury and Housing and Urban Development (HUD) restarted the very negotiations that you, personally, asked our group to eschew. Apparently considering our presence superfluous, you nonetheless find our work product essential; I am told that the administration is using our settlement framework and our negotiating drafts. I can only conclude that this is at your direction.

I was also disappointed by your behavior after I learned of the secret talks and informed the White House of my concerns. While my follow-up calls to you went unreturned, HUD staff quietly began to call others amongst the cities and states to inform them of "recent

developments." I hope you understand that we can differentiate between genuine teamwork and the ploy of someone caught with his hand in the cookie jar.

2. Where we were before the administration "joined" the negotiations

I believe that before you injected yourself, support on both sides of the table was beginning to coalesce around a few broad principles. Prior to your involvement, we had discussed with the industry a Code of Conduct that would govern design, safety, and distribution of handguns, and would establish an enforcement mechanism to ensure compliance:

Principle 1: Manufacturers will take responsibility for their downstream sales. For years, manufacturers have argued that once a gun leaves their factory, they have no control over it. It was none of their business, they argued, how their guns happened to end up in the hands of murderers, rapists, and drug dealers, or why a small number of gun dealers sold the disproportionate number of guns used in crime. Until our recent discussions, the manufacturers felt that it was not their job to cut off renegade dealers, but rather the federal government's job to revoke their licenses. In short, they laid the failure to shut down renegade dealers squarely at your feet.

Some companies are now recognizing that they have a responsibility to use their economic power to combat the criminal market. They appear prepared, for the first time, to use their contract rights to exercise control over their distributors and retailers. In short, by using the same kind of contractual pass-through rights that are used in many other commercial contexts, some are ready to cut off wholesalers who keep selling guns to those dealers who sell too many guns into the criminal market.

Perhaps the most important conceptual shift is the manufacturers' recognition of the principle that they could and should prevent sales to straw purchasers. While we had not yet agreed to specific terms, proposals under discussion ranged from outright restrictions of multiple sales to restrictions on the timing of delivery of purchases.

Principle 2: Manufacturers will not design or sell handguns that are unduly appealing to criminals. It is no secret that certain gun manufacturers have targeted criminals as a distinct market, going so far, for example, as to advertise guns that are "fingerprint resistant." There was broad consensus among the manufacturers that guns should not be designed specifically to appeal to criminals. There was no consensus, however, as to what makes a gun attractive to criminals. Barrel length? Color? Large magazine capacity? Price?

There is no need to guess, and no need to predict. Data can resolve the inquiry. By combining their own sales figures with Bureau of Alcohol, Tobacco and Firearms ("ATF") traces showing which models are used in crime, manufacturers can see exactly which guns are used disproportionately by criminals. Thus in our Code of Conduct, we were negotiating with

manufacturers to discontinue models that are or may become disproportionately used by criminals. Debate over barrel length, color, and price would evaporate, and the heart of the problem -- guns desirable to criminals -- is addressed.

Before you announced your interest, we designed the compliance system in the Code of Conduct to work by counting the number of trace *requests* that ATF makes of manufacturers; each time a manufacturer answered the request it was put on notice of which model was used in crime and to whom the manufacturer had sold it. With you now at the table, the manufacturer no longer has to do the math. Your cumulative data can directly answer the questions.

Principle 3: Manufacturers will design guns to be as safe as reasonably possible for purchasers and their families. Many manufacturers agreed with this principle so wholeheartedly that some were prepared to negotiate concrete deadlines for the introduction of specific safety features, such as selling every gun with an effective lock; requiring magazine disconnect safeties (which greatly reduce accidental firings) on all guns sold to the public; recalling guns that accidentally fired when dropped; and committing to specific dollar set-asides for research and development on gun safety, including smart gun technology.

A stumbling block for manufacturers was with guns procured by the government. Manufacturers argued that federal government specifications -- particularly the FBI's -- called for guns that *lacked* certain safety features, such as magazine disconnect safeties. Your ability to assist on this point is self-evident.

Principle 4: Compliance with the Code of Conduct must be verified. Once the Code of Conduct is in place, we must all have assurances that it is actually being followed. The cities and states were clear with the industry that we would not accept ATF as the sole monitor. Over the years, Congress has severely limited ATF's resources and powers. And, as a federal agency, ATF quite properly owes its fealty not to a private code of conduct but to its authorizing and appropriating statutes.

Our answer was a private monitor who would function as an independent, private-sector inspector general. A kind of super-auditor, the monitor would have full access to the books and records of the manufacturers and their distributors, investigative capability, and the power to force any non-compliant signatories to the agreement to adhere to its principles.

Among the many serious issues in the negotiations, the monitor question proved particularly difficult. Some in the industry insist that ATF be the monitor. Others realize that a clean bill of health from the plaintiffs' monitor would be a potent, almost irrefutable, statement of a manufacturer's good corporate citizenship. In short, the industry will never receive the full benefit of a Code of Conduct without the sign-off of someone universally viewed as more independent than ATF.

3. How you can restart the lost momentum

All of the provisions of the Code of Conduct were crafted in the absence of a federal presence at the negotiations. With a federal presence, the possibilities expand significantly. By bringing available tools to bear, you should be able to break through the deadlock that your staffer described to me.

Use federal contract money as an incentive

First, you have a potent enticement at your disposal: the federal purse strings. Manufacturers sell countless firearms to federal law enforcement and the military. Others seek grants for "smart gun" technology. Progress could be swift if you made gun manufacturers' adherence to a Code of Conduct a prerequisite for receiving grants or for doing business with the government.

Create transparency in the crime gun market: Make ATF trace data public

You have invaluable data at your disposal, namely the ATF trace records showing exactly how guns get from manufacturers to wholesalers to the retailers who are portals into the underground market. While current data obviously would need to be withheld to protect ongoing investigations, older data should be made available to the nation, so that the public, the press, scholars, lawmakers, and the industry can see for themselves just how and where crime guns have flowed over time.

Sunshine is the best known cure for social ills. Knowledge leads to solutions. Consequently, I propose that all ATF trace data (save identifying information about the police officers who recovered the gun and about individual final purchasers) be made public and placed on the internet.

There is clear legal authority for the release of the data. Specifically, 27 C.F.R. § 178.25 ("Disclosure of Information") provides: "Upon the request of any Federal, State or local law enforcement agency, the regional director (compliance) may provide such agency any information contained in the records required to be maintained by the Act or this part." The ATF trace data falls within this definition. The Department of Law of the State of New York, of which I am head, is a "state agency" under the regulation. I, therefore, request the trace data, which -- by regulation -- you "may" provide to me. The debate about crime guns will be advanced enormously by transparency, as academicians, the press, the public, legislators, and the judiciary use the information to craft the appropriate policy solution to a thus-far intractable problem.

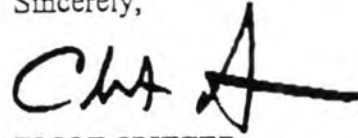
In conclusion, although disappointed and angry at the way that you have proceeded, I am hopeful that the resources of the federal government will be used in a productive fashion. I trust

6

that this letter is the first step in clearing the air, and that we will be able to move forward together in a true partnership.

I look forward to hearing from you.

Sincerely,

A handwritten signature in black ink, appearing to read "Eliot Spitzer", with a stylized flourish extending from the end.

ELIOT SPITZER

cc: Gun Litigation Negotiating Group

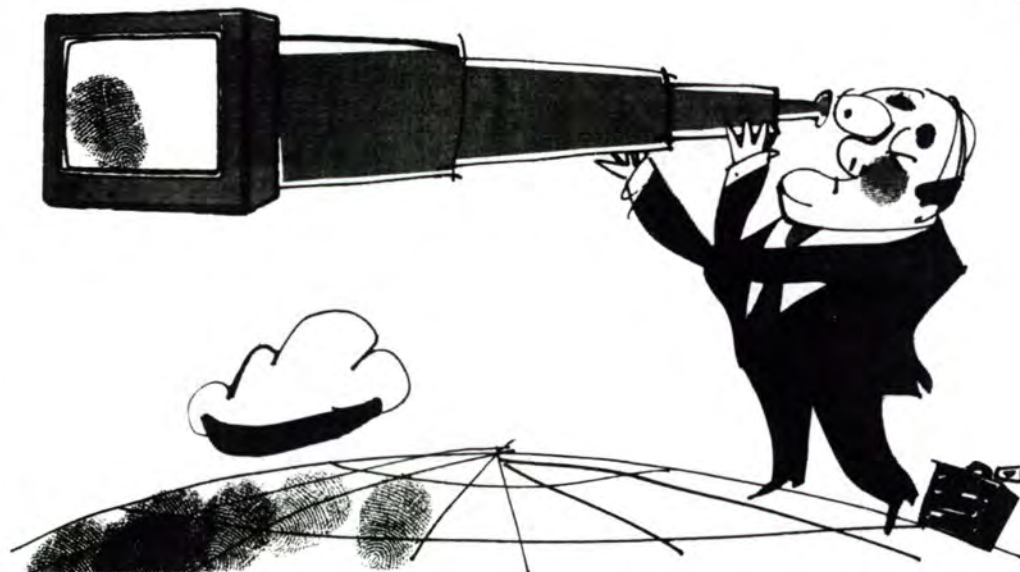
GLOBALISATION AND TAX

Guns

Agg - v. interesting

Bx

copied
Sperling
Podesta



The mystery of the vanishing taxpayer

IT WAS not a pretty sight. In 1839, the roads of Wales were crowded with men wearing women's clothes, in an obscure reference to a story from the Bible. By the time they were back in their usual attire, several turnpikes (tax collection points) had been demolished. During the following five years, these "Rebecca rioters", as they became known, donned their frocks and smashed turnpikes many times, doing what most taxpayers before and since could only dream about. But now some governments are starting to worry that globalisation, spurred by the Internet, will do to their tax systems what those transvestite Taffies did to the turnpikes.

Like the boy who cried "wolf", governments have raised the alarm about globalisation so often that their credibility is in doubt. For all the talk of footloose capital heading for low-tax countries, starting a "race to the bottom" in which governments slash taxes and services to lure global business, the taxman's cut of world income is larger today than it has ever been. Yet in the story the wolf eventually did attack the sheep, and the boy's shouts for help went unheeded. Is the same thing about to happen to the world's governments?

It does not help that globalisation can mean many things to many people, but a minimum definition would probably include a diminishing role for national borders and the gradual fusing of separate national markets into a single global marketplace. The term "globalisation" was probably first coined in the 1980s, but the idea has been around for a long time. Indeed, by some measures the world was more globalised a century ago than it is now: certainly people were far likelier to emigrate to find work. After an anti-trade backlash in the 1920s and 30s, globalisation has been accelerating during the past three decades. And thanks to innovations in

communications and transport that let people and capital travel at great speed, it is now moving into a different gear altogether.

As globalisation ebbed and flowed, the taxman's share of economic output went relentlessly up, despite warnings from politicians that globalisation would make it harder for governments to collect taxes and thus to provide public services. But now a new factor has entered the equation: the Internet. It epitomises borderlessness, and the irrelevance of being in a particular physical location. By being everywhere and nowhere at once, it seems certain to speed up globalisation. And in doing so, according to the Organisation for Economic Co-operation and Development, it might damage tax systems so badly that it could "lead to governments being unable to meet the legitimate demands of their citizens for public services".

Shopping around

The Internet age has dawned just as tax collectors are getting worried about another aspect of globalisation: tax competition. Both the European Union and the OECD have declared war on "harmful" low-tax policies used by some countries to attract international businesses and capital. The OECD says that tax competition is often a "beggar-thy-neighbour policy" which is already reducing government tax revenues, and will start to be reflected in the data during the next couple of years. The Internet has the potential to increase tax competition, not least by making it much easier for multinationals to shift their activities to low-tax regimes, such as Caribbean tax havens, that are physically a long way from their customers, but virtually are only a mouse-click away. Many more companies may be able to emulate Rupert Murdoch's News Corpo-

Globalisation, accelerated by the Internet, is exposing serious flaws in the world's tax systems. So will we all be paying less tax in future? Matthew Bishop investigates





ration, which has earned profits of £1.4 billion (\$2.3 billion) in Britain since 1987 but paid no corporation tax there.

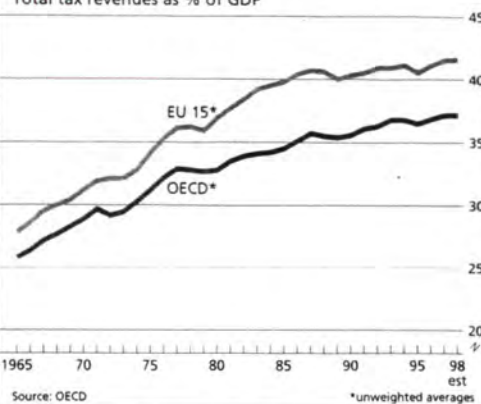
This survey will seek to discover whether all this poses a real threat to tax revenues. Inevitably, this will involve a good deal of speculation. The Internet is still young, and nobody can know how big it will grow. For the taxman, its increasing use raises two main challenges. The first is unique to the Internet. The World Wide Web is an entirely new channel for moving goods and services from producers to customers, and taxing virtual goods and retailers is much more difficult than taxing physical ones. Music can now be downloaded via the Internet, from a retailer located who knows where, without a need for discs or tapes. Other products may similarly dematerialise, making it hard for the taxman to pinpoint them. New Internet taxes, such as the proposed "bit tax", levied on the volume of electronic transmissions, make little sense, and would face huge political opposition from those who want to keep the taxman out of cyberspace—including some American presidential hopefuls.

Taxpayers, too, may dematerialise. In a famous *New Yorker* magazine cartoon showing two dogs sitting in front of a computer screen, one tells the other: "On the Internet, nobody knows that you are a dog." The ability to collect tax is contingent on knowing who is liable to pay it, but taxpayers may become increasingly hard to identify as anonymous electronic money and uncrackable encryption technology are developed.

As almost everybody knows, there are two ways of cutting your tax bill. Tax avoidance is doing what you can within the law. As a great American judge, Learned Hand, put it, "There is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich and poor; and all do right, for nobody owes any public duty to pay more than the law demands." Tax evasion is what hap-

Ever upwards?

Total tax revenues as % of GDP



pens outside the law. There may be a thin line between the two, but in one sense it is a solid one: as Denis Healey, a former British chancellor, once put it, "The difference between tax avoidance and tax evasion is the thickness of a prison wall." The Internet is likely to make it easier to break the law.

The second challenge the Internet raises for the taxman is its potential for intensifying tax competition between governments. Tax collection around the world is built on the belief that every nation-state has the right to decide for itself how much tax to collect from the people and businesses within its borders. Governments may be willing to pool their sovereignty by joining international bodies such as the UN, the IMF or the EU, but they cling to their right to set their own taxes. Even in what some see as the nascent EU superstate, member countries refuse to give up their control of direct taxation.

Competing visions

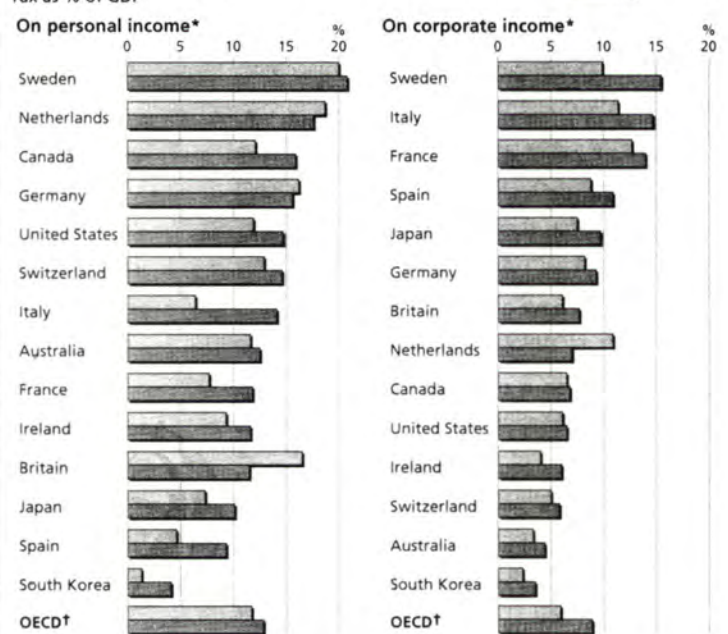
Many countries have bilateral tax treaties with other countries, mainly to avoid double taxation. But again the rules of such treaties assume that the nation-state is what counts: they merely determine which nation-state has priority where more than one country has a claim. Multinational companies complain that nationally based taxation inhibits them from operating as truly global businesses. But for governments, it makes sense to design tax systems that attract footloose wealth.

Tax competition raises three big questions which this survey will try to answer. First, is there really such a thing? Some pundits doubt that tax-cutting governments are indeed motivated by hopes of poaching economic activity from other countries. Yet, as we shall see, there is enough evidence to suggest that tax competition should be taken seriously, and that without intervention it will only get fiercer.

Second, can it be stopped? It will not be easy. Not many people will defend tax havens. But although they make fine whipping boys, tax havens simply do in a more extreme form what many "respectable" governments themselves increasingly indulge in. Ireland opposes harmonising corporate tax rates in the EU because its low rates give it a competitive edge. Britain blocks an EU savings-tax directive because it might hurt the City of London. Luxembourg and Switzerland will not agree to share information with foreign tax authorities because people who want to cut their tax bills come to them looking

Where not to live

Tax as % of GDP



for discretion. And America may well ask for a worldwide ban on new Internet taxes because as a net exporter of e-commerce it would be the biggest beneficiary.

Some policymakers think that a World Tax Organisation should take its place alongside institutions such as the UN, NATO, IMF, World Bank and World Trade Organisation (WTO). But tax nationalism is likely to ensure that this will not happen. The OECD lacks sufficient clout, especially over non-members. The EU has a better chance of curbing tax competition among its own members, both through its directives and through the European Court of Justice, which is steadily, if slowly, enforcing tax harmony in the name of the single European market. But any success the EU achieves internally may simply make it more vulnerable to tax competition from non-EU countries.

Third, is tax competition really so bad? The OECD thinks it could undermine democracy by stopping countries from pursuing the tax policies their voters want. Footloose capital is free-riding on less mobile taxpayers, getting the benefit of services provided by governments in higher-taxing countries while paying taxes in low-tax jurisdictions, if at all. The EU objects mainly to special tax treatment offered to some taxpayers but not others, on the ground that it interferes with the single market. Some EU governments also argue that tax competition makes it ever harder to tax mobile factors of production such as capital. Instead, they complain, they have to increase taxes on less mobile factors, notably labour, which may drive jobs away.

Charles Tiebout, an American economist, argued back in the 1950s that competition between governments can be as good for everybody con-



A brief history of tax

"NO TAXATION without representation." The slogan of the American revolution has long been a rallying cry for taxpayers and tax evaders alike—though not always with such dramatic consequences. Arguably, the struggle to tax people in ways they find acceptable has been the main force shaping the modern nation-state. But are tax policies designed when the nation-state was all-powerful still appropriate now that globalisation, spurred on by the Internet, is rapidly eroding national borders?

Prostitution may be the oldest profession, but tax collection was surely not far behind. The Bible records that Jesus offered his views on a tax matter, and converted a prominent taxman. In its early days taxation did not always involve handing over money. The ancient Chinese paid with pressed tea, and Jivaro tribesmen in the Amazon region stumped up shrunken heads. As the price of their citizenship, ancient Greeks and Romans could be called on to serve as soldiers, and had to supply their own weapons—a practice that was still going strong in feudal Europe. As Ferdinand Grapperhaus recounts in "Tax Tales" (International Bureau of Fiscal Documentation, Amsterdam, 1998), the origins of modern taxation can be traced to wealthy subjects paying money to their king in lieu of military service.

The other early source of tax revenue was trade, with tolls and customs duties being collected from travelling merchants. The big advantage of these taxes was that they fell mostly on visitors rather than residents. One of the earliest taxes imposed by England's Parliament, in the 13th century, was "tonnage and poundage" on wine, wool and

leather, targeted at Italian merchants. Sometimes rulers went a little over the top. Excessive taxation was one reason why King Charles I of England lost his head. Many of those guillotined during the French Revolution of 1789 were much-resented private tax collectors. And the Boston Tea Party was a protest by American patriots against the tea tax imposed by their British rulers.

Income tax, the biggest source of government funds today, is a relatively recent invention, probably because the notion of annual income is itself a modern concept. Governments preferred to tax things that were easy to measure and therefore to calculate liability on. That is why early taxes concentrated on tangible items such as land and property, physical goods, commodities and ships, or the number of windows or fireplaces in a building. The first income tax was levied in 1797 by the Dutch Batavian Republic. Britain followed suit in 1799, and Prussia in 1808. Like most new taxes, these imposts were first introduced as temporary measures to finance war efforts. After the European powers had made peace in Vienna in 1815, Henry Addington, the British prime minister of the day, swore that an income tax would never be imposed again. But in 1842 the British government revived the tax.

What stands out about the 20th century—and particularly its second half—is that governments around the world have been taking a growing share of their countries' national income in tax, mainly to pay for ever more expensive defence efforts and for a modern welfare state. Taxes on consumption, such as the sales tax that is a big source of revenue for America's state and local

governments, and the value-added tax on goods and services in Europe, have become increasingly important.

Big differences between countries remain in the overall level of tax. America's tax revenues amount to around one-third of its GDP, whereas Sweden's are closer to half. There are also big differences in the preferred methods of collecting it, the rates at which it is levied and the definition of the "tax base" to which those rates are applied, as well as the division of responsibility for taxation between levels of government.

Global economy, national taxes

The increasing globalisation of economies in the 20th century was accompanied by a rare outbreak of internationalism by the tax authorities. Many countries chose to tax their citizens—individual or corporate—on their global income, whether or not they had already paid their due on some of it abroad.

The League of Nations, the forerunner to the United Nations, in 1921 commissioned a report by financial experts who concluded that this practice of "double taxation" interfered with "economic intercourse and...the free flow of capital". It suggested rules for determining when tax should be paid to the country in which the income is generated, and when to the taxpayer's country of residence. It drafted a model treaty (now updated by the OECD) that spawned many bilateral agreements. Initially intended to stop income being taxed twice, these bilateral treaties opened the way for multinational companies to avoid tax on their profits altogether by setting up in business where taxes were lowest. Combined with greater mobility of capital, this new flexibility encouraged tax competition between countries.



cerned as competition in any other marketplace. Like companies, governments can compete by offering different combinations of public services and taxes; if people want bigger government and are happy to pay for it, they are free to choose it, just as some people choose a snazzier car, or fly business class. Tax competition will put pressure on governments to provide their services efficiently, but that need not mean they have to be minimal. There

are limitations to this theory, notably Tiebout's assumption that every taxpayer is mobile, and can vote with his feet. In reality, richer taxpayers tend to be more mobile than poorer ones. If tax competition becomes stronger, using the tax system to redistribute money from rich, mobile taxpayers to poor, less mobile ones may become worryingly hard. The Internet will make more people mobile, rendering the rest even more wretched.

Net losses

Why the taxman fears the Internet

LIKE a newborn baby, the Internet is still young enough for people to predict all manner of things for it without anybody being able to prove them wrong. Some people say that e-commerce will never really take off. Others insist that it is the most important development since the invention of the printing press. Whoever is right, taxmen the world over would be wise to prepare for the worst.

Whereas most people worry that the Internet will reduce personal privacy, some tax experts reckon that it will allow unwilling taxpayers to hide more easily. According to Jeffrey Owens, head of fiscal affairs at the OECD, the Internet may make it hard to pinpoint the identity or location of people who are carrying out potentially taxable activities. A domain name used on the web may give no clue to the location of its originator. Even websites of well-known international businesses may not reveal the location of the offices that maintain them. The tax authorities still rely on paper-based records, yet the Internet will encourage the keeping of electronic records—which may well be stored in some foreign jurisdiction, safe from the taxman's dawn raids.

When gathering information, tax collectors also rely heavily on independent third parties such as re-

tailers, who have little to gain by helping others to evade taxes and can therefore be a valuable source of impartial data. However, e-commerce may well cut out many of these middlemen. Over the Internet, customers can buy direct from producers. One area of e-commerce that is expected to grow rapidly is online business-to-business auctions which allow, say, widget producers and widget users to make direct deals. These sites could make traditional brokers and dealers redundant, removing a useful information source for the taxman. The sites may also establish themselves in a country whose rules make data hard for tax authorities to get hold of. On the other hand, the Internet may make it easier for different countries' tax authorities to communicate with each other, privacy rules and national interests permitting.

The Internet may also make it possible for secret transactions to take place through the use of anonymous e-money and highly secure encryption. Tax authorities, as well as the police, fear that this kind of technology will foster a culture of evasion and lead to an increase in money-laundering—moving money obtained by criminal activity into legitimate bank accounts.

How justified such fears are is difficult to judge. E-money has yet to catch on with e-commerce consumers, who seem to have come to terms with using their credit cards online. Thanks to government pressure, most of the different versions of e-money now being developed deny their users the anonymity needed to evade the taxman, and certainly the anonymity provided by old-fashioned cash.

Oakington, a firm developing a digital-cash system called eBits, is trying to persuade the American government to throw its weight behind its not-wholly-anonymous product so that fully anonymous alternatives never get established. However, the American government's attempts to stop encryption technology being exported to places that might put it to nefarious uses have merely caused much of the development of the technology to be carried out in other countries.

Even if they can pinpoint their elusive taxpayers, the tax authorities may find it harder than ever to collect the money. Some of the third-party information gatherers that are now being cut out by technology have also played an important role as tax collectors. Retailers, for example, often collect taxes on the sale of goods, and companies collect income tax on behalf of their workers. In an effort to replace those middlemen, some tax authorities are now casting an eye in the direction of shipping compa-



nies such as FedEx, as well as credit-card companies, but are getting an unenthusiastic response.

Governments worry that the wired world may make it easier for many more people to take advantage of tax havens, hitherto the preserve of a wealthy few. Mr Owens of the OECD sums up the argument: "Internet banking will offer simple access, low transaction costs, a degree of anonymity and instant ability to move money around the world, to an extent not widely available now. If this is combined with well-run, well-regulated offshore institutions, a much wider clientele is likely to be attracted to these services than are using them today."

Everywhere and nowhere

But it is the potential of the Internet to revolutionise the nature of work that may create the biggest challenge to the tax authorities. Today's tax system relies on knowing where a particular economic activity is located. But the Internet may enable individual workers to operate in many different countries while sitting at the same desk.

Multinational companies may increasingly operate as seamless global organisations, with teams of workers based all over the world, passing projects backwards and forwards via the Internet or the companies' private in-house intranets. This will make it more difficult for the tax authorities to demand that economic activity and value creation be attributed to a particular physical location. In the past, a company was deemed to have a taxable presence in a country if it had a "permanent establishment" there. But at the moment it is not clear whether the existence of a server or a website qualifies as

such a presence. Tax authorities have shown considerable enthusiasm for a proposal by Luc Hinnekens, a lawyer at the University of Antwerp, for servers to be designated as "virtual permanent establishments". The old trick of finding out where a company's board meets to establish its place of residence may no longer work, because such meetings are increasingly conducted via satellite or the Internet.

Tax choices may play a much bigger role in deciding whether the Internet is a success than for previous technologies. "The costs of illuminating manuscripts were so much greater than those of printing them that the taxation of printed matter would probably have had little impact on the choice of technology," says Charles McLure, an economist at the Hoover Institution. E-commerce, by contrast, is one of several different ways of delivering essentially the same product. These delivery channels are quite close substitutes for each other, so if one of them has a tax advantage, that may well give it the edge, he says.

Moreover, Mr McLure points out, "The taxation of electronic commerce faces technological constraints." The Internet is so new that the direction of technological change is fiendishly hard to predict. By contrast, tax rules are precise and inflexible, and take a long time to change. As one frustrated taxman puts it, "They can move millions of dollars at the click of a mouse, and five years later, when we've changed the rules, they've come up with another scheme." Mr Owens concludes: "Tax authorities cannot remain passive in the face of such developments." But what should they do? The first place to look for an answer is online shopping.



The happy e-shopper

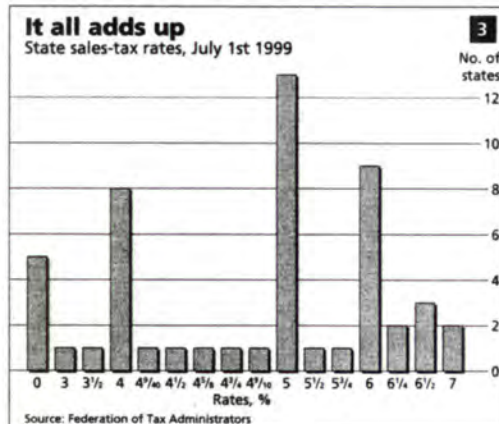
"ROAD-KILL on the information superhighway." According to one sage, that is the likely fate of America's sales tax. It is possible. Buy a novel from your local Manhattan bookstore, and you will pay a combined state and city sales tax of 8.25%. Purchase the same book over the Internet from Amazon.com, and there will be no tax to pay. This advantage is doing wonders for e-retailers in their battle against traditional high-street stores. If e-commerce grows as big as some predict, this could blow a large hole in tax revenues. In America, sales tax is levied at the state and local rather than the national level, and many state governors are getting nervous about the potential loss of yield from a tax that currently supplies around half of state and local-government revenues. Most other countries have different arrangements, but face many of the same issues.

Some American states decided on pre-emptive strikes, such as slamming taxes on Internet access, which upset the don't-tax-the-net lobby. Now the two sides have been brought together in the Advisory Commission on Electronic Commerce, set up by Congress under the 1998 Internet Tax Freedom Act. The very name of the act gives a strong hint of what the tax collectors are up against: the idea that the Internet is the true land of the free, in a way that offline America no longer is. The act also included a three-year ban on "new Internet taxes" while a perma-

nent arrangement is debated. The inclusion of the word "new", however, may be a piece of political weaselry: it leaves open the possibility that the "old" sales tax might simply be extended to currently untaxed e-commerce.

Besides, purchases from an online retailer are not, in fact, tax-free, whatever Americans may have come to believe. Rather, the online retailer may simply have no legal duty to collect it, thanks to two Supreme Court rulings on tax disputes involving mail-order companies shipping goods to other states. In

How feasible is it to tax Internet spending?





1967, the Court said that states could not require an out-of-state company to collect a sales tax on goods coming into the state unless the company had a physical presence or "nexus" within that state. This decision was reaffirmed by the Court in 1992, in a case involving Quill, a big catalogue seller. Many lawyers had thought that improved technology would undermine the argument used in the 1967 case that it was too burdensome for the out-of-state seller to discover what tax the customer should pay.

Legally, most consumers buying goods from outside their state are supposed to pay a "use tax" equal to what the sales tax would have been, but hardly anybody does. America's so-called "tax-free e-commerce" really amounts to mass tax evasion. Online-only retailers such as Amazon, unencumbered with a high-street nexus, have neglected to remind consumers that they may have a legal duty to pay a use tax. Many online retailers have added to their advantage by basing what physical presence they do have (eg, warehouses and offices) in the five American states—Alaska, Delaware, Montana, New Hampshire and Oregon—that do not levy a sales tax.

This strategy is not entirely risk-free. Except in states that have explicitly ruled it out, such as California and New York, it is conceivable that the tax authorities will challenge online-only retailers on the ground that using a server or being contacted at a website located within their borders constitutes "nexus", obliging them to collect taxes. But under the Internet Tax Freedom Act they will have to wait until next year to do so.

All the same, the "tax break", however doubtful, and however unfair to the (mainly less-well-off) people who do not have access to the Internet, has given the online-only retailers a big boost. According to a study by Austan Goolsbee, an economist at the University of Chicago, 1998 Internet sales would have been 25-30% lower if state taxes had been charged on them, if only because (often high) delivery fees have to be added on top. The overseas sales of American-based online retailers probably benefited as well, because they are trading from what is currently an e-commerce tax haven.

Offline retailers who want to sell online are facing serious dilemmas. If they collect tax, they concede a price advantage to their online-only rivals. If they break the law, they risk being taken to court and having to pay back taxes. One short-term way out is to pay the tax on behalf of the consumer, but this is feasible only as long as e-commerce makes up just a small part of the firm's sales.

Another option is to restructure the business so that for tax purposes the online retail operation becomes a separate legal entity from the offline one. This is what Barnes & Noble, a chain of bookshops, has attempted with its bn.com site. There are some legal precedents; for example, Saks Fifth Avenue Folio is a legal non-tax-collecting direct-mail operation run separately from its high-street sibling.



But many of America's biggest traditional retailers consider this strategy too risky. According to Walter Hellerstein, a lawyer at the University of Georgia, courts in up to 20 states may not be prepared to accept the legal separateness of what is essentially the same brand online and offline. Having dithered for ages, high-street retailers are beginning to throw their considerable lobbying weight behind taxing online sales (and, for that matter, mail order) to create a level playing field with traditional shops.

The Advisory Commission considered several dozen proposals at its meeting in December. At one extreme, Congressman John Kasich advocated no taxation of anything sold online. Some lawyers reckon that this would prompt every high-street store in America to convert itself into an Internet retailer by turning its checkouts into Internet terminals over which customers could "order" and pay for the goods they have just taken off the shelf. Hal Varian, of the University of California at Berkeley, one of the few economists who know a lot about both e-commerce and tax, proposes scrapping the sales tax and raising state income taxes, or levying a new consumption tax based on an individual's annual income minus savings.

Mr McLure, of the Hoover Institution, favours a European-style value-added tax, to be levied on household consumption of all goods and services, whether sold online or offline, in or out of a state. He would reduce the burden on firms of collecting these taxes by adopting a common nationwide definition of the base to which they are applied, and by greatly reducing the number of different tax rates. For the states, Michael Leavitt, the governor of Utah, proposed a voluntary scheme that would both simplify the system and pass responsibility for tax collection to a "trusted third party", such as a credit-card firm.

Some software firms say they have products that allow retailers to charge the right rate of tax even under the current system, so there is no need to simplify the system. However, this kind of software depends on knowledge of the consumer's location, which may be different from the billing address. Credit-card companies often have that information, but supplying it would probably breach confidentiality rules. Besides, consumers may be using e-money rather than a credit card. At least nobody revived the old idea of a "bit tax" based on the amount of digital information transmitted electronically—although if taxing the Internet proves harder than expected, it may well be dusted down.

Even if agreement on the best tax can be reached, it will still have to be implemented. One way would be for all of America's state and local governments to reach agreement on a solution, but that is highly unlikely because some of them benefit from leaving things as they are. Another would be for Congress to pass a law overriding the Supreme Court's Quill verdict, but Congress has no appetite

for a federal-versus-state-government turf war, particularly if it might end up being blamed for "taxing the Internet to death".

Many policymakers feel they have time on their side. At present most state governments are running a budget surplus. E-commerce, worth an estimated \$20 billion in 1999, or less than 1% of American retail sales, is not yet hurting tax revenues much: as a recent report by Ernst & Young, an accountancy firm, put it, "The Sky Is Not Falling". Yet e-commerce is proceeding in Internet time; blink, and it has doubled. If consumers get used to buying online without paying tax, politicians may face strong opposition to changing that happy state of affairs. "We may have only two more Christmas shopping seasons before it is too late," says Mr Leavitt.

Meanwhile, elsewhere

Most rich countries tax consumption quite differently from the way America does: usually at national level, and generally raising far more revenue from it (see chart 4). Yet some of the problems they face are similar.

Within the EU, online retailers are supposed to collect value-added tax (VAT), a tax levied on purchases made by individuals but not businesses. Although VAT rates in different EU countries vary widely, the EU has ruled that cross-border retailers should collect the tax at the rate applying in the member state where the purchase is consumed. In theory, that should stop online firms setting up in whichever EU country has the lowest VAT rate on its product, and exporting to countries with higher rates. However, enforcing this policy may prove harder than EU officials suppose. As one British customs official explains: "If we visit a company in Britain and find that it is not charging VAT on goods it is shipping to, say, Germany, we will certainly tell them they are supposed to be charging German VAT. But it is not our job to enforce the collection of German taxes or to tell the German government that it is missing out." Nor is it clear who will ensure that firms deliver any tax they collect to the appropriate government. Retailers selling from outside the EU are even harder to keep in line.

With physical goods, the taxman can at least

check that items entering the country have had the appropriate duties paid on them. But if online customers find they have to pay extra when their package arrives, they may get irritated enough to pressure retailers into complying with tax rules. According to Charlie Gilreath, chief executive of Globalfulfillment.com, a firm that helps online businesses with their customers' orders, extra taxes or duties that were not included in the purchase price are among the main reasons why goods ordered online are returned.

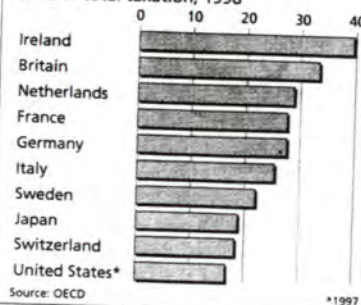
The EU has decided that intangibles delivered online should be taxed as services. But collecting tax on services is tricky, and e-commerce can only make it harder. If a supplier sets up in a country that does not require it to collect taxes on the intangible goods it sells, and delivers the product online, the taxman in the consumer's country may never know.

Many products that are currently tangible, and thus fairly easy to tax, may become virtual. Already, music can be sent to customers via the Internet rather than in physical form. Books may soon follow. The dematerialisation of products could accelerate as Internet bandwidth increases. Clearly there are limits: nobody has yet devised a way of downloading a Big Mac. However, even with physical goods it may be possible to "unbundle" the price of a good into a tangible component and intangible ones—such as design, advice or customisation—that could be located in a low-tax regime.

Taxing digital goods where they are consumed may prove almost impossible. Collecting a sales tax from the supplier may be easier, and in America a shift towards such origin-based taxation has been suggested for intangibles. Since the country is a net e-commerce exporter, this is hardly surprising. But imposing such taxes might reduce the competitiveness of American firms if competitors set up in countries that do not impose the origin tax. And even American entrepreneurs may well decide to form new companies in a tax-friendlier place. There are plenty of countries competing to attract them.

Nice little earners

Taxes on goods and services as % of total taxation, 1998



Gimme shelter

"BILL GATES would be fabulously more wealthy if he had started Microsoft in Bermuda," says William Woods, chief executive of the Bermuda Stock Exchange. "He may have known a lot about computer programming when he started the company, but his ignorance about tax cost him a fortune." Mr Gates has not done badly even so, but he knows better now. Teledesic, a company co-founded by the Seattle-based billionaire that plans to offer broad-band Internet access by satellite, is incorporated in Bermuda.

Any firm that expects to earn profits from more than one country, and to have shareholders from more than one country, should set up in Bermuda, says Mr Woods—and not just because the British island dependency levies no corporate income tax,

but also because it is "tax-neutral" in its treatment of holding companies. A holding company incorporated in America that receives cash dividends from overseas subsidiaries, which have probably been taxed already in their country of origin, would also have to pay some American tax before any money is distributed to shareholders. A Bermudian holding company could pass those dividends, gross, direct to shareholders. The tax savings could easily have been 10-15% for Microsoft, which earns around half its profits outside America, says Mr Woods. This would have meant higher profits and presumably a higher share price—and thus an even wealthier Mr Gates.

Alas, once a holding company is incorporated in a country such as America, the cost of moving to Bermuda can be prohibitive. The taxman is likely to

Is tax competition among countries a good or a bad thing?



take the view that a firm transferring its citizenship is, in effect, selling off its assets, and hit it with a hefty capital-gains tax bill. Going offshore makes most sense for truly global firms, says Mr Woods. If you are writing software over the Internet, with teams of workers spread across Seattle, Bangalore and Israel, it would be hard for any one country to claim the right to tax you as a holding company—and this is increasingly how companies work, particularly in Internet-related business. That is why Bermuda is busy marketing itself to entrepreneurs as an e-commerce centre.

Ireland wants to be the e-commerce centre for Europe, so, like Bermuda, it has passed a state-of-the-art e-commerce law. It has identified 100 global technology companies it wants to attract. Like their counterparts in Bermuda, politicians in Dublin are being bashful about what many would consider Ireland's main attraction: low taxes. Instead, they like to emphasise their high-quality regulation, the advantage of being able to do business in English, Ireland's entrepreneurial spirit, and its highly educated yet relatively low-cost workers.

Pssst... know a good tax regime?

Boasting about attractive tax policies is unwise just now because of international efforts to crack down on "harmful tax competition". This is not, at least not explicitly, an attempt to harmonise taxes. The EU, for example, has been campaigning against the singling out of particular taxpayers for preferential tax treatment, which is how many EU countries now try to attract investment by multinational companies. The main target of this campaign was initially Ireland, which has long annoyed some of its bigger European partners by offering a modest 10% tax rate on profits earned by foreign manufacturing companies that move there, and latterly to foreign financial companies operating there. But in a brilliant (if expensive) pre-emptive move, the government in Dublin agreed to stop giving preferential treatment to some companies and offer the same 12.5% tax rate on profits to Irish as well as to foreign firms by 2010.

This has left other EU countries with more time to accuse each other of offering preferential tax treatment. A report to the EU's Helsinki summit last December identified 66 different varieties, ranging

from the Netherlands' willingness to negotiate secret advance agreements with foreign firms on how much tax they will pay, to Gibraltar's tax exemptions for branches of non-resident companies operating there. The report found that all EU members except Sweden engaged in some "harmful" tax practices.

The OECD is mostly after the more familiar sort of sun-drenched tax haven. In particular, it makes a distinction between tax rates designed to attract "real" economic investment and those aimed at merely "financial" capital flows, which are its main targets. It is particularly hostile to countries that attract "brass plate" or "booking" operations, with no real work or employment attached to them. It gets suspicious when a location offers low or no taxes but is unwilling to exchange information with foreign tax authorities, or if companies setting up there do not appear to have "substantial activities".

What constitutes substantial activities is debatable. Gone are the days when finding out what a firm does and where it makes its money simply meant visiting its factories. An increasing share of companies' profits comes from financial and other services, which are much more elusive than manufacturing plants. It can be hard to tell exactly what constitutes substantial activities, and will get even harder as the Internet allows, say, servers and databases to be based in low-tax countries.

The OECD is currently preparing a list of countries that it thinks are indulging in harmful tax competition, which it plans to publish in June. Countries worried that they will be labelled "tax havens" are mounting a furious lobbying effort. Most of them insist that companies within their borders do many worthwhile and substantial things, and no doubt they often do. Bermuda points out that it hosts a thriving, innovative insurance industry, and that its government takes a full 22% of the country's GDP in taxes, though these are levied on consumption and employment rather than on profits or other income. The Cayman Islands claims that it is the world's fifth-largest financial centre, and is home to 45 of the world's biggest banks.

All this regulatory activity seems to reflect a belief that tax competition does indeed exist, that it is intensifying, and that it can be harmful (although



both the EU and the OECD quietly concede that it can sometimes be beneficial by penalising inefficient governments). But is any of this true?

Tax-competition sceptics point out that in most developed countries tax revenues as a proportion of GDP have in fact risen over the past 30 years, and that the share of taxes on corporate profits in overall tax revenues has remained much the same. On the other hand, there is plenty of evidence that lower tax rates have pulling power, and as economies become more open, the pulling power is getting stronger. A 1998 OECD report on harmful tax competition noted that total direct investment by G7 countries in tax havens in the Caribbean and South Pacific grew more than fivefold between 1985 and 1994, to over \$200 billion.

So-called tax havens accounted for 1.2% of world population and 3% of world GDP, but 26% of the assets and 31% of the net profits of American multinationals (though only 4.3% of their workers), according to a 1994 study*. A more recent analysis†, by James Hines of the University of Michigan, found that "taxation significantly influences the location of foreign direct investment, corporate borrowing, transfer pricing, dividend and royalty payments." Another recent study** asked, "Has US investment abroad become more sensitive to tax rates?" It analysed corporate tax-return data for 1984-92 (the lat-

est then available), and found that by the end of this period the typical American multinational had become twice as likely to locate its operations where taxation was lowest as it had been at the beginning.

Falling corporate tax rates around the world also provide strong circumstantial evidence that governments are trying harder to cater for international firms' and investors' appetite for lower taxes. Yet such rate cuts have often been accompanied by a widening of the tax base—for instance, by scrapping corporate-tax exemptions—which has reduced the impact of rate cuts on the bottom line.

Are governments wise to engage in tax competition? Ireland's example suggests they may be. The country's recent economic boom owed much to low taxes on foreign firms moving there. Its GDP per head, which as recently as 1990 was 70% of the EU average, now exceeds Britain's, and is expected to exceed the EU average by around 2005. But within the EU, no other country has tried to compete head-to-head with Ireland on tax. By contrast, some devel-

*"Fiscal Paradise: Foreign Tax Havens and American Business", by James Hines and Eric Rice. *Quarterly Journal of Economics*, 1994.

†"Lessons from Behavioural Responses to International Taxation", by James Hines. *National Tax Journal*, June 1999.

**"Has US Investment Abroad Become More Sensitive to Tax Rates?", by Rosanne Altshuler, Harry Grubert and T. Scott Newlon. National Bureau of Economic Research working paper, January 1998.



To Victor the spoils

WITH its smoke-filled pubs, tacky gift shops and seen-better-days streets, Gibraltar might be mistaken for an English seaside resort that slipped through a time warp back in the 1970s. But the tiny British dependency on the southern tip of Spain is bang up-to-date in at least one respect: tax competition.

In the past year, it has become a haven for bookmakers fleeing a 9% tax on bets levied by the British taxman. Several leading bookies now have offshore operations there, including Coral, Ladbroke's and William Hill. The firm that started the exodus, Victor Chandler, has abandoned Britain altogether, moving its entire business to "the Rock". Its office—full of screens, like any investment bank, except that its staff are actually meant to be watching the sport—is open 24 hours a day, taking tax-free bets by phone (and soon via the Internet as well) from customers all over the world. Since making the move in May last year, it has become Gibraltar's largest private-sector employer. By some measures it accounts for 7% of the economy.

Victor Chandler, the eponymous boss of the firm, points to tax competition by Ireland, which last year cut its betting tax from 10% to 5%. Irish bookies, he

says, looked set to clean up in the British market. He considered moving to Ireland, but the Irish government did not "encourage" him; he suspects it was "protecting its own bookies". So he chose Gibraltar: "As well as low taxes, there is the English language, British law, no corruption, a good pool of educated labour, and good telecoms," he says. The British colony compared well with alternatives in the Caribbean that have become popular locations for Internet gambling firms. But the firm has hedged its bets by buying a casino in Antigua, which it plans to put online.

The British government is furious, but at present all it can do is to restrict Victor Chandler's ability to advertise offline (though not online). It has an-

nounced a wide-ranging review of gambling legislation which will include offshore and Internet betting, but this will not be completed until mid-2001. Meanwhile, high-street bookies in Britain are lobbying the government to scrap the betting tax to save thousands of jobs from being lost to offshore competitors.

Where there is a will

In America, where gambling is tightly regulated and often banned, Victor Chandler's clients evade American controls by opening bank accounts abroad through which they place their bets and get their winnings paid. As Victor Chandler has no assets in America, the authorities there have no means to make the firm comply with their gambling laws. Offshore betting by telephone or over the Internet is, in effect, deregulating the global gambling industry.

"You can be considered a pirate doing this," says Mr Chandler wistfully. But firms up sticks only if they feel they have to, he says. "All we are doing is showing the government that there is demand for something that wouldn't be viable if we had to stay in their tax regime. Don't think I wouldn't rather be in England—though my wife misses it more than me." Perhaps that is why he recently decided to sell the business to Enic, a big sports and media company.





oping countries have found that their attempts to attract firms by offering low taxes have been trumped by similar countries taxing even less.

In some countries, the tax authorities have responded to tax competition by getting tough with multinational firms that operate within their borders but try to take advantage of lower taxes elsewhere. When filing tax returns in a high-tax country, multinationals typically claim that they have earned as little of their profits there as they can get away with. Instead, they try to attribute as much profit as possible to their operations in low-tax countries. They do this by arranging "transactions" between their subsidiaries in the two countries, and setting the "transfer price" of those transactions so that it has the desired effect on profits.

In theory the transfer price is supposed to be the same as the market price between two independent firms, but often there is no market, so nobody knows what the market price might be. This is particularly true of firms supplying services or intangible goods. So multinationals spend a fortune on economists and accountants to justify the transfer prices that suit their tax needs. Increasingly, firms try to restructure their operations to get their tax bill down as far as possible. There are plenty of opportunities: according to the OECD, around 60% of international trade involves transactions between two related parts of multinationals. But tax authorities are increasingly looking out for such wheezes. In America, in particular, the taxman has been putting the squeeze on companies, which have responded by allowing more of their taxable profits to arise there to keep him happy. This is prompting other countries to get tougher, too.

America is also trying to get a grip on American-based multinationals' tax behaviour in other countries, using an instrument known as controlled-foreign-company legislation. The main way American multinationals take advantage of low-tax regimes is by "deferral", which means sitting on profits earned in those countries instead of sending them back to the parent. If the tax authorities think that a foreign subsidiary is used only for avoiding tax, the subsidiary can be deemed a controlled foreign company and obliged to repatriate its profits to the holding company, where it is subject to full American taxation.

This kind of tightening up does not necessarily produce a lot more revenue for the tax authorities in question, but it does mean companies are spending ever more money on tax advice and wasting ever more time filling in forms. "Transfer pricing is increasingly complex, and divorced from economic reality," says Huub Haemaekers, of the International Bureau for Fiscal Documentation in Amsterdam, who helped design the transfer-pricing system in the 1970s. The "arm's length principle" on which



transfer pricing is based—in essence, that a multinational's businesses in different countries are taxed as if they were independent firms operating at arm's length from each other—makes it ever harder to run multinationals as global businesses.

Philip Gillett, group tax controller at ICI, explains:

Commercially, transfer pricing makes no sense. It forces us to spend a lot of time doing things that are pointless from a business point of view. We have to waste time trying to price unfinished goods being 'sold' from one plant to another. It is like asking Ford to value a camshaft half-way along the production line: a nonsense. Businesses want to organise as if there were a single global or regional product market. Instead,

tax is determining how they organise themselves. It makes local managers think more territorially, to start looking after their own particular country issues. The tax system promotes parochial thinking.

National tax systems also put a huge price on re-organising national businesses into single, seamless global operations. For instance, consider a multinational with a buying and selling operation in France that it wants to scale back to the status of a sales agent, transferring most customers to a marketing operation in, say, Germany. The tax authorities in France would say that the multinational had transferred the goodwill in the French operation to another country, incurring a huge tax liability. This is such a big problem in the EU, says Mr Gillett, that "it can be easier for a multinational to come from the US or Japan and set up on a pan-European basis than for an existing European firm to make that transition."

A better way?

Mr Gillett would prefer to scrap transfer pricing and replace it with a system better suited to the needs of global firms. There is no ideal solution, but one option would be a "unitary tax", which involves taking a firm's total profits and allocating different slices of that total to individual countries on the basis of a formula that reflects the firm's relative economic presence in that country. The country can then tax that slice of profit at whatever rate it sees fit. This would still allow tax competition, but without the inefficient corporate structures. "Businesses still want tax competition," says Mr Gillett. "If government faces no downward pressure on tax rates, they tend to rise."

The prospects for the EU and the OECD "harmful taxation" initiatives look distinctly unpromising. Neither carries a big stick, and both are relying on drawing up blacklists and "naming and shaming". Yet it is doubtful whether many countries black-listed by the OECD will feel shamed. After all, two wealthy member countries—Switzerland and Luxembourg—have said they will not be bound by the OECD's recommendations. Indeed, some of the wilder tax havens regard the whole exercise as a wel-

come bit of free advertising.

OECD officials speculate that it might be possible to do some sort of deal with tax havens to buy their good behaviour. As one of them puts it, "The amount of tax revenue being lost to the world to give only a very small nick to the tax havens is very large. It would make sense for the bigger countries to buy them off." Or perhaps OECD governments could bring co-ordinated pressure to bear on multinationals not to use tax havens—after all, 85% of multinationals are incorporated in OECD countries. But there is so much tax competition amongst OECD and EU countries that hopes of such co-ordinated action seem forlorn. As Mason Gaffney, an economist at the University of California, Riverside, trumpeted in a recent speech in the Bahamas in favour of tax competition: "Freedom anywhere foils tyranny everywhere. Tax tyranny is a balloon: seal every leak, or it collapses."

Certainly, if the EU were to put a stop to the "harmful" tax practices within its borders, many of the businesses now taking advantage of them might simply move to, say, Switzerland. All the same, the EU's initiative has a slightly better chance of succeeding than the OECD's. It is possible that the European Commission, the nearest thing the EU has to an executive government, will add muscle to its code of conduct by taking action against miscreants in the European Court of Justice, on the argument that preferential taxes are essentially the same as state aid. The commission has been waging war on such state aids for years on the ground that they distort competition in the EU's single market. It has taken disputes to the European Court, and usually won, so it believes it can do the same with taxes. The trouble is that such cases usually take years to work their way through the court, so the commission would prefer countries to fall into line voluntarily.

Some experts think that the European Court may even cause corporate tax rates within the EU to be harmonised—long a dream of politicians in Germany and France, and a nightmare for their counterparts in lower-taxing Britain and Ireland. According to Albert Rädler, a tax lawyer at Oppenhoff & Rädler in Munich, the court sees its mandate as completing a single market in Europe, and its verdicts on tax have been moving steadily in the direction of harmonised corporate taxation, even though the member states' governments think they have a veto over EU tax policy. If the European Court makes a decision, the member states have to accept it.

Last year the European Court found that denying benefits under the German-American bilateral tax treaty to the German permanent establishment of Saint-Gobain, a French firm, amounted to a denial of fundamental EU rights. "This was a revolution in taxes, extending bilateral-treaty benefits to non-residents," says Frans

Vanistendal of the University of Louvain. In future, EU member governments may become much keener to co-ordinate tax policies, if only to stop the European Court eroding their political control of taxation, says Pasquale Pistone, a lawyer at the European Tax College in Louvain, who has been working on proposals for an EU model tax convention.

A contradiction in terms

Some officials at the OECD now regret ever using the phrase "harmful tax competition". As one of them puts it, "As an economist, how can you ever say anything bad about competition?" The OECD's main objection to some forms of tax competition is that they reduce another country's tax base, or force it to change its mix of taxes, or stop it taxing in the way it would like. But that seems a bit one-sided: what about the democratic rights of people in poor countries to enjoy a higher standard of living by pursuing tax policies that attract overseas investment? Indeed, says Edward Troup, a lawyer at Simmons & Simmons in London, it would be possible to argue that the OECD initiative is "an attempt to create a cartel amongst certain developed countries who have an unsustainable activity—raising revenue by taxing capital—that they want to protect."

Economists favouring tax competition often point to an article by Charles Tiebout entitled "A Pure Theory of Local Expenditures", published in 1956. In that article he argued that, faced with a choice of different combinations of tax and government services, taxpayers will choose to be where they get closest to the mixture they want. Variations in tax rates across different countries are a good thing, because they give taxpayers more choice, and thus more chance of being satisfied. They also create pressure on governments to be efficient. That makes harmonising taxes a bad idea.

A fascinating paper* by Reuven Avi-Yonah, of Harvard Law School, questions that optimistic conclusion. Certainly, tax competition can make governments deliver services more efficiently. Even so, argues Mr Avi-Yonah, tax competition may reduce redistribution and thus weaken the social safety net

that in a global economy is needed more than ever. This could start a backlash against globalisation of the sort that pushed the world into depression 70 years ago.

Tiebout assumed that taxpayers are highly mobile, but many taxpayers, including the great majority of workers, have not so far shown much sign of getting on their bikes. Perhaps they are happy with their lot. Perhaps, though, they are simply unable to move. Will globalisation, supercharged by the Internet, change that?

*"Globalisation, Tax Competition and the Fiscal Crisis of the Welfare State". Harvard Law School working paper, July 1999.



Getting personal

Taxing people is becoming harder, too

LUCIANO PAVAROTTI may be a proud patriot, yet the famous Italian singer has gone to court to prove that he does not live in the land of his birth. The Italian government claimed that Mr Pavarotti was resident in Modena, and therefore owed over \$2m in taxes. The tenor argued that he lived in Monte Carlo and spent only a few days in Italy during the years in question, not the 183 days a year that usually constitute residency. He also disputed the government's claims that his companies in Italy represented his vital economic interests, another criterion for residency. He said they were mainly vehicles for his hobbies and charitable activities.

After a court ruled against Mr Pavarotti last year, he launched an appeal. There has been no settlement, but he has complied with a law requiring him to pay some of the money as a deposit. Francesco Tesauero, his lawyer, is up in arms. As somebody who does not spend 183 days a year in any one country, he says, his client has merely been exercising his right to choose a place of residence—which happens to be with other tax-avoiding millionaires in

Monaco. He owns houses in Italy, “but so does the queen of the Netherlands, and nobody is claiming that she is resident in Italy.” The real issue, says Mr Tesauero, is that the Italian government has launched a campaign against the rapidly growing number of Italians who have shifted their residence abroad to avoid taxes, “and they wanted a person to spotlight; a symbol.”

Even so, what differentiates the present period of globalisation from past bursts is not that so many people are moving abroad, but so few. Within the EU, where citizens of member countries have freedom of movement, only 5.5m people, or around 1.5% of the total population, live in a member country different

from their own. Even in America, which welcomes foreigners more than most rich countries, new immigrants in 1997 added only 0.3% to the population. Contrast that with the long wave of globalisation in which some 60m Europeans crossed the Atlantic, and which ended in the 1920s. Back in 1900, 15% of the American population were foreign-born, compared with 8% now.

In those days, many migrants were fleeing poverty or persecution. Today's disaffected find it harder to move in search of a new life. Most developed countries grant entry only to a carefully controlled few, usually because they have family ties in the new country rather than because of the economic contribution they might make. Even those who are allowed in may find that pension and welfare rights do not travel easily to another country. But most people stay where they are because they like it there, which suggests that there is more to life than a smaller tax bill.

On the face of it, this lack of mobility looks like

good news for the taxman. Even if companies become more footloose, and corporate-tax revenue declines, personal income tax can always be relied upon to supply the lion's share of government revenue. Yet income-tax revenue may not be as invulnerable as it appears. Incomes are becoming more unequal everywhere, which means that a growing share of the total income-tax take is being paid by a shrinking group of the population. In America, for example, over 30% of income tax is collected from the top 1% of earners, and over 60% comes from the highest-earning 10% (see chart 5). The highest earners are much the most mobile.

Even within the EU, there is evidence of tax competition being used as a way of attracting wealthy individuals. The French press has recently been full of stories about some of the country's leading entrepreneurs moving to London for its lower taxes. And the Dutch government, according to Carlo Romano, a tax lawyer at the International Bureau of Fiscal Documentation, will “agree tax reductions with highly skilled foreigners to attract them, just as it does with companies”.

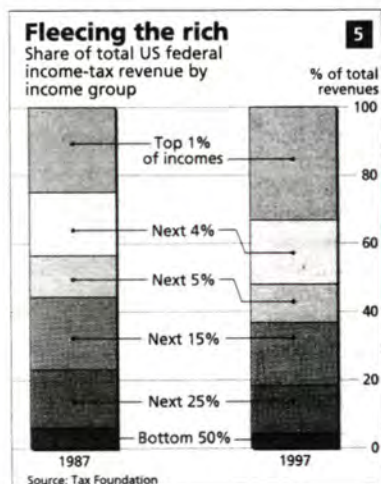
Moving targets

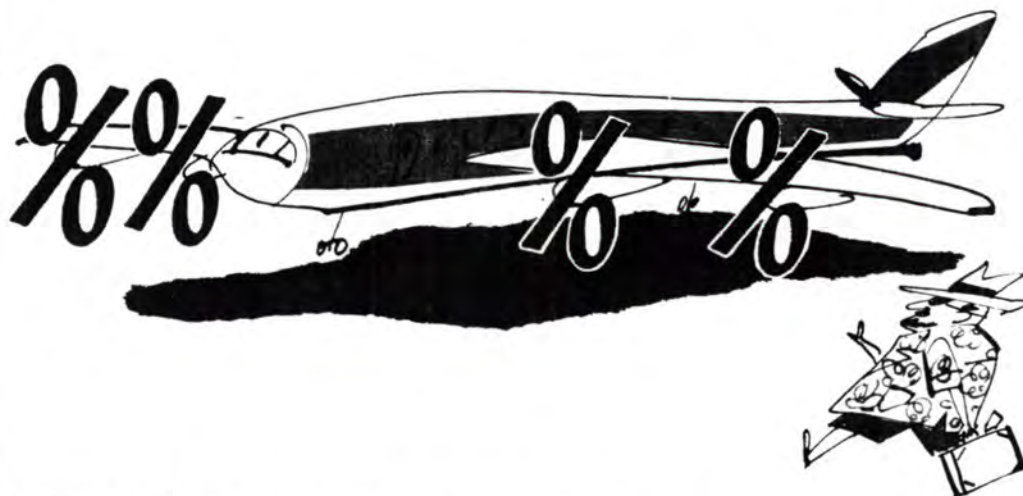
Globalisation increases the mobility of high earners. As the influence and importance of multinational companies grows, so do the opportunities for their workers to move from country to country. Increasingly, multinationals operate in developing economies which have low taxes, or are willing to negotiate a favourable tax regime to attract the business. While abroad, workers from developed countries can squirrel away large amounts of capital that their home tax authority need never discover. The Internet will increasingly let people work anywhere, or appear to the taxman to be working abroad even if they are not. Companies increasingly contract out work to self-employed consultants, shifting responsibility for collecting personal income tax from usually law-abiding companies to those consultants, who can be hard to pin down.

Even if people themselves do not move abroad in search of lower taxes, their money can, and increasingly does. In most countries the share of direct personal tax revenue arising from taxes on income and capital gains from savings and investments has fallen steadily over the past 20 years. But this may be only the beginning.

Tax havens are starting to market their services much more vigorously to new groups of potential customers. For instance, British Airways recently mailed details of its own-brand “offshore deposit account”, based in Jersey, to members of its frequent-flier club. Among other things, the literature promised the “notable advantages” of gross interest, although the small print did contain all the usual warnings about disclosure and tax liability. The OECD expects the Internet to lead to a rapid increase in offshore banking, but perhaps only in “reputable” tax havens, such as Jersey, because of customers' fears of being ripped off.

According to Joanna Wheeler, of the Interna-





tional Bureau of Fiscal Documentation, in recent years a growing number of continental Europeans have put their assets into offshore trusts—a tax-avoidance device long employed by wealthy people in Britain and America, but not previously much used on the continent. The tax authorities have “not found an answer to this”.

Individuals investing money in tax havens are often illegally evading tax, rather than legally avoiding it. Germany has a 30% withholding tax on interest paid on bank deposits that has prompted vast numbers of Germans to put their savings in bank accounts elsewhere, notably Luxembourg and Switzerland, both of which have strong bank-secrecy laws. It is estimated that German tax is being paid on less than one-fifth of all the income earned abroad by German investors. Germany has been a champion of an EU savings directive requiring member governments to collect a 20% withholding tax on interest payments made to foreign residents.

One reason why much of the world has stopped levying withholding taxes on interest is strong tax competition from America, which unilaterally scrapped its withholding tax in 1984. The likely effect of an EU-wide withholding tax would be to drive savings away to more tax-competitive destinations. It is hard to get a grip on tax competition, particularly for financial capital, unless the whole world agrees to co-operate. “I do not think it possible to carry out the taxation-of-savings proposal if we do not have at least Jersey, Guernsey, Switzerland, Liechtenstein and Monaco on board,” says Frits Bolkestein, the EU commissioner responsible for the savings directive. As none of these countries is a member of the EU, it seems unlikely that any of them will get on board.

The difficulty of getting co-operation was underscored by Britain’s blocking of the savings directive in December. The EU is now pondering what to do next. Britain had argued that investors in bonds traded in the City of London would be driven away to countries outside the EU, such as Switzerland. As an alternative, Britain said it would accept mandatory disclosure of interest payments made by financial firms in EU countries to foreign residents. But Luxembourg, which attracts international capital largely because it is so secretive, would have none of that. It is now hard to see how the EU can come up with anything that would not be unaccept-

able to, and vetoed by, either Britain or Luxembourg.

Tax havens are widely used not just for tax evasion, but also for another undesirable activity: money laundering. Some officials involved in tackling money laundering fear that international pressure on secretive tax havens to become more open on tax matters will actually make them less co-operative on other crimes. And new technology, such as encryption and anonymous electronic money, may make it even easier to keep financial transactions secret, and hence evade tax.

Rather than try to find out how much investment income their taxpayers have earned abroad, governments may want to copy the Netherlands, which from next year will levy a tax on “deemed income”, based on the assumption that the taxpayer earns a rate of return of 4% a year on his assets. However, some tax experts fear that this will simply drive wealthy Dutchmen abroad.

The American way

America’s approach to personal taxation is at odds with that of most other countries. Instead of taxing its citizens only if they are resident for at least 183 days in the year, it assesses them on their total global income, whether or not they are resident in America; but it allows them to offset income tax paid in their country of residence against their American tax liability. This does not work quite as well as it might because it requires a good deal of transparency and information-sharing, which not all countries are willing to engage in just to oblige the American taxman. Still, other countries might do well to adopt similar systems, if only to give everyone an incentive for more information-sharing.

Greater transparency might reduce tax competition, but this could be dealt with by setting a fair price for changing citizenship. A few years ago stories in *Forbes* magazine about “taxpatriates”—wealthy Americans who had renounced their citizenship to avoid large tax bills—caused a political furore and prompted a series of measures that penalised people for giving up citizenship (eg, by imposing strict limits on being able to visit America). Certainly there is something in the idea of connecting citizenship, and the right to vote, with tax liability. It could be marketed under the heading, “No representation without taxation.”



You pluck, we hiss

To cope with globalisation and the Internet, governments will need to reform taxes in ways that will make them more unpopular than ever

THE taxman has never been a popular fellow, and probably never will be—but he can alleviate his unpopularity by following the famous advice of Jean-Baptiste Colbert, Louis XIV's treasurer: "The art of taxation consists in so plucking the goose as to obtain the largest possible amount of feathers with the smallest possible amount of hissing." Over the next few years globalisation, accelerated by the Internet, is likely to test the taxman's plucking skills.

The Internet will make the goose harder to catch, and noisier in defence of its plumage. Tax competition is likely to go on. Although the EU, urged on by the European Court of Justice, may move towards tax harmonisation, this will be a slow process, and the only effect it may have on tax competition in the wider world is to increase the incentive for countries to offer lower taxes to lure firms and investors out of the EU. It is hard to imagine any government agreeing to join a World Tax Organisation, although the existing WTO (World Trade Organisation) may get more involved with tax matters.

Even so, tax competition is unlikely to result in a "race to the bottom". As Tiebout argued in the 1950s, governments offering competitive packages of high-quality services and high taxes may well attract mobile taxpayers, perhaps more successfully than governments offering minimal services and low taxes. But using taxes to redistribute wealth from mobile firms and people to the less mobile, and less well-off, may become harder. And even though death and taxes will remain inevitable, coping with globalisation is likely to require considerable changes in the tax system over the next few years. Such changes almost always generate a good deal of political strife.

The present system of taxing multinationals is a source of growing inefficiency. With each passing day, the transfer-pricing process bears less relation to the way that global companies operate now—and less still to how they would like to operate if they had a free hand. A unitary tax, which allocates slices of a multinational's total profits to different countries for tax purposes, is not flawless, but it would at

least free firms to organise themselves in whatever way they think will let them use their global resources most efficiently. For such a tax to be introduced, however, several large countries would have to agree on it at the same time. That might be possible within the EU, but probably not elsewhere.

A tax reformer's dream

What would be even better, though even less likely, would be to put an end to company taxation altogether. This would let firms concentrate on doing what they do best, and to establish themselves wherever they can operate most efficiently without wasting time and resources on playing games with the tax authorities. A government of a big country, such as America or Britain, could bring this about by unilaterally scrapping corporation tax and letting tax competition do the rest. But whoever did such a thing would doubtless be accused of giving hand-outs to the rich. That charge might not be justified: the most sensible way of looking at corporate tax is simply as a pre-payment of tax that would otherwise be collected from a firm's shareholders, employees or customers. But the perception would probably be enough to warn off any politician contemplating such a move.

Governments may also need to make changes to accommodate e-commerce. For instance, in America revenues from sales taxes could plunge if nothing is done to stop the Internet from undermining them. What needs doing is fairly plain; the difficulty is getting politicians to do it, given that "taxing the Internet" is likely to prove a massive vote-loser.

If redistribution through the tax system becomes more difficult, the less mobile, poorer people will have to choose between fewer government services or bigger tax bills. In many countries, this choice will be complicated further by demographic changes which by themselves will require taxes to rise sharply to keep retirement-benefit and health-care promises made to future pensioners. And the harder it gets to tax mobile people and businesses, the bigger the burden that will have to be borne by the immobile. Land taxes, which used to be one of the most important revenue-earners, may regain their former pre-eminence. Consumption taxes on purchases of physical goods and services which the taxman can track may have to rise. In future, local environmental taxes—say pollution taxes, or road pricing—may well come to look attractive to tax-starved governments.

Many economists would welcome greater emphasis on consumption and environmental taxes because they cause fewer economic distortions and inefficiencies than income taxes. But this would not make them popular with those contemporary Welshmen, and their kindred spirits, who are unable to vote with their feet. They may no longer don women's dresses or vandalise the local tax office, but they will certainly complain bitterly. As Colbert might have put it, if they can't run, they can still hiss.

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Jawid
February
PC

What is Europe?

FORGET geography, forget culture. The thing called "Europe" that a dozen or more ex-communist and other countries want to join, and with which they engage in formal talks next week, is about politics and economics. But Europe's political and economic order is by no means settled. It is shifting, and more rapidly than would have seemed likely even five years ago. So pronounced is the recent change in fact that one may even question how distinctively European this Europe will seem in, say, another five years.

In *The Economist* this week we look in turn at Europe's new politics (pages 19-22) and Europe's new capitalism (pages 71-74). To a surprising extent, especially when measured against what politicians say, Western Europe's parties of the left, many of them now in power, are moving away from their traditional statist dogmatism towards a pragmatic, if reluctant, recognition of unavoidable economic facts. At the same time, the global market for capital is encroaching on European boardrooms, which have traditionally run their companies as though shareholders were of little account, valuing order and stability (of managers' careers, especially) over return on equity. If you were alarmed by these developments, you would say that the tyranny of market forces is driving both changes, and that Europe's social model—esteemed by Europe's citizens, if not by global financiers—is in rapid retreat and must in the end be destroyed. Thus, democracy loses and borderless capitalism wins.

Next year's model

The prospect poses an enormous challenge to Europe's governments, not least in thinking about what the new European Idea, if any, should be. The spirit that for years has animated the European project—the striving for "ever closer union"—draws in some quarters on distaste for and distrust of American might in business, diplomacy and arms. It cannot have escaped notice that, in economics and economic policy, the European model which seems in retreat is giving way to none other than the American kind, with leftist parties narrowing the gap between themselves and America's New Democrats, and hitherto national markets for corporate control in Europe merging not merely into one EU pool but into a truly global (that is, American-dominated) common market, forgive the expression. Put it this way: what is the point of "Europe", if Europe is turning out to be just another United States?

In certain obvious ways, of course, that is a fate devoutly to be wished. A stiff dose of American competition, innovation and enterprise is not something that only global financiers should want to see in Europe. Europe's citizens will also see the benefit, in lower unemployment and a higher stan-



dard of living. It is precisely because Europe's governments, and their voters, are at last coming to see this connection that moves are afoot to liberalise their economies. If the will of the people called for high double-digit unemployment and economic backwardness, Europe's democratic governments could carry on supplying both quite happily, global market or no. So it is wrong to say that democracy is losing. People are voting for lower taxes, less public spending, a lighter hand of regulation: that is why hitherto leftist governments have made a start on delivering them.

In all this, of course, there are difficult choices to be made. Labour and capital markets as ruthlessly efficient as America's offer more wealth but, for many at least, less economic security. If Europe's leftist parties are correct, voters want to see the trade-off shifted towards wealth, but maybe not by much. And there is no reason why the degree of shifting should not vary from country to country within Europe. The "European model" may be bad as description (since the EU's economies do vary a lot), but as prescription it is positively harmful. Friendly competition among policy regimes—in the context of free movement of labour, goods, services and capital—could prove to be Europe's greatest asset. Competition makes for better government, just as it makes for better business.

That kind of rivalry, within a union of national systems sharing a common currency, would indeed stand as something both promising and distinctively European. Unfortunately, it might require an even bigger adjustment than the one that is already under way. In Europe's governments, consensus still tends to be valued above challenge, let alone competition—and among its politicians there is no consensus like Euro-consensus.

The desire to speak for Europe, even when there is no merit in speaking for Europe, is illustrated by the remarkable response to Jörg Haider's Freedom Party entering the Austrian government, a row that shows no sign of subsiding. Formally, the EU's 14 angry governments are having to ostracise Austria bilaterally, not through their club, of which Austria is a member in good standing. Yet Portugal's prime minister, speaking as club president, still says Mr Haider's party is "not suitable" to be in the EU. Belgium's foreign minister says "Europe can very well do without Austria." His French counterpart says "we can't have trustful relations with a government which doesn't completely share the same objectives of the European Union." And so on. Never mind that such statements are likely to gain Mr Haider further support. The point is that Austria has broken no EU rules: there is nothing here about which "Europe" should have a view, one way or the other.

So what is Europe? It is a union of democratic states,

whose members must meet agreed-upon standards of political decency as well as economic competence. It is a co-operative venture, in which states accept a measure of mutual interference in specific areas. And it is a work in progress, which must constantly debate its direction, its speed and its

geometry, and which must soon change its rules to accommodate the applicants at its door. Its goals are, or should be, peace and prosperity in the region. They are plenty to be getting on with. For the foreseeable future, Europe will need no bigger Idea than these.

Wahid's big test

Indonesia's unorthodox president must succeed in his struggle to assert control over the armed forces

A FRAIL president, nearly blind from a stroke and with a tenuous grip on power, goes on a long overseas trip. While he is away, his most powerful general is accused in a government report of involvement in atrocities. The president fires him, but he refuses to go. Meanwhile, fellow generals are said to gather for a clandestine meeting. Prepare to hear martial music on the radio and the announcement of a coup? Not so fast: this is Indonesia and its president is Abdurrahman Wahid. Although Mr Wahid may seem an unlikely person to face down the soldiers who once shored up one of the world's most autocratic regimes, he may prove to be rather good at the job. The world should hope he is.

In his stand-off with General Wiranto, his minister for security affairs, Mr Wahid has reached a defining moment in his four-month-old government. If the president, who is due home on February 13th, fails to remove General Wiranto from his cabinet, he will be judged to have completely lost his grip on power. That could shatter what little confidence there is in Indonesia's economic recovery. It could also inflame passions in the country's provinces, several of which are convulsed by communal or separatist violence.

The power struggle matters because at the heart of almost all of Indonesia's problems lie the armed forces, and General Wiranto is their former commander. He is thus the most conspicuous hangover from the 32 years of oppressive rule by ex-President Suharto. As long as he remains in the government, people will believe that the old order clings on.

Perhaps the generals are not powerful enough, as Mr Wahid has claimed, to be able to mount a coup. But a coup was never the most likely threat. The real danger is the one that remains: a sustained attack on Mr Wahid's ability to govern in the form of a campaign to destabilise the country. It is the sort of campaign that the armed forces have already shown themselves quite capable of orchestrating. If Mr Wahid's government can be made to look ineffective, then any soldiers anxious to recover their influence and privileges would soon see to it that their cronies took over the reins of power.

Plainly, Mr Wahid needs to ease the armed forces out of politics. Yet, as much as he may want them to remain in their barracks, he also needs them to keep violence under control. If destabilisation is their aim, they will quickly stir things up, just as they did in East Timor when the territory voted last year to split from Indonesia. It was for their part in bringing about this mayhem that an Indonesian commission has bravely recommended criminal investigations of a number of officials, among them General Wiranto.

Mr Wahid, a moderate Muslim intellectual, may well have realised that the publication of the commission's report

would mean he would have to sack General Wiranto. That he nevertheless chose to go abroad suggests that he took a calculated risk. The trip provided opportunities to show Mr Wahid hobnobbing with foreign grandees, and enjoying their declarations of support. It was also a sign of self-confidence. Even the long-distance order to sack the general may have been an unconventional show of strength. At the same time it was, like so many other of Mr Wahid's actions, soon clouded in ambiguity. The president later said that "sack" might be a bit strong, but he would anyway "ask him to quit". He also said General Wiranto would be pardoned if found guilty.

Mr Wahid may be trying to confuse his enemies with his oblique ways. In the process he may also have achieved a more fundamental aim: to create the sort of atmosphere in which General Wiranto could save face and depart without causing further trouble. If that does happen, the president will have taken a major step towards putting the armed forces under civilian control. Already their power has been reduced (see page 37). The seats reserved for them in parliament are being phased out and for the first time in over 40 years Indonesia has a civilian as defence minister.

But even if the general does go, the military threat will remain. Such threats have been all too common in South-East Asia. Thailand endured umpteen coups before its most recent military government was driven out in 1992 by popular protest. The army remained a shadow over the politicians in the Philippines long after a "people power" uprising in 1986 had overthrown the dictatorship of Ferdinand Marcos. Both countries now have strong democracies. Democracy throughout the entire region, however, would be strengthened if it could be made to work in Indonesia too (see survey after page 54).

Push, but not too hard

All of which presents outsiders with a problem. How hard should they push such an unorthodox leader as Mr Wahid when his country is so volatile? Perhaps not very hard, so long as he seems to be going in the right direction. Not everyone will be pleased, however, if the many crimes of the past are followed by neither punishment nor atonement. Pardons for those responsible for atrocities in East Timor may be acceptable to some Timorese politicians, but perhaps not to the victims and their families. The UN, which has carried out its own investigation, will also want to see some senior soldiers brought to book. If outside pressure can strengthen Mr Wahid in his pursuit of justice, it will be well justified. If it pushes him too far, the price might include all hope of building the world's third-largest democracy. A fine judgment indeed.



EUROPE'S NEW LEFT

Free to bloom

BERLIN, LONDON AND PARIS

Europe is changing. In the political arena, the parties of the left—often without openly admitting it—are adopting policies more friendly to the free market. In the business world, especially after the Vodafone-Mannesmann takeover, a new sort of corporate control is emerging. On pages 71-74, we look at the future of European capitalism. Below, we look at the new shape of the left

FRESHLY back in his office in Berlin, the government adviser was exasperated. He had just endured yet another round of preaching by Washington economists, and worse: a lecture by Tony Blair, prime minister of a country whose people are less rich than his. Of all the indignities, "They just don't understand us!" he sighed.

Mr Blair had offended with a speech he had just made to the World Economic Forum in Switzerland. "Does Europe continue with the old social model, that has an attitude to social legislation and welfare often rooted in the 60s and 70s," he asked, "or does it recognise that the new economy demands a re-direction of European economic policy for the future?" Europe's political leaders, he urged, should make a definite stand in favour of market reform.

Britain's prime minister seldom misses a chance to preach like this to his centre-left colleagues in Europe. His people grumble that he is often misrepresented: that his vision mixes markets with compassion, enterprise with fairness. The prickly Europeans, they moan, always forget that Mr Blair introduced a minimum wage and is reinforcing union rights. All the same, he has gone farther than any of his continental counterparts towards both accepting and promoting the principle of deregulation.

The rivalry between those who yearn to deregulate Europe's social model, and those who mean to defend it, is sharpening ahead of a summit of European Union governments in Lisbon on March 23rd and 24th. The political leaders are ostensibly there to discuss the renewal of the social model for the age of the Internet. As usual, they are likely to promise that all good things can be achieved at once—growth and jobs and competitiveness and compassion. And the old prejudices will prevail on each side. Opponents of the "Anglo-

Saxon" way will complain that it liberates enterprise only at the expense of equality and social cohesion. Opponents of the old European model, as practised in countries such as Germany and France, will counter that it shelters the poor at the cost of stifling



economic growth.

Ever since the centre-left swept to power, in Britain (1997), France (1997), Germany (1998) and Italy (1998), alarmist voices on the centre-right have been proclaiming a return to old socialist ways. The left, they predicted, would upset the trend towards deregulation at just the time when Europe's single market and single currency were about to offer the best opportunity Europe would ever have to

shake up its listless economy.

Some of those fears proved at once to be unfounded. All governing centre-left parties in the euro zone, constrained by the budgetary rigour imposed by the single currency, now follow conservative macro-economic policies. And in Britain, by invading the centre ground, Mr Blair has turned out to sound almost as market-minded on structural reform as his Tory predecessors.

But what of his continental counterparts? Surely they still resist the idea that individuals should be nannied less and look after themselves more? The traditional approach has been summed up by Lionel Jospin, the French prime minister: "Yes to the market economy; no to the market society." To exasperated outsiders, nothing so symbolises this ossified thinking as Mr Jospin's own policy of forbidding businesses to employ workers for more than 35 hours a week before overtime kicks in.

Yet scratch beneath the surface a little, and matters begin to look rather different. Continental Europe, under the leadership of a majority of centre-left governments, is not clinging unthinkingly to old ways. The political boilerplate is deceptive. In fact, something more subtle is taking place: the gentle, growing, if sometimes reluctant, recognition by Europe's left that reform of the social model they did so much to develop is necessary.

Tunnel vision

Listen carefully, and an unfamiliar, continental accent can be heard these days echoing from the rooms of those who supply policy ideas to Mr Blair. Over the past six months there has been a quiet surge of visits, in both directions, between policymakers in France and Britain. The Third Way, "new social democracy", call it what you will, has been the subject of many recent think-ins. The usual suspects from Paris include Aquilino Morelle, Mr Jospin's speechwriter, Pierre-Alain Muet, his economic adviser, Jean Pisani-Ferry, economic adviser to the finance minister, Christian Sautter and Gilles Finchelstein, also from the minister's cabinet.

At first, much of what took place at these meetings was the trading of misconceptions. The French now take part on the basis that this is a balanced exchange of ideas, and bristle at the hint that it forms part of Mr Blair's crusade to remould Europe in a liberal image. The British, who now scarcely mention



Careful Jospin, evangelist Blair, Schröder confused

the word "socialism", have begun to learn that they cannot breezily use terms such as flexibility, liberalisation or even privatisation, since to French ears these sound like totems of the conservative right.

Nor will the French stand for any talk of the Third Way. Ever since Mr Blair and Gerhard Schröder, the Social Democratic German chancellor, published a joint pamphlet last year on the virtues of a market-led form of social democracy (which was met with much suspicion on the German left), Mr Jospin has distanced himself from the phrase. He turned up at one Third Way seminar in Florence last year only after much arm-twisting by Mr Blair—and after the British prime minister had agreed to attend the Socialist International meeting in Paris shortly before. On a continent where "liberalism" carries a Thatcherite echo, there is nothing that so irks a French Socialist as the label "left-wing liberal".

Yet behind the differences of presentation—the grandiose visions, the taboo words, the patriotic talk of defending European values—the two sides have much in common. Take "welfare-to-work", a policy Mr Blair has made much of and which borrows heavily, as does so much of his thinking, from American experience. The British have gone farther than most in compelling those receiving welfare or the dole to seek, and accept, jobs. This measure is designed not only to lighten the welfare rolls, but to instil some sort of "moral purpose" into the lives of the unemployed. Combined with this is a change to the tax system introduced by Mr Blair's finance minister, Gordon Brown, whereby an unemployed person who supports a family gets a tax credit on part of his earnings when he accepts a job: "making work pay", in the jargon.

Continental Europeans, whose welfare systems are hugely generous in comparison with the British one, argue vigorously that their welfare state is what defines them as Europeans: an emblem of the values of solidarity and social cohesion that set them apart from individualistic Americans. "Europeans are Americans who refused to take the boat," declares Henri Weber, a French Socialist senator and regular participant in the debate on modernising Europe's left: "We do not take the same risks; we have a need for greater security."

Yet Mr Jospin is well aware that the strains imposed on Europe's welfare system by a combination of stubbornly high unem-

ployment and a greying population make change inevitable. For the first time, his advisers now talk about the problem of "poverty traps", whereby generous welfare cheques discourage the unemployed from looking for a job. His economic team is working on tax and benefit changes, along Mr Brown's lines, to steer the jobless into work.

Moreover, America's stunning recent economic performance is beginning to persuade the French that a more deregulated labour market need not lead, as they so often fear it will, to the creation only of low-paid *petits boulots* (odd jobs). In the past, the French have tacitly accepted that the price they pay for their insistence on tolerating only "decent" jobs is high unemployment: it currently stands at 10.6%, compared with 5.6% in Britain and 4% in the United States.

Today, it is still too costly for French employers to hire many workers, because of a mix of a relatively high minimum wage plus the social charges they must pay on top. Yet where the government has loosened things a bit, employers have taken advantage: four-fifths of jobs created in 1998, when GDP surged by 3.2%, took the form of short-term contracts, precisely the sort of flexible work that Mr Jospin professes to distrust.

A similar evolution can be detected in pensions reform. Mr Jospin may have spent over a year inconclusively reviewing how to overhaul the system: as in all western countries, the ratio of workers (who pay today for their elders' pensions) to pensioners is steadily declining. He may cling publicly to the rhetoric that private schemes, as urged upon him by Medef, the employers' federation, are divisive and too chancy for risk-averse Europeans. Yet even Mr Jospin lets it be known that "we are examining the idea of linking pensions with new forms of savings." If nothing else, the big stakes held in so many top French firms by American and British pension funds, which have invested eagerly in the perky Paris bourse, have brought home to the French government the implications of not nurturing French ones.

Even France's high level of taxation, in the past a badge of both right and left in a country with a profound reverence for the state, is no longer sacrosanct. The French state still spends 52% of GDP, compared with 40% in Britain and 30% in America. With one eye on the 2002 presidential election, Mr Jospin now promises tax cuts even for the middle classes—a pledge once regarded by the left as a gift to the rich. Although plans to cut

taxation on share options fell foul of the left last year, these too are on the table.

All of which points to a more flexible, market-oriented social system unfolding in France behind the rhetoric. But only up to a point. Could the French consider going as far as the British, for instance, in limiting welfare entitlements? That, insist Mr Jospin's people, would be "unthinkable".

Odd man out

In all this spirited cross-Channel debate, one voice is notably absent: that of Chancellor Schröder. "We just don't have the same contact with him," concedes an aide to Mr Jospin. "We've lost touch with him," admits one of Mr Blair's circle. It is curious, for both leaders, that this link is so weak. For the French, because of the traditional Franco-German axis, combined with a mutual sympathy for old-style social democracy. For the British, because the Labour Party helped Mr Schröder during his election campaign and beyond, thanks in part to a friendship between Peter Mandelson, then Mr Blair's trade minister, and Bodo Hombach, then head of Mr Schröder's chancellery.

More curious still, both the British and the French privately admit that they cannot quite fathom what Mr Schröder is trying to do. Mr Jospin may disguise his modernisation programme behind a promotion of old values. Mr Blair may dress up his practice of sticking to his predecessor's policies as a radical modernising of Britain. But at least there is some coherence of approach. With Mr Schröder, matters are a lot muddier. "It's a bit hard," concedes a top economic adviser to Mr Jospin, "to tell what is the precise strategy of Chancellor Schröder."

Recent months supply just a few examples of the policy slalom the chancellor seems to be embarked upon. In the space of just three months, Mr Schröder has with one hand stepped in to rescue Holzmann, an ailing building firm, in order to save jobs, and squealed—in the end, to no effect—that Vodafone's bid for Mannesmann represented the sort of hostile bid that could upset Germany's "consensus culture". With the other, and thanks to his surprisingly bold finance minister, Hans Eichel, he has pushed an ambitious parcel of budget cuts through parliament, and proposed cuts in taxes on both personal incomes and corporations, which impressed even his detractors.

Ever since he and Mr Blair published their pamphlet, the German chancellor has

gone off the idea of "vision", and seldom talks these days of *die Neue Mitte* (the new middle), which was to have been his version of Mr Blair's Third Way. There is nothing wrong with pragmatism, of course. But Mr Schröder does not seem to know where he wants it to lead.

As a political operator, constantly weighing up chances and risks, he will do as much as his shaky political position, in coalition with the Greens and as the head of a distrustful Social Democratic Party, allows him to—but no more. Insofar as he has reformist convictions, they seem weakly held and date chiefly from his links to business: he sat on the supervisory board of Volkswagen before he was elected chancellor. This instinct can prompt some shrewd decisions, as witness his tax cuts. But sympathising with the needs of business is not necessarily the same as believing in the market, and Mr Schröder's effort to prop up Holzmann showed that very clearly.

Though he has nothing resembling Mr Blair's tightly run Downing Street policy unit, the chancellor has gathered a few energetic people round him to ponder what changes are needed to the high-cost, job-poor, yet productive German economy. Further income tax cuts are in store. So is long-term pension reform. "On the way to a knowledge economy, the German labour market will have to become much more responsive to market forces", concedes Klaus Gretschmann, Mr Schröder's economic adviser, who has worked in America at Johns Hopkins University and the Brookings Institution. "But", he adds, "we'll never have the sort of job structure the US has."

If his grasp of German business's desire for deregulation leads him to consolidate his modest efforts in this area, then Mr Schröder may just help German industry to improve its competitive position. That he was unwilling to exercise his right to fend off Vodafone's acquisition of Mannesmann suggests that he knows he cannot stem the tide of European business in the name of national interest or culture.

But Mr Schröder cannot be counted as a firm believer in free markets. There is no sense, for instance, that he is prepared to bust the industry-wide union bargaining system that so hampers business competitiveness. Moreover, the timing of the Vodafone deal made that particular decision simple for him. He faces an enfeebled opposition: the Christian Democrats have been muted by their financial scandals. The economy is recovering nicely: GDP could grow by up to 3% this year, after years of sluggishness. The party is under his thumb: the Social Democrats overwhelmingly confirmed him as

their leader at a congress in December. And the unions have been temporarily quietened. If he finds himself once more up against the wall, as he was only last autumn, the chancellor might well lose his courage.

The limits to liberalism

If the continental left is embarking on a quiet path of deregulation, a sceptical outsider might well ask, then what on earth are the French up to with their 35-hour week? The short answer is a heroic exercise in political symbolism. Mr Jospin was elected at a time of lacklustre economic growth, low consumer confidence and high unemployment, on a promise to create jobs, and as part of a restive coalition that includes Greens and Communists. By cutting the working week,



the prime minister hoped both to boost confidence and jobs, and to satisfy his left-wing friends.

Although it is debatable whether the jobs created in the French economy since the Socialists took power have had anything to do with the 35-hour week, the policy has at least achieved part of its design. The IMF last year described France's consumer-led economic upturn as "remarkable". Moreover, employers have managed to wring concessions from workers over more flexible working practices in return for the shorter week. In the latest ironic twist, as disillusion sets in among the unions at this unexpected consequence, it could turn out to be the employees who come to regret the policy most keenly.

In short, there is often a startling gap be-

tween rhetoric and reality on Europe's left. This is partly because coalition government, so common in continental Europe, severely restricts the centre-left's ability to drive through new policies with impunity, as Mr Blair is able to do with his massive parliamentary majority in Britain.

Already, partly as an electoral reaction to "left-wing liberalism", some parties are under pressure to move further leftwards. Italy's (ex-Communist) Democrats of the Left, for example, in a governing coalition under Massimo D'Alema, were once seduced by Mr Blair but may now veer further to the left in search of votes. Even Spain's Socialists, who once pioneered a modern variety of the centre-left, have signed a pact with the Communists in an effort to regain power in the general election next month.

Liberalisation by stealth, if that is what is going on, is a perilous political exercise. It requires tremendous skill to ensure that gestures to the left are at once neither economically harmful nor politically empty. It takes patience in carefully constructing consensus, or at least compromise, in a continental political culture of consultation. This is why the French and Germans are so much keener on paying intellectual homage to the Dutch than they are to the British. The Netherlands, with its tight-knit political culture, has managed to use a corporatist model to bring about a happy outcome: a consensus by politicians, employers and unions on wage restraint, part-time work and flexible practices has helped bring about a near-American mix of low unemployment, robust economic growth and low inflation.

All the same, faith in deregulating Europe's social model has its limits. As continentals rightly point out, if what the British have is so great, then why are the Germans and French still richer, on average, than the British? Even after absorbing 17m poor easterners, Germans still feel rich and sense no urgency to tighten their belts. Moreover, in as much as Britain's economic restructuring in the 1980s was a success, it was a qualified one: productivity, for those who do have jobs, is still lower than in France and Germany.

In the end, the choice is a political one: how far should Europe's social model be protected from the "mercilessness" of the American version, given that such protection carries an economic cost? Continental Europe's new leaders on the left may be the merchants of a more modern brand of socialism, but they are proud to call themselves socialists nonetheless. And no amount of preaching by neo-liberals from across the waters will alter that.

EUROPE'S NEW CAPITALISM

Bidding for the future

FRANKFURT, LONDON AND MILAN

Vodafone's hostile, and successful, bid for Mannesmann is the biggest and most visible example of the growth in shareholder power that promises to remake European capitalism. On pages 19-22 we consider how flexibly the continent's parties of the left can respond to this—or any other—economic challenge. Here we examine its effect on Europe's companies and managers

NOBODY likes to throw in the towel, especially when the bell is only moments away. But, as Klaus Esser is aware, it pays to know when you are beaten. Mannesmann's boss fought hard to save his firm from the clutches of Vodafone AirTouch, but once he realised that he was on the ropes, he did the decent thing. Four days before the bruising takeover's deadline of February 7th, Mr Esser bowed to pressure from big shareholders—and, it is said, colleagues—and cut a deal with Chris Gent, his opposite number at Vodafone. In exchange for recommending the British group's hostile bid, worth some \$190 billion, Mr Esser won some valuable concessions for his shareholders. More surprising, he did so in the best American and British tradition: the deal cost him his job.

The world's biggest-ever bid was quite a spectacle, with three months of punch, counter-punch and even the occasional insult. But it was as remarkable for what did not happen as for what did. When Vodafone first launched its bid, few fancied its chances of surmounting all the obstacles that might be put in its way: resistance from Germany's politicians and unions, a legal fog surrounding takeovers, and all manner of dirty defences. Despite protesting at first, however, the politicians stayed out. Mr Esser resisted the urge to roll out the "barbed wire", insisting instead that investors should be the judges of the two companies' arguments. Indeed, both sides carefully listened to the markets during the battle. And at the moment of his defeat, Mr Esser delivered his remarkable verdict: "The shareholder is king."

As Germany's first properly contested takeover, this deal demonstrated a new transparency in the market for corporate control. In the past, hostile bids have mostly involved firms surreptitiously building stakes

in possible targets. Vodafone's open tender obliged the German authorities to clarify the rules of engagement. Now that the legal jungle has been hacked through for the first time, other would-be bidders may set out on the journey. Bankers think Germany will



soon see more bids for firms whose shares, like Mannesmann's, are widely held. Norbert Reis, the head of German investment banking at Credit Suisse First Boston, thinks the deal is "a wake-up call to anyone who thought they could rely on the old system" to see off unwelcome bidders. Anyone who thinks a merger makes commercial sense need no longer be deterred by legal, cultural or political uncertainty.

As Mr Gent begins to wrestle with the task of gaining regulatory approval for the bid and making the two huge telecoms groups into a single \$350-billion entity (see page 68), the rest of the world is wrestling with the question of what his coup means for Germany, and for Europe. One answer is already clear. The bid demonstrates that even the most successful firms can be taken over. Managers might not like that message, and may try to protect themselves by turning their backs on Europe's fast-developing capital markets. But that would consign their firms to the sidelines while Europe's industries restructure, and it could spell disaster in any competition with better-financed rivals.

As much as the Vodafone-Mannesmann deal is a cause of change, it is also a measure of how much Europe has changed already. Hostile takeovers were once taboo. But they have recently succeeded in Italian telecoms and insurance, French banking and energy. Venture capital, leveraged buy-outs and cross-border mergers are booming. Old companies are shrinking and new ones springing up. Europe, which has for years been exporting more capital than it imports, may finally start to attract the investment from foreign financiers that it needs. And as a genuine market for corporate control is forged, managers might at last be held to account for their companies' performance.

Rhenish finished

Not everyone is delighted. German critics charge that the Mannesmann takeover is the first severe blow to their country's time-honoured system of Rhenish capitalism, which is built on consensus and close ties between bankers, industrialists, unions and the state.

In fact, that model has been crumbling for some time. Although corporate restructuring came more slowly to Germany than to America or Britain, German companies have for years been responding to the challenges and opportunities created by deregulation and the spread of competition across borders. A single page of a recent issue of the *Frankfurter Allgemeine Zeitung*, a leading German newspaper, featured articles about the Mannesmann battle, the planned flotation of the state railway, new rules on corporate governance, demergers and cut-throat competition among deal advisers. This sounds remarkably similar to the staple fare on the business pages of

American newspapers.

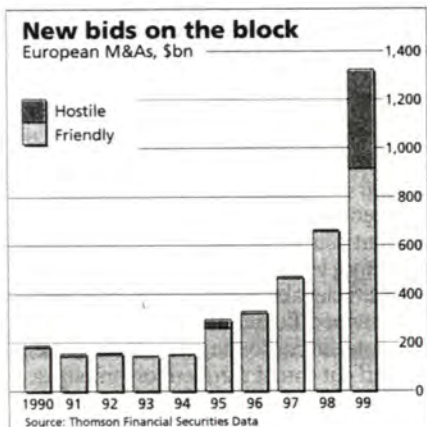
In the mid-1990s the idea of jettisoning peripheral activities to focus on a few core businesses was limited to a handful of pioneering conglomerates, such as Hoechst and Daimler-Benz. Hoechst's overhaul cleared the way for a merger with France's Rhône-Poulenc; Daimler's paved the way for its merger with America's Chrysler in 1998.

Since then, other firms have been refocused in similar ways, and some have completely reinvented themselves. When Vodafone pounced, Mannesmann was preparing to hive off into a separate company the engineering and automotive operations that formed its core until a decade ago (a move that pleased shareholders, but made the firm more vulnerable to takeover). Preussag has achieved a similar trick, moving deftly from old-line businesses such as shipbuilding and mining into package tourism.

Even lost causes are starting to come good. Siemens, a microchips-to-fridges conglomerate, has long been a sleeping giant, active in plenty of industries but a world-beater in only a few. Last year, after several failed attempts to restructure and boost profits, the company unveiled a radical plan to sell or float on the stockmarket businesses that employ a third of its workforce. As a result, its share price has more than tripled.

Behind this trend is a new generation of managers who understand that firms belong to shareholders, not bosses or "society". In the mid-1990s, "shareholder value" became a fashionable objective for big German firms. It was not, however, always pursued with much zeal. Veba, an electrical conglomerate, found favour with investors by promising to put their interests first, but failed to honour its pledges to restructure. Its shares shot up, then quickly fell again.

Such experiences have taught Germany's bosses, not least Veba's Ulrich Hartmann, that paying lip-service to shareholders is not enough. Most now know that a high share price makes acquisitions possible (just look at Vodafone) and that investors will mark down the shares of conglomerates unless, like America's General Electric, they are very well run.



Although many big German firms remain closely held, more of them want to widen their appeal to international shareholders and thus lower their cost of capital. Many are looking to list their shares on America's stockmarkets. Nine of Germany's biggest companies have already done so. Even in the *Mittelstand*, the medium-sized German firms that have been the powerhouse of the country's post-war success, many managers have begun to set themselves targets for return on equity.

Angered by cross-shareholdings

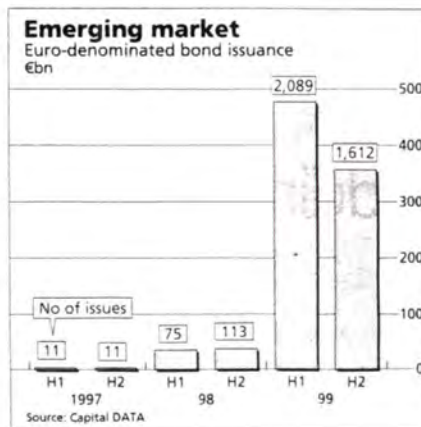
Underpinning these new attitudes is a fundamental shift in relations between Germany's companies and its banks. In Germany, as in much of Europe, commercial banks dominated the post-war financial landscape, lending large sums to corporate clients and often taking stakes in them, especially when they had trouble servicing their debts. This spun a web with such financial firms as Deutsche Bank and Allianz, an insurer, at the centre. Financial institutions were more interested in guarding their privileged position as a firm's banker or insurer than in acting as demanding shareholders.

No longer. Banks are pulling out of corporate lending, which offers paltry returns. They are also treating industrial stakes more like other investments. Deutsche Bank, which owns a €30 billion (\$29 billion) slice of corporate Germany, set up a special unit in 1998 to manage its stakes as a fund manager would. Axel Pfeil, who runs the unit, says he wants to "make bosses sweat". Allianz, Europe's largest insurer, has brought in Paul Achleitner, a former Goldman Sachs executive, to shake up its even larger holdings.

At the same time as the banks are becoming more active as shareholders, ordinary Germans are themselves piling into shares: in 1990-94, equity holdings averaged 10% of household disposable income. By the start of last year the figure had risen to 22%, according to Salomon Smith Barney (although Germany still lags far behind Britain, at 82%).

Thanks largely to the success of the Neuer Markt, the small-company stockmarket where both young technology firms and old family-owned businesses have flocked to list their shares, the number and value of initial public offerings are doubling annually. Venture capitalists have flocked in too, now that they can float their investments more easily. American-style share options have been legal in Germany only since 1998, but are fast becoming acceptable. Several big firms, including DaimlerChrysler, Siemens and SAP, a software firm, have set up schemes for top and middle managers. Many of the companies on the Neuer Markt have schemes for their entire workforce.

The arrival of shareholder capitalism has set the stage for more deals. But the action will be slow until a crucial piece of legislation has been repealed. Just before Christmas,



Germany's government proposed eliminating the capital-gains tax on sales of industrial stakes. If, as looks likely, the reform becomes law, banks, insurers and companies will be free to sell blocks of shares without paying a 50-60% tax on the difference between their low book value and high market value.

If so, the €250 billion-worth of large cross-shareholdings, which have in the past protected German firms from predators, could become their main vulnerability. Banks and firms seeking to become more efficient could redeploy capital from corporate investments to their core businesses by selling their minority stakes in other companies. Germany's nascent shareholder culture would benefit as blocks of shares were spread among many new owners. Passive shareholders would give way to active investors who seek out undervalued assets and expect a capital gain. German and foreign investors would jostle for stakes that could provide stepping stones to a bid.

The great virtue of this will be to keep managers on their toes. For every Mannesmann, whose shares are spread across many institutional investors, there are dozens of companies with at least one protective minority investor. It is no coincidence that such firms include MAN, Deutz, Linde, Metallgesellschaft, Continental, Holzmann, and other industrial companies whose shares have all lagged behind Germany's better performers. A company such as MAN, an engineering conglomerate, has everything to fear. With a third of its shares in the hands of Allianz, Munich Re and Commerzbank, two insurance firms and a bank, MAN has been able to delay restructuring. If its core shareholders were to sell their stakes, MAN would soon hear the knock on the door.

Europe, awake

Indeed, underperforming managers across Europe have reason to worry. The continent is caught in a merger boom, clocking up \$1.2 trillion of deals last year, a rise of almost 50% over 1998. Relative to the value of European stockmarkets, deals in Europe exceeded those in America for the first time in years.

Companies are increasingly looking out-

side their home markets. Does Europe's single market and single-currency zone need twice as many car makers and ten times as many tractor makers as America? Executives think not. From 1990 to 1998, cross-border deals accounted for less than a third of European mergers by volume. Last year, they accounted for almost half the total.

This merger boom has two other eye-catching features. One is technology deals. Measured by value, last year's total was greater than the rest of the 1990s combined, according to Broadview International, an investment bank. The other feature is hostility. Last year, unsolicited bids counted for a third of the total by value, a huge rise. That level of activity is likely to persist, even without another bid on the scale of Vodafone's for Mannesmann.

Fear is as much of a motive as opportunity. Last week Compart, a holding company, bid €3.5 billion for the shares that it does not already own in Montedison, an Italian conglomerate. Compart's backers, which include Mediobanca, an Italian investment bank, feared that if they did not tidy up Montedison's financial structure themselves, someone else would do it for them.

In other industries, deregulation and globalisation are promoting deals that would otherwise have happened years ago. Consider energy. Having dabbled in chemicals, metals, logistics and telecoms, all three of Germany's main listed electrical utilities, Veba, Viag and rwe, are now concentrating on power generation in the hope that they can take advantage of deregulation to expand across Europe. Until recently, the oil and gas industry was dominated by national champions. This week it emerged that Eni of Italy and Repsol-YPF of Spain are talking about an alliance. Last month, Eni bought a strategic stake in GALP, a Portuguese energy group.

Across all industries, the euro is at work. The single currency has created a liquid market in European corporate bonds. Although this still pales beside America's corporate-bond market, it grew by 235% last year, even though global issuance fell. European firms are increasingly issuing euro-denominated bonds to refinance expensive bank debt, their traditional source of finance, and to raise money for takeovers. Olivetti's highly leveraged \$58-billion hostile takeover of Telecom Italia last year would have been impossible to finance only a couple of years ago.

Armed with a proper prospectus, even family firms can now raise large sums in international bond markets. This week, Mame et Champagne, a French champagne maker planning a stockmarket listing, said that it is

replacing bank debt with €400m in bonds, secured against its champagne stocks. Last year Camuzzi, an Italian gas-distribution firm, raised €200m via a syndicate of investment banks. Investors in the deal were a thoroughly international lot, reassured in part by the bonds' credit rating issued by Standard & Poor's.

As markets have flowered, so has corporate governance. Activist institutional shareholders are still rare in Germany, not least because the country lacks a properly funded pension system. However, some of the bigger fund managers, such as DWS and Union Investment, have growing influence over company bosses.

When managers know that they may have to call on the capital markets to finance

parted after his firm's takeover by TotalFina.

Aware that investors are now looking over their shoulders, managers are trying to communicate with them. ILTE, an Italian printing firm that is controlled by the family-owned Farina group, recently won a prize for its annual report. Firms that list on Germany's Neuer Markt must choose between accepted American or international accounting principles and must file quarterly accounts in German and English—an explicit acknowledgment that the market for their shares is international. Listed British firms have long been used to the "roadshow" needed to sustain a diversified shareholder base. More continental European firms are also now visiting large institutional investors to encourage them to buy (or hold) their shares.

One more push

Despite all this, Europe has a long way to go. By most measures, its firms remain laggards. Profit margins may be the highest since 1972, but they are still only half those of American companies. Owners cling to power at the expense, of minority shareholders. One in five of Germany's 100 biggest companies—typically those with a history of family ownership—still issue preferred stock with special voting rights. Furthermore, European restructuring is at an early stage, with cost-cutting a priority. Having already cut costs, American firms such as America Online and Time Warner are by contrast merging to expand revenues or bring together convergent industries.

In some countries, structural rigidities are delaying progress. The failure to reform pensions affects national budgets, and also stunts the development of institutional shareholders. Radical restructuring and deregulation are threatened by union power and rigid labour markets. Vodafone's bid was for the high-tech part of Mannesmann, in which the unions play only a small role. The bid might never have been made had the target included the engineering division.

Almost as worrying as labour protection is economic nationalism. In France, politicians are quick to decry foreign "invaders". Whereas French companies completed \$126-billion worth of deals outside France last year, foreigners completed deals worth only \$36 billion in France, mostly of smaller companies that would not arouse public ire.

Such barriers look set to fall. The revolution in European business has just begun. There may be hesitations and setbacks along the way, but the direction seems clear: a capitalism more transparent, more efficient and, yes, redder in tooth and claw.



bids—or fend them off—it can have a sobering effect on their behaviour. Rather than face a shareholder revolt, Olivetti abandoned a restructuring of Telecom Italia last year that would have cost minority shareholders a small fortune. Last month, a group of German business leaders, including Veba's Mr Hartmann, began to draft a set of corporate standards for listed companies. Their proposals include timely publication of share-sensitive information, sanctions against ineffective supervisory boards and an overhaul of top managers' pay.

In France last month, two business associations called for managers' pay packets to be made public. This followed a fuss last year over an undisclosed pay-out to Philippe Jaffré, the boss of Elf Aquitaine, who de-

vestment bank, been "rudderless".

Although Wal-Mart operates in nine countries outside the United States, it is one of the top three retailers in only three—neighbouring Canada and Mexico, and now Britain. Wal-Mart's forays elsewhere in Latin America have been unhappy and Carrefour and Ahold have beaten the firm to some good acquisitions there. In China, too, Wal-Mart trails Carrefour. In Europe, now the focus of consolidation, it is behind rivals in the Mediterranean countries and in the "golden triangle" of Germany, France and Britain, the biggest retail markets. Wal-Mart is tiny in Germany and absent in France.

Non-American sales still account for only 13% of total revenues. The international division's 6% return on total assets lags far behind the astonishing 39% in America. Without market dominance, these returns will remain weak, because the firm's admired supply-chain systems will lack scale and global sourcing will offer few efficiencies.

One explanation for the difference is that, to the firm's top executives at group headquarters in rural Arkansas, Wal-Mart International has always been a poor relation. Bobby Martin, the international division's previous head, tried to use the position as a staging-post to becoming chief executive and did little to unite a loose federation of assets, says George Strachan, an analyst at Goldman Sachs.

Since Mr Martin resigned, after missing the top job in February 1999, the division's number two and the head of the Mexican operation have also left. Wal-Mart has appointed John Menzer, a finance man, to take Mr Martin's place, but also elevated Allan Leighton, ASDA's boss, to the new position as head of Europe. This lack of management depth coincides, says Mr Radford, with Wal-Mart "trying to manage a complete U-turn on international strategy from piecemeal organic growth to aggressive acquisition."



Wal-Mart weddings come cheap

The difficulty for Mr Leighton and his new masters is that Wal-Mart's success in North America will be hard to replicate in Europe. Back home, Wal-Mart launched its "every day low pricing" in the context of massive "Supercenters", a non-unionised workforce and unrivalled supply-chain systems built up over years. In Canada and America, it has taken market share from unfocused department stores and local grocers.

In Europe, by contrast, Wal-Mart faces powerful unions; strong, entrenched competitors; and regulatory constraints on what it can sell, and where and when it can sell it. In Germany, the continent's largest market, Wal-Mart's acquisition of Wertkauf in 1997 for an expensive 100% of sales, and InterSpar in 1998, has brought it 95 stores across a bewildering range of formats. Yet that gave Wal-Mart only 4% of a German market that is already highly concentrated. Nor is low pricing a new idea to shoppers. Some 30% of the German market is supplied by deep discounters, led by Aldi.

Moreover, the idea of global sourcing,

which Wal-Mart sees as a thread to unify its international operations, as well as a huge opportunity to cut costs, will take a long time to realise. Most products on supermarket shelves are still sourced locally. The group will therefore need first to achieve scale in local and then regional markets.

The obvious solution is for Wal-Mart to buy itself critical mass—and soon, while its American growth continues and it is richer than its rivals. Ironically, though Wal-Mart's international strength is exaggerated, its fear-some reputation is driving up valuations of targets and causing them to erect defences. In France, which Wal-Mart will surely try to enter, retailers trade on a fancy 30 times earnings. Those such as Auchan and Casino that are privately controlled will not sell themselves cheaply. Meanwhile, Metro may try to merge with Carrefour or Britain's Kingfisher.

Wal-Mart therefore has a limited chance to acquire the European scale it needs. When it moves, it will be as much out of weakness as out of strength—though that may, admittedly, be of little comfort to its victims.

Clinical trials in India Patient capital

DELHI

India promises to become a world centre for testing new medicines

INVESTORS seeking opportunities in developing countries count a large healthy population as a plus. If they specialise in testing drugs and other medical therapies, the lure may be a lot of the not-so-healthy. India has such people in industrial quantities, and contract-research organisations (CROs), which undertake clinical trials and other services for pharmaceutical companies, are beginning to notice. Their activities are one of the odder ways in which India is making more of a mark in services than it ever has in the export of manufactured goods.

Quintiles Transnational, a big CRO based in North Carolina, is one pioneer. Its Indian joint venture began three years ago and now has a staff of 40 and a score of customers, mainly American and European pharmaceutical and biotech firms. Covance, a CRO from New Jersey, has started clinical trials in India and may expand its operations.

Indian companies have also spotted an opportunity. Nicholas Piramal, a pharmaceutical company in Mumbai, recently hired a chief executive for a new clinical-trials business that it hopes will have revenues of 100m-120m Indian rupees (\$2.3m-2.8m) within three years. Max India, which among other activities makes bulk pharmaceuticals, has signed a deal with an affiliate of Harvard Medical School to conduct clinical trials in India and in other developing countries. The potential return on investment in

India's infrastructure for conducting clinical trials "is tremendous," says Renu Gupta, Covance's vice-president of global safety and medical therapeutics.

The advantages look so obvious it seems a wonder that more companies have not entered the market sooner. Discovering and developing a new drug is expensive; the industry claims to spend as much as \$500m to bring a new molecule to market. A big chunk, perhaps a third of the total, goes towards clinical trials. Much of that is spent just before seeking regulatory approval on "phase-three" trials that use lots of human subjects. Since the life of a patent begins to ebb away from the moment it is filed, near the start of the entire process, each day saved on testing can bring millions of dollars in extra revenues to the patent's owners. A few years ago, the biggest drug-consuming countries, the United States, Japan and the European Union, agreed on common standards for running clinical trials. In principle, America's Food and Drug Administration should now accept data from a trial anywhere in the world that meets those standards.

Clinical trials in India ought to be cheaper and faster than those in developed markets. CROs can hire researchers, nurses and computer staff at less than a third of western wages. India's billion potential guinea-pigs suffer not just from tropical and poor-country diseases such as malaria and

tuberculosis, but increasingly from ailments such as cancer, heart disease and AIDS, which trouble rich countries. Though Indians are spread out and mainly live in rural areas, people with serious ailments flock to advanced hospitals in cities, which makes them accessible. Ferzaan Engineer, the boss of Quintiles's venture, says that for some diseases this can dramatically cut the time needed to bring new therapies to market.

Until now, though, multinational drug companies and the CROs that work for them have preferred to test therapies closer to home. In part this is because large trials are also marketing efforts: doctors who test the drugs are more likely to prescribe them, and drug firms prefer that their patients be rich. When pharmaceutical firms have looked further afield, it has been to countries such as Brazil and Turkey, which offer more-sophisticated health-care facilities and higher incomes than India. Even China has attracted more interest, despite India's English-speaking doctors and technicians.

But India itself shares some of the blame for this neglect. Until recently, Indian clinical trials mostly tested knock-off versions of western products for the local market. India thus lacks the institutions, know-how and procedures that make internationally acceptable trials possible. The country's excellent doctors are said to have an old-fashioned regard for their own authority, which can interfere with giving patients the sort of information they need to participate in trials. Patients may disappear to their villages in mid-trial. Few health workers know



how to keep records as fastidiously as international trials demand. The trials infrastructure, says Dr Gupta, is "embryonic".

Firms also worry about bureaucracy. Indian regulations make it difficult to transport biological samples; the process of getting government approval for a trial can take up to two years, eliminating the head-start that pharmaceutical firms hope to get from working in India. Swati Piramal, Nicholas Piramal's chief science officer, says regulatory delays are "the single biggest hurdle". Just as bad, India does not yet fully protect pharmaceutical patents, which makes drug firms understandably nervous.

Then there is the ticklish issue of multinationals testing drugs in a poor country. Many trial participants are too unlettered to understand what is going on. Dr Arun Bal, head of the Association for Consumers Action on Safety and Health in Mumbai, alleges that subjects are often asked to sign consent forms in English and that women are pres-

sured into signing by their families. Many hospitals lack independent ethics committees, which are supposed to look after the welfare of patients participating in trials. Few Indians will be able to afford the drugs once they come to market, especially after patent rules are tightened up.

Yet, properly monitored, international trials ought to improve India's health-care standards. Quintiles insists that it has surmounted Indian hurdles without compromising quality or ethics. It conducts trials in only a few of the best hospitals, and adds new hospitals only as they meet international standards.

Mr Engineer claims that the company has helped upgrade ethics committees. Quintiles's answer to patients' failing to finish long-term trials is to set up a network of social workers to follow them after they leave the hospital.

Gradually, it will take less courage to venture into India with a test tube. Now that re-engineering foreign drugs is becoming illegal, local pharmaceutical companies are starting to invent their own. Most will test them at home, building local know-how. India's medical establishment has started what looks like a crash ethical-fitness programme: the main research watchdog in Delhi has drafted new guidelines; in Mumbai an independent ethics committee has been set up for hospitals that lack them. The World Health Organisation has recently established a forum on clinical trials in Asian countries. With some misgivings, Indians are getting ready to do what the doctor ordered.

Indian privatisation takes wings

DELHI

IT WAS only two years ago that India's finance minister dared to use the word "privatisation" in public. This week, though, the government announced the sale of a 51% stake in that most potent of national symbols, an airline. Yet it is not clear that the government really means to let go.

The decision, by the new "cabinet committee on disinvestment", applies to Indian Airlines, which flies within India and to nearby countries. The airline badly needs private management and fresh capital. It has only recently returned to profit, after several years of losses. Although it expects to earn about \$9m before tax in the year to March 2000, it has an ageing fleet, and cannot afford to buy new aircraft. Its workforce is too big: 350 staff serve one aircraft, compared with 200 or fewer for other carriers. Like other state-owned enter-

prises, it is beholden to its unions.

The airline's privatisation still faces hurdles. Various ministries, which are normally eager to hold on to their property, are to have a hand in selling the majority stake. A "strategic partner", which would manage the airline, will have a 26% stake. The remaining 25% is to be sold to institutions, employees and the public. That is better than an earlier proposal to sell the whole stake to employees and investors with a purely financial interest. But perversely, under current Indian law, the strategic partner cannot be a foreign airline, and neither of India's two main private airlines seems interested. The government has said that the strategic buyer will have a free hand in running Indian Airlines. It may get cold feet if the airline's 22,000 employees fight a deal that they are bound to see as a

threat to their perks and numbers.

Still, the idea of India's largest airline passing into private hands encourages recent cautious optimism about the country's restructuring. The committee that put Indian Airlines on the block at the same time sold Modern Foods, a bakery, to Hindustan Lever, part of Unilever, a big European consumer-goods company. The transfer of this 74% stake is the first true privatisation by India's central government.

There has been progress elsewhere in India too. This week, the government of Uttar Pradesh, India's largest state, settled a strike by some 100,000 electricity workers, who opposed plans to restructure the utility and stem its losses. The deficits of the state electricity boards and their inability to deliver reliable power are one of the economy's biggest problems. The government's agreement with the workers will not jeopardise its restructuring plans. These are hesitant steps, certainly. But at least they point in the right direction.

Chicago Tribune

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WASHINGTON, D.C. 20005

THE PRESIDENT HAS SEEN

3-13-00

TELEPHONE
202/637-2030

February 18, 2000

Dear Mr. President:

Since you expressed such interest in the human genome project during our interview, I thought I would pass along a Pulitzer Prize-winning series the Tribune published on the subject.

Thank you again for taking the time to meet with us.

Naftali Bendavid

Naftali Bendavid

✓
Copied
Podesta
Reed
Jennings
Lane

cc: New article to
JP/Boren/CTanning

Sent to Head Line

Fgt-

How close are we to
on the security project?
What's happened to it?
Isn't there a way to fairly
share benefits of indigenous
people - we need more, not
less, of this research

BZ

Chicago Tribune

Sunday, April 27, 1997

Controversial genetic quest is unlocking secrets of the human rainbow

Basically, we are all the same

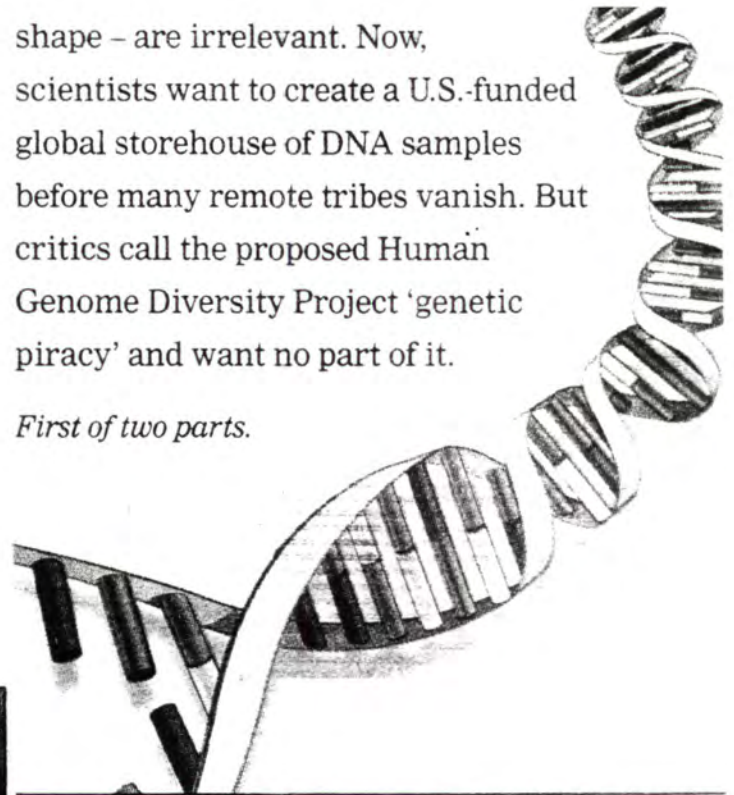
For years, researchers have been collecting DNA samples from peoples around the world to find out how closely human beings are related. Their conclusion? All of us are amazingly similar, and traits that determine cultural notions of 'race' – skin color, eye

shape – are irrelevant. Now, scientists want to create a U.S.-funded global storehouse of DNA samples before many remote tribes vanish. But critics call the proposed Human Genome Diversity Project 'genetic piracy' and want no part of it.

First of two parts.



National
Geographic photo





AP photo



Tribune photo by Ernie Cox

By Paul Salopek
TRIBUNE STAFF WRITER

UNIVERSITY PARK, Pa.—In a beat-up refrigerator humming away in his laboratory storeroom, Ken Weiss is storing vials of human blood: by grim default, the largest gene pool left of a tribe of people inexorably vanishing from the Earth.

The insides of the freezer, not much different from ones used by many people to store groceries, hold the DNA of 12,000 Yanomamo Indians, a fierce Amazonian tribe that lives in Brazil near the watershed of the Orinoco River. The blood samples were collected by anthropologists a generation ago, and there are now more vials in the nondescript room

Research indicates people of appearances as diverse as a Tutsi woman (above), a Yanomamo Indian (far left) and an Amish woman and child share at least 99.99 percent of their genetic makeup.

at Pennsylvania State University where Weiss is a researcher than there are Yanomamos still alive.

Like many remote populations, the Yanomamo have been ravaged by Western diseases and, in this case, the shotguns of invading gold prospectors. Their rain forest home is scarred by airstrips and mines. Of a population numbering in the tens of thousands at the turn of the century, fewer than 10,000 remain.

So it is that Weiss' storehouse has become one obscure if vivid example of a genetic quest so vast, controversial and unprecedented that even those who know of its existence can't agree on its principal goal.

It is the Human Genome Diversity Project, a title that has proved confusing because it is so close to the more famous Human Genome Project that is mapping the entire code of human DNA.

By contrast, the Human Genome Diversity Project, over five years and at a cost of \$25 million, calls on geneticists at universities worldwide to collect 10,000 blood samples from at least 400 ethnic groups ranging from Afghans to Apaches, from Basques to African Bushmen.

In short, it is the first genetic survey of humankind, a painstaking portrait of how and why members of the human species

SEE LEGACY, PAGE 10

Humanity's rich legacy

Blood samples collected a generation ago preserve the genes of Brazil's Yanomamo, a fierce Amazonian people now largely vanished. Mapping the genetic bonanza, part of a trove gathered from ethnic groups around the world, could help science in the treatment of ailments ranging from Alzheimer's disease to diabetes.



CONTINUED FROM PAGE 1
duplicate or differ from one another.

Weiss is the North American coordinator of the project, which is awaiting approval by the National Academy of Sciences, a step that would open it to government funding and increase its public profile. If approved as expected this summer, the project would serve as an official institutional umbrella for research that has been going on unofficially for decades by a scattered group of scientists and commercial researchers.

Which human tissue samples will come under the project's aegis—those of the Yanomamo included—is just one of the complicated ethical and logistical questions that will have to be resolved.

To some, the project is a scramble to salvage the fading biodiversity of our species—a genetic inheritance that shrinks with the demise of every tribe such as the Yanomamo. Moreover, by collecting and comparing the DNA from the far-flung populations, scientists say they will at last be able to sketch a global family tree and “read” the tale of human evolution, how our ancestors populated the Earth.

Still others call the diversity project a medical bonanza that, by exploring why some groups resist certain diseases, might lead to breakthroughs in the treatment of ailments ranging from Alzheimer's disease to diabetes.

But it is the project's revelations about race that promise to rattle our perceptions of identity the most and ignite debate in classrooms, taverns and homes across the world.

Indeed, the father of the project, Luigi Luca Cavalli-Sforza, an eminent Stanford University professor who has slogged the globe collecting blood samples from Italian villages to sweltering rain forests, has received an incongruous trickle of hate mail:

How dare Cavalli-Sforza suggest, the obscenity-spattered missives read, that our notions of race are irrelevant and that groups such as blacks and whites—or anybody else for that matter—are basically the same.

“Outward appearances tell almost nothing about our roots—the shapes of our noses, the color of our skins change with climate,” said Cavalli-Sforza, a reserved, silver-haired academic with an elegant Mediterranean accent, impatiently waving off the racist attacks. “It's our genes

that tell our story best.”

Meanwhile, a vocal, angry minority see the project as something altogether different: a cultural ripoff or at least a callous abuse of aboriginal rights.

As the debate escalates, the vast store of human tissue that Cavalli-Sforza and others have collected will be carefully cultured in labs so that the cells live on for decades—a biotech process called “immortalization.” In a final, Dr. Strangelovian twist, the cell lines—a cross-section of humanity kept alive in petri dishes—would be stored in genetic repositories around the world.

Some of the preliminary findings have proved controversial:

■ After analyzing thousands of DNA samples collected in smaller studies, experts are amazed at the genetic unity that binds our diverse, polyglot species. Any two people, regardless of geography or ethnicity, share at least 99.99 percent of their genetic makeups—a deep sameness that makes a mockery of racist ideologies such as Nazism.

■ Paradoxically, the minuscule .01 percent of our genome that *does* make people different doesn't shake out along visible racial lines. Instead, some 85 percent of human genetic diversity occurs within ethnic groups, not between them. The traits that so polarize our culture—the shade of our skin, the shape of an eye, hair texture—actually hide a dazzling and unexpected molecular tapestry that reflects our true origins. The European gene pool, for example, carries the story of where its members came from—and where they later migrated. It is a swirl of 35 percent African genes and 65 percent Asian genes.

■ In a development that enthralls

medical researchers, a global genetic survey will tap the "healthy genes" locked away in the nuclei of different ethnic groups. With the marvels of genetic medicine, disease resistance unique to one population might soon be shared by all.

"This project is going to infuriate bigots," declared Kenneth Kidd, a project planner at Yale University. "It peels away our cultural bias with molecular data."

Yet if experts such as Kidd and Cavalli-Sforza hold up the diversity project as a humanist's dream come true, there are doubters—and not all of them are irrational hatemongers.

Some anthropologists think the project has been oversold and say that the black box of human identity cannot be unlocked with DNA alone.

Ethicists, meanwhile, worry that in a decade obsessed with the hot-button issues of genes and race, the results of the survey, no matter how high-minded, will inevitably stoke the fires of intolerance. Studies showing that some Asiatic populations lack a so-called novelty-seeking gene has been seized upon by racists to explain why Asians supposedly favor predictable, authoritarian regimes over the free-wheeling quirkiness of democracy.

Others fear that the project's treasure-trove of genetic data could fall into the hands of unscrupulous governments bent on developing racially targeted "genetic bombs."

As the gigantic scale of the survey begins to lumber into the public eye, a growing number of aboriginal groups, who are the main if not exclusive target of the study, see the project as simply another form of high-tech exploitation—scientists arrogantly using tribes as guinea pigs while offering nothing tangible in return.

"It's biocolonialism, plain and simple," said Jeanette Armstrong, a member of Canada's Okanagan Nation. "First, they take our land, then they take our culture and now they want our genes."

Saving the markers

By all accounts, that certainly wasn't the idea back in 1991 when a handful of the brightest geneticists dreamed up an almost biblical plan to safeguard, at least in test tubes, the fading kaleidoscope of human diversity.

Writing an impassioned open letter in the journal *Genomics*, the researchers warned that if the story of our species is embedded within the genes of living populations, then "the gate to preserve these clues is closing rapidly."

Why?

In essence, scientists can't reconstruct our family tree if there are no branches: The small, isolated populations that make the best subjects for diversity research are slowly disappearing.

Five centuries of European colonization, anthropologists say, have snuffed out countless small ethnic groups through disease, intermarriage and outright genocide.

Today, mass culture is rapidly steamrolling much of the diversity that remains—most of it clustered within the DNA of tribal minorities whose gene pools offer clear glimpses back to Paleolithic times. With the lure of pop culture and vast migrations to urban melting pots, the subtle palette of humanity is being muddled by assimilation—and with it the picture of our past.

A thumbnail measure of this homogenizing trend is the death of the world's languages, which are loosely associated with genetic distinctness. By one estimate, fully 90 percent of the 5,000 tongues that are still used—most of them spoken by tribal peoples—will vanish within the next century.

That, scientists hope, is where the diversity project comes in.

"The idea is to have colleagues on each continent sample the populations that wish to cooperate and then pool the data globally," said Cavalli-Sforza, a principal author of the 1991 call to arms and one of the intellectual fathers of the global gene survey. "Nobody gets rich off of this, nobody oppresses anyone. It's a shared, open resource for all humanity."

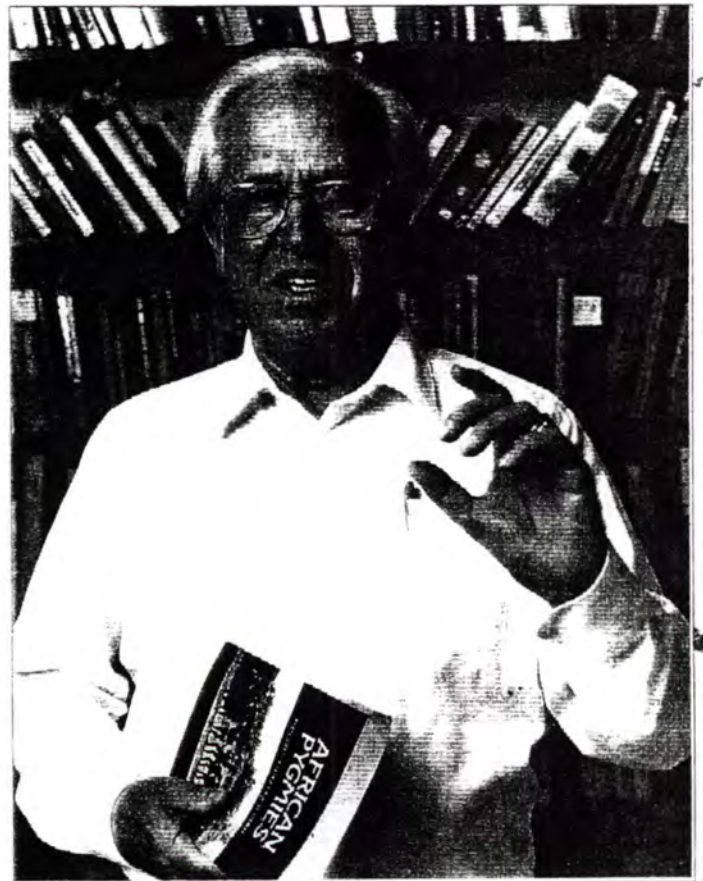
How, exactly, would Cavalli-Sforza's DNA survey offer a window into history?

Inside each one of our cells lie coiled the 3 billion nucleotides—or molecular rungs—that make up the spiral ladder of DNA, the blueprint of life. During the course of evolution, random and mostly harmless flaws called mutations accumulate in the ladder, and it is this record of glitches that allows scientists to track our ancestry—much as a unique surname can be traced through time by genealogists.

First, geneticists identify the most stable of these mutations, called gene markers, in populations around the world. Archeological evidence is then marshaled to date the ancestry of the peoples who carry those markers. By merging both sets of data, scientists can bring to light unexpected connections between peoples.

DNA markers associated with Middle Eastern peoples, for example, have been discovered in a clear south-to-north gradient across Europe. They are the faint molecular footprints, experts say, of prehistoric farmers who brought agriculture to Europe from Asia Minor thousands of years ago—genetic echoes that linger in the DNA of French businessmen and German housewives.

Mapping markers, though, tells only half of the human story. Scientists also are working to perfect "genetic clocks" that measure the mutation rates in DNA to time when our ancestors last diverged and



"The idea is to have colleagues on each continent sample the populations that wish to cooperate and then pool the data. ... Outward appearances tell almost nothing about our roots. ... It's our genes that tell our story best."

—Luigi Luca Cavalli-Sforza, diversity project founder

went their separate ways.

With both of these tools, the entire pageant of human history lies waiting to be read in every drop of blood or in the root of a hair or in a scraping of cells from a cheek.

Here is a sampler of some recent "genography" discoveries:

■ A comparison of gene markers worldwide supports the Out of Africa theory of human evolution, which holds that modern humans first migrated out of Africa barely 100,000 years ago—an evolutionary blink of the eye—during which most racial features emerged. Because Africans' genetic roots penetrate at least another 100,000 years deeper into the soil of Africa, they have had more time to diverge genetically than other populations. Far from being a monolithic race, Africans are the most genetically varied peoples.

■ The DNA of Native Americans, whose genes reveal hidden links with an ancient homeland somewhere near Mongolia, indicates that the famed Bering Straits crossing occurred between 15,000 and 30,000 years ago, far earlier than archaeological evidence suggests. DNA testing on both sides of the waterway also hints at reverse migrations of Native Americans back into Siberia, findings supported by linguistics.

■ In Europe, DNA tells us that the Basques are the oldest residents of that continent, with a lineage that stretches back 30,000 years to Cro-Magnon man. At the other end of the time line, Finns appear to be among the youngest Europeans: Their genes traveled north with a small band of Middle Eastern people as recently as 4,000 years ago. Settling in the forests of sun-deprived Scandinavia, they quickly lost their ancestors' coppery complexions.

■ Genetic surveys in Japan debunk the widely held notion that

the Japanese are a single, unvarying ethnic group. Markers on the male Y chromosome show that the island-nation's populace are an admixture of two ancient tribal peoples whose homelands lie near Mongolia and the Korean Peninsula.

While these discoveries have intriguing implications for people fascinated with roots, they can still smack of musty academia—the stuff of faculty lounge debates.

But the awesome power of DNA technology is changing that, thrusting even the dimmest episodes of history into the realm of daily life, making them immediate and personal as never before.

One example is Michael Hammer, a young geneticist at the University of Arizona. He made headlines recently by showing that the DNA of *Cohanim*—the Jewish priesthood whose duties are passed strictly from father to son—is indeed genetically distinct from the rest of the Jewish population.

Hammer's discovery has sent shivers of unease through some ultra-orthodox Jewish communities. What if—priests are asking—we don't carry *Cohanim* gene markers?

Even more remarkably, Hammer hopes with additional sampling to track the entire lineage back 3,300 years to Aaron, the brother of Moses who founded the priestly caste.

"A decade ago, we started with maybe 100 good genetic markers, but now we have thousands," said Hammer, a soft-spoken researcher who is as casual in black jeans and silver earring as Cavalli-Sforza is aristocratic. "The picture of who we are becomes clearer all the time."

Dreamily, Hammer ticked off some other major quests of diversity research: reconstructing the human diasporas that settled Polynesia,

plumbing the roots of India's caste populations and digging back through the double helix to find the ancient homelands of African-Americans.

Noting that scores of molecular sleuths are turning up markers faster than journals can publish them, Hammer added puckishly, "We're going to have some amazing stories to tell."

Actually, with cutting-edge technology that automatically replicates and sequences vast chunks of DNA at speeds unimaginable even five years ago, the number of markers waiting to be discovered could theoretically mushroom into the millions.

The upshot?

With that astonishing degree of resolution, any two people—Swede, Tibetan, Navajo or Tutsi—could trace their lineages back to a shared ancestor, whether 5,000 or 50,000 years ago.

Tribal uproar

Unfortunately, it is exactly such genealogical wizardry that has sucked the diversity project—and, by extension, all genetic surveying—into a widening maelstrom of political and religious controversy.

The almost magical ability of science to peek through the keyhole of history, potentially debunking long-cherished beliefs about heritage and identity, is an unsettling prospect for even the most worldly of people. But for many of the tribes that are being asked to participate in the massive study, the idea can seem soul killing.

"I don't need somebody to look at my genes. I have my own origin stories," said Nilo Cayuqueo, a Mapuche Indian from Argentina and the director of the Abya Yala



"I don't need somebody to look at my genes [to tell me where I came from] I have my own origin stories. ...Who are they to tell us where we came from? Don't they understand that's sacrilegious."

—Nilo Cayuqueo, director of Abya Yala Fund,
an indigenous organization that opposes the diversity project.

Fund, an indigenous organization in Oakland that opposes the diversity project on philosophical grounds.

A member of Argentina's small remnant of 50,000 Indians, Cayuqueo said that gene hunters had already marched through the Mapuche's dusty cinder block villages, drawing blood that ended up at U.S. universities. He angrily denounced them, despite their best intentions, as the latest in a long line of outsiders coming to chip away at eroded native cultures and cosmologies.

"Imagine the arrogance of coming in and giving tribal people a machete or 15 bucks for their blood, then telling them, 'Well, you're from so-and-so place 1,000 years ago,' " he said. "Who are they to tell us where we came from? Don't they understand that's sacrilegious?"

The architects of the diversity project insist that the global survey would never happen that way.

"You don't just parachute in with some syringes," said John Moore, a University of Florida anthropologist who is helping design the sampling effort. "You invest time with people, you build relationships, you respect local beliefs."

Moore says that new ethics protocols would require scientists to explain why blood is being collected and obtain letters of informed consent. Contracts also would guarantee that the ownership of the DNA remains with the donors.

"What people don't realize is that this research will continue with or without the project," he said. "With the project, we can address sensitive issues in an organized way. Without it, the scattershot collecting goes on."

Moore is betting—like most scientists—that officials at the National Academy of Sciences will agree, thus opening the door to funding from agencies such as the National Science Foundation and the National Institutes of Health.

Still, the huge size of the project and the fact that it was planned essentially without public input has alienated many of the very people whose DNA it hopes to preserve.

In 1992 when project anthropologists hammered out a tentative list of populations to be sampled—a boggling roster of minority cultures that included Sherpas, Apaches, Tuaregs and the last six members of Chile's Ona Indians among 700 other groups—the response from the international indigenous community was at first disbelief and then outrage.

The World Council of Indigenous Peoples promptly called on its members to boycott the DNA survey, accusing the scientists of being more interested in rescuing exotic genes than people. The notion of warehousing humanity in gene banks, they said, was ghoulish. The \$2,500 cost of maintaining each of the 10,000 cell lines, they added, could be much better spent on health clinics or schools in tribal areas.

Since then, in fiery manifestos and Internet postings, native activists from the Philippines to Peru have jumped on the bandwag-

on, pounding the project as "immoral," "illegal," and, in a supreme irony for diversity scientists, "racist."

"The [project scientists] might be big brains, but when it comes to public relations, they're clueless," said Craig Benjamin of Cultural Survival-Canada, a native-rights group monitoring the stormy debate. "A lot of tribal groups were shocked to see their names on that list because absolutely nobody had been consulted."

Of all the hostility stirred up by the project, nothing stings researchers more than the dire rumors that their data could somehow be harnessed for weapons research.

Though scientifically improbable, the allegation gathered steam last May when a well-publicized U.S. Army workshop on 21st Century warfare included a "genetically targeted superpathogen" in its arsenal.

Such news drives diversity project scientists nuts. They insist that the macabre notion of genetic weapons ignores the double enigma of human variation—that we are far too identical and our tiny genetic differences are far too independent of ethnicity—to make a racial bomb work.

"That just betrays the activists' own paranoia and racism," said exasperated project geneticist Kidd. "There is no particular 'race gene' for a genetic weapon to zero in on. The whole idea is ludicrous."

Other diversity researchers, however, empathize with the fear, noting that tribal peoples have been the victims of biological warfare dating to the days when the U.S. cavalry began handing out measles-infected blankets to Plains Indians. Troubled by the protests, the scientists promise to broaden the sampling to include larger human populations.

"In retrospect, we made a big mistake early on by overemphasizing endangered cultures to build up public interest," Weiss said. "Now, everybody forgets that we want to test all sorts of populations—even big groups like the Han Chinese."

So far, the activists aren't buying it. In September, they picketed a Montreal genetics conference where project planners stumped for their grand vision: to create genetic life rafts for the sinking Titanic of human variation.

About 30 protesters, many of whom were not indigenous, stood outside on a chilly sidewalk and waved placards that taunted, "Check Your Ethics At the Door."

Scientific doubters

As if the complaints from tribal-rights groups weren't enough, the herculean effort to unlock the rainbow of human diversity also has taken some lumps from closer quarters.

Some anthropologists assert that the diversity project's reliance on building family trees with DNA markers is a crude way to measure human history, much less capture so nuanced and fluid a notion as race.

A better metaphor for tracking our biological identity, they argue, is to trace a braided river that splits and rejoins and splits again, often erasing its genetic channel over the meandering course of eons. In other words, they say it probably can't be done.

"I'm sorry, but I think this project is half-baked," said Jonathan Marks, a biological anthropologist at Yale and one of the most vocal scientific critics of the sampling effort. "The leaders are first-rate geneticists who happen to have a folk knowledge of anthropology. They're still asking questions like, 'How close are the Irish related to the French?' These are things most people stopped asking in the 19th Century. What's French anyway? That's a cultural precept, not a biological one."

"Frankly, I think they're naive," Marks added tartly. "It reminds me of a bunch of teenagers trying to build a cyclotron in their backyard."

Undaunted, project supporters reply that any confusion about "Frenchness" or "Irishness" is exactly what a global DNA survey will clear up once and for all by neatly unbraiding the knotty rope of culture and biology.

The trump card in the debate is that the gene pools that hold many of the answers are evaporating.

"You can nit-pick about methodology for years, but in the end, it comes down to having this one opportunity to take a genetic snapshot of the world," Weiss said. "Do we do it or don't we?"

"We're scientists, not politicians," he said, invoking a mantra repeated by all bringers of knowledge, from the first who harnessed fire to the splitters of the atom. "But at least we can lay the biological information out on the table. People can see it out there."

Watching a graduate student isolate the DNA from the Yanomamo samples and drip it into small capsules, Weiss observed wistfully that the primordial chain of molecules that makes us all so fundamentally alike and yet profoundly unique is transparent and without color—that in its purest form, the stuff of life is always absolutely clear.

Chicago Tribune

Monday, April 28, 1997

Genes offer sampling of hope and fear

Cures possible,
but groups worry
about exploitation

By Paul Salopek
TRIBUNE STAFF WRITER

It was supposed to be a simple bargain—an honest if somewhat bizarre deal struck between one of the last Stone Age peoples and the most technologically advanced society.

Soon after the Hagahai emerged from the cloud forests of Papua New Guinea in the late 1980s and made their first contact with the outside world, anthropologists stumbled across a remarkable secret flowing in the tribesmen's blood.

The Hagahai, who have harvested yams and hunted wild boar along the remote Yuat River for millennia, carried a rare virus in their white blood cells. It was a pathogen similar to ones that cause leukemia, but it did not harm the tribesmen.

THE GLOBAL GENE SEARCH

Whether or not the Human Genome Diversity Project receives the financial support it seeks, numerous groups are collecting blood samples from people around the world in a race for more genetic knowledge and cures.

Key: ● Genetic research projects



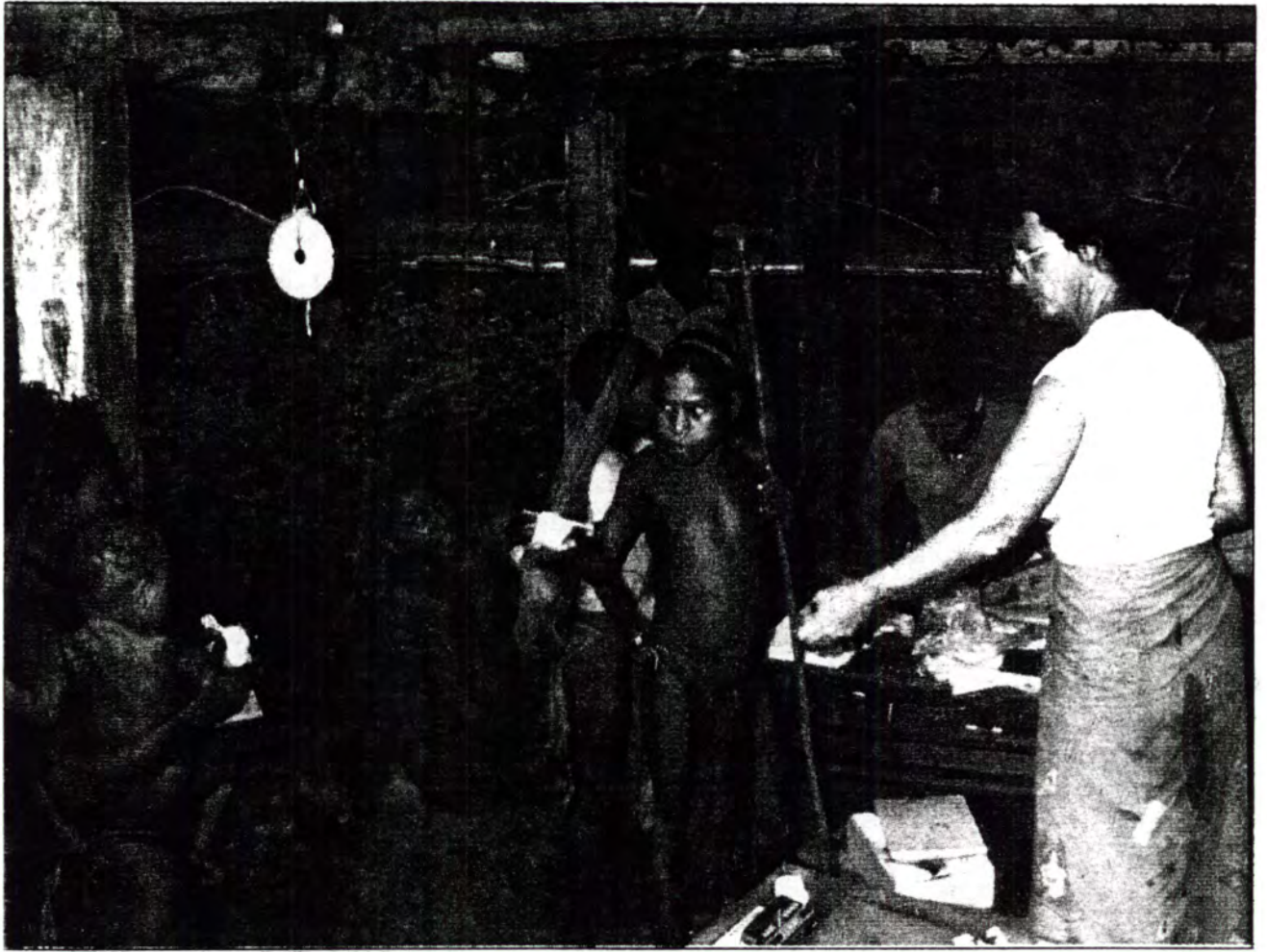
Chicago Tribune

American scientists wanted to understand why, so they made the tribe a quiet offer: Let the U.S. government patent their cells in exchange for half of the royalties from any breakthroughs in leuke-

mia research derived from their blood.

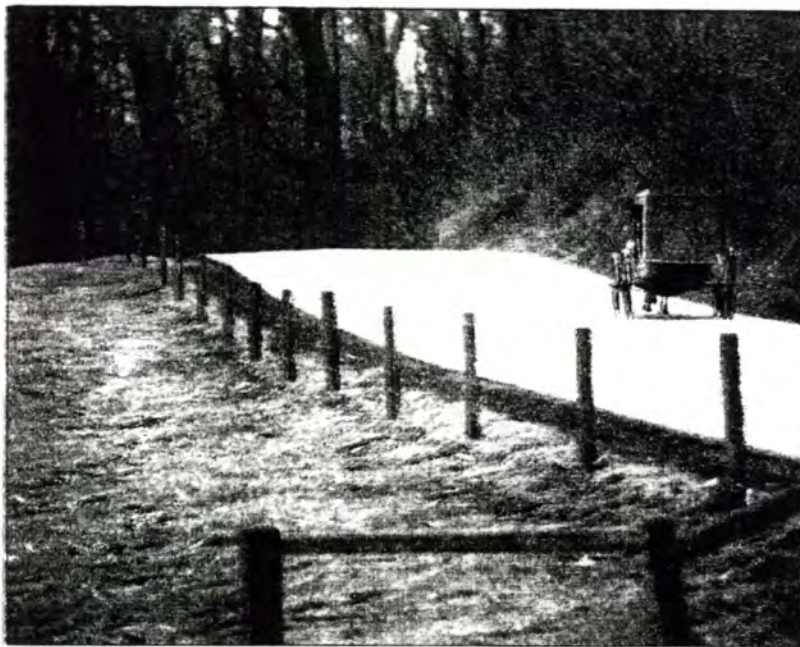
The Hagahai, who by then were familiar with money, agreed. After donating a few test tubes of blood

SEE GENES, PAGE 8



AP photo

The patenting of cells from the Hagahai tribe in Papua New Guinea has caused a storm of controversy.



Tribune photos by Ernie Cox

The religious strictures against outmarriage have kept the Pennsylvania Amish community's gene pool nearly unchanged.

Genes' power, potential

Gene sampling could produce many results. It might lead to cures for some terrible diseases. It could produce windfall riches, and it may make victims out of the peoples whose blood is used.

CONTINUED FROM PAGE 1

to the National Institutes of Health in Bethesda, Md., they promptly went back to stalking wild game.

If the story of U.S. Patent No. 5,397,696—for a DNA sequence dubbed "Papua New Guinea human T-lymphotropic virus (PNG-1)"—had ended there, it probably wouldn't rank as a footnote in the dazzling saga of the genetic revolution in the 1990s.

But the tale of the 1995 Hagahai patent and its bitter aftermath is far from forgotten in scientific circles. Instead, it has become the defining morality fable for one of the most intriguing and highly controversial new frontiers in human biology: the hunt for genetic cures in the DNA of small ethnic groups.

Buoyed by technical advances that make massive DNA testing economically feasible and spurred by the realization that humanity's genetic diversity is yielding to cultural assimilation day by day, researchers are scrambling to the most secluded corners of the Earth, hoping to tap the "healthy genes" embedded in the nuclei of the Cherokee, the Amish, Solomon Islanders, the Hagahai and others.

So far, the strange quest has fired the imagination of individual academic researchers and big biomedical companies. Probably the most compelling proposal on the horizon is the Human Genome Diversity Project, a plan put forth by a loose coalition of international geneticists to collect and preserve the DNA from 400 human populations and ethnic groups.

If funding is approved by Congress after a recommendation by the National Academy of Sciences, the diversity project could officially begin gene sampling this year, adding to a store of samples collected without government involvement.

"We've always known the strength of any species lies in its diversity," said Victor McKusick, a pioneering population geneticist at Johns Hopkins University who supports the global DNA-sampling effort. "Now, we're finally beginning to put those differences to useful work. These are truly exciting times."

To some, the case of the Hagahai genes proves otherwise.

When news of the New Guinea patent spread, howls of outrage sounded from human-rights groups.

Is human tissue, they asked, just another natural resource like timber or gold? If so, what government has the right to poach on a foreign country's genetic heritage?

Charges of "biopiracy" echoed in news reports across the Pacific. News releases declared that the United States had done the unthinkable and "patented itself a foreign citizen." Rattled by the publicity, Papua New Guinean officials summoned the U.S. ambassador for an explanation. The anthropologist who brokered the deal was hauled off a flight at Port Moresby, the Papua New Guinean capital, and interrogated like a spy.

What the Hagahai made of the fracas is not recorded. The NIH, however, was stunned: Though the blood still remains frozen in its freezers, it quietly dropped its

claim on the intellectual property rights to the tribesmen's cells and the research is largely dormant.

Unique traits

Flaps over patenting biological material, especially DNA, are not new, but they are growing louder as science reaches out across the human family tree to pluck at exotic genes that could form the basis of new and expensive drugs.

The thrust of such "diversity research" has gathered momentum only in the last decade as experts began unraveling the biological mysteries of race and ethnicity. Along the way, they have discovered that different human populations have evolved unique resistances or susceptibilities to common diseases.

The key lies hidden within the 3 billion nucleotides of DNA within each of our cells that code for who we are, what we look like and how we function.

Though the similarity in all ethnic groups' DNA is boggling—all our blueprints differ on average by just one nucleotide in every 10,000—enough minute differences can accumulate over the generations to impart subtle advantages in warding off infections and illnesses. In effect, natural selection has thousands of such complex experiments running in diverse human populations all the time.

"We basically let Mother Nature do our work for us," said Georgia Dunston, a Howard University geneticist who has helped plan the gene survey proposed by the diversity project. "Why waste years of research trying to come up with cures from scratch? Evolution tells us that there are groups out there whose genes have been tinkering with ways to fight disease since day one."

How do beneficial genes settle out in different ethnic groups?

Scientists credit three elusive forces of evolution: time, isolation and group size.

It is difficult for unique traits to gain a foothold within large, dynamic populations, geneticists say, because they can be easily swamped or diluted by the constant influx and outflow of genes, the swirling of genetic tides.

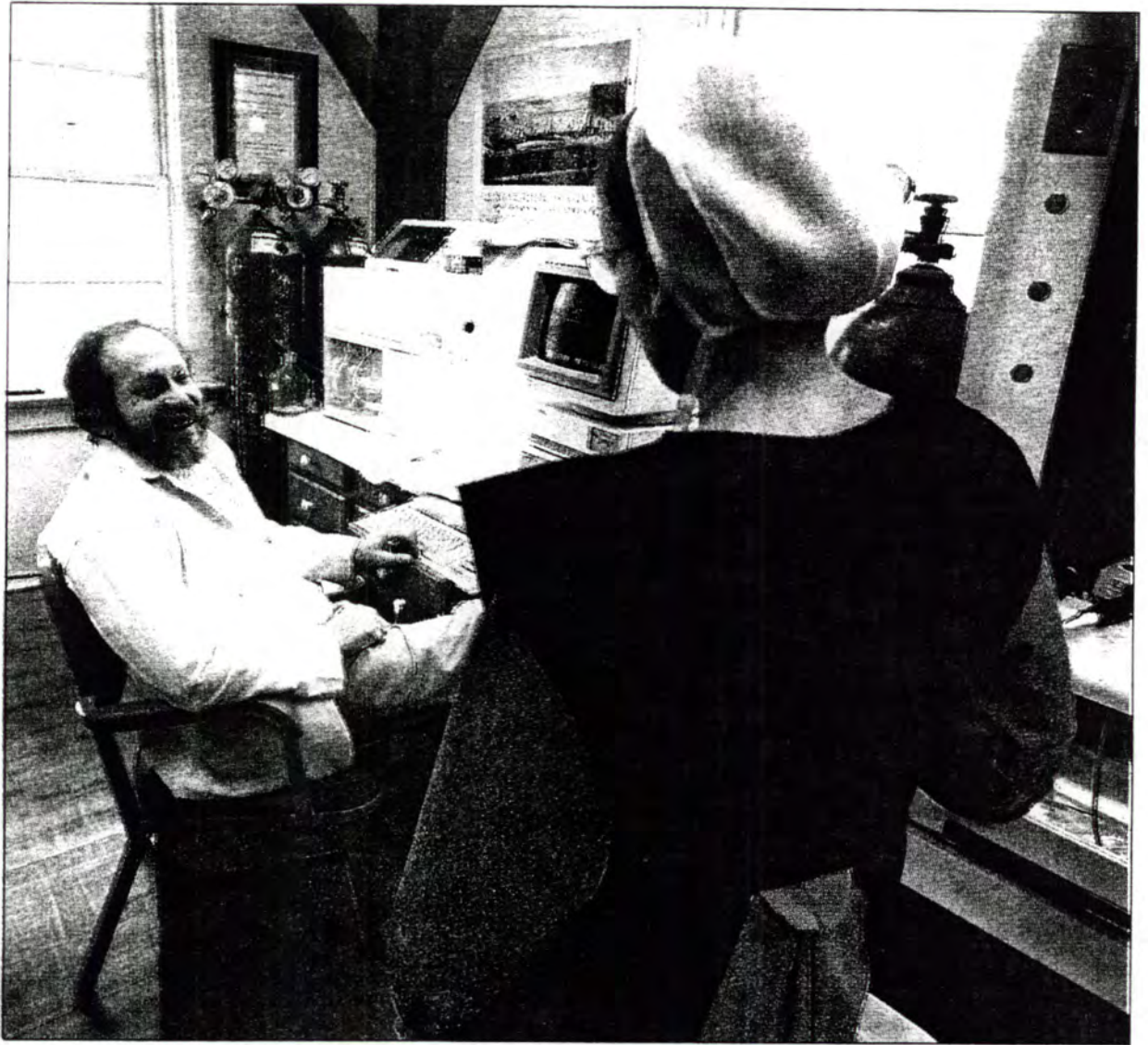
Only in smaller, more stable populations—especially ones where oceans, deserts or mountains minimize outmarriage—can the subtlest genetic ticks become accentuated and magnified. In these cases, a positive mutation, such as one that imparts a tougher immune response, can percolate widely through the gene pool within a few thousand years.

The sort of biological solitude required for such differentiation, experts note, is increasingly rare in today's cosmopolitan world.

"You can't really go gene hunting in Chicago," said Alan Shuldiner, a geneticist at the University of Maryland who recently uncovered genes associated with obesity in Native American tribes. "There's so much intermixing and so much environmental variability that the job would be a nightmare. That's why remote populations make perfect laboratories."

One human experiment that has become legendary among geneticists is the village of Limone Sul Garda in Italy.

The medieval village, perched on a lake, was untouched by



Rebecca Huyard, a medical administrator in Strasburg, Pa., talks with Dr. Holmes Morton. Huyard says the Amish are wary about gene sampling after hundreds of samples were taken in the 1970s and '80s.

Italy's road system until the 1950s. Its gene pool remained largely unrippled by outside gene flow until that time. Researchers have discovered to their amazement that the residents, though they eat the same rich foods as neighbors, suffer almost no heart disease.

Geneticists have now isolated a peculiar mutation—thought to have first appeared randomly in a resident in the 1700s—in the villagers' DNA called the A-1 Milano gene, a localized oddity that appears to gird them against the ravages of atherosclerosis, or hardening of the arteries—one of the most common diseases in the industrialized world.

"You can imagine the sort of therapeutic potential discoveries like these have," said Robert Farrell, a professor of human genetics at the University of Pittsburgh who is studying diabetes and hypertension in different population groups. "That town has been combed by dozens of researchers looking for ways to translate whatever that gene does into some sort of synthetic drug. The payback would be amazing."

Yet it isn't just unique resistances to illness that diversity researchers are homing in on. Tight-knit human groups that suffer unusually high rates of inherited ailments also have caught the eye of gene hunters because they set the stage for mapping and understanding the workings of complex disease genes.

The granddaddy of all such population-specific disease studies involves the Pima Indians of Arizona and late-onset diabetes.

A desert people whose genes have adapted over the centuries to a lean, hunter-gatherer existence, the Pimas have been riddled by health problems associated with

the switch to processed foods and a more sedentary lifestyle. The 6,000-member tribe suffers the highest diabetes rate of any ethnic group in the world. For 30 years, researchers at the NIH have been tracing Pimas' genealogies and drawing their blood, trying to crack the genetic underpinnings of a disease that afflicts millions worldwide.

"We'd really like to see some breakthroughs," said Viella Johnson, director of the hospital in Sacaton, the Pimas' tribal headquarters an hour drive east of Phoenix. "We've got families where half the people in them are diabetes patients. It's a plague."

In the brave new world of diversity research, places such as Sacaton—with its adobe huts melting into the Sonoran Desert and its dogs curled on a lonely main street—are becoming the unlikely new capitals of disease research.

So are the battered trailers and tents of Israel's Bedouin, who are being studied for clues to obesity and certain inherited forms of deafness. So are the small towns of Canada's Quebecois, who are the subjects of a quest for the genetic underpinnings of manic depression. And so are the remote villages of the Arhuacan Indians of Colombia's rugged Santa Marta Mountains, who, like the Hagahai, play host to a type of virus associated with leukemia and AIDS.

"The irony of all this is that by focusing our attention on the white European populations that can afford advanced medical care ... we've been missing the boat on genetic variation for a long time," said Roger Rosenberg, a University of Texas researcher who is studying Oklahoma's Cherokees for their remarkable resis-

tance to Alzheimer's disease, a fatal degeneration of the nervous system. "This is a whole new frontier."

If there were any doubts about the promise of such research, one need only follow the rainbow of human diversity down to the pot of biomedical gold—an economic reality that is triggering the most volatile debates over the commercialization of DNA from small and often poor populations.

Big pharmaceutical companies are quietly sinking millions of dollars into the sort of massive DNA surveying that purely anthropological proposals such as the diversity project have been pushing for years.

The stakes, even at this early stage, are tantalizing:

■ Multiple sclerosis researchers supported by Genethon, a French biomedical firm, have discovered a remote population on Reunion Island in the Indian Ocean that seems to be immune from the crippling effects of the illness, even though they carry the disease genes. A "protective" genetic factor might be in play and, if ever isolated, could lead to lucrative new drugs for millions of MS sufferers.

■ Asthma experts are testing a hotbed of bronchial disease on Tristan da Cunha island in the South Atlantic, where a third of the roughly 300 interrelated farmers suffer from the ailment. The California firm Sequana Therapies has signed a \$70 million deal with Boehringer Ingelheim, a German pharmaceutical company, to help find the Tristanians' disease genes and develop a broad-scale genetic therapy from them. Sequana expects to announce the discovery of its first asthma-related gene as soon as next year.

one of the first tangible returns from diversity research.

■ In a breathtaking gene hunt that will dwarf the diversity project, the international biomedical company Genset signed a deal last year to sift China's 1.2 billion citizens for mutations that might have beneficial health effects. The company will focus on China's remote rural populations and its 40-plus minority groups. The value of the contract, like that of an unexplored mining lease, is incalculable but likely immense.

Which is why indigenous-rights advocates are crying foul.

"You've got this potentially lucrative traffic in human DNA zipping from lab to lab across the world and none of it benefits the donors," said Edward Hammond, an activist with the Canada-based Rural Advancement Fund International, or RAFI, a group concerned with biodiversity and tribal property rights. "There's just this huge potential for exploitation."

Ethics questions

It was RAFI that led the charge against the patenting of the Hga-hai's cell line in 1995. The tiny organization, with a staff of about a half-dozen, has gone on to earn the wrath of academics and industrial geneticists for its David-and-Goliath campaign against diversity research.

According to RAFI and a shifting coalition of other indigenous groups, the expanding hunt for cures locked within the nuclei of the isolated peoples is an unsavory replay of an earlier genetic safari to the Third World.

In the 1970s, big agribusiness firms raided equatorial countries for lucrative crop hybrids that, with a bit of genetic engineering, later earned billions in profits—cash that rarely trickled back to the impoverished farmers who raised the strains initially, Hammond said.

"Today," he said, "the crop is human beings."

Declarations such as these have sent alarm bells ringing around the world, especially in the ethnically diverse nations of Asia. India, which launched its human-

diversity project this year, takes the threat of "bioprospecting" seriously enough to declare its citizens' DNA a national treasure. Blood samples can't leave the country.

Meanwhile, RAFI's bioengineering crusade marches on, pushing for a ban on the patenting of human DNA, demanding that companies share profits with the populations who offer their genes for commercial research and lobbying the United Nations to regulate the burgeoning "human-tissue trade."

Medical-industry spokesmen dismiss such demands as wishful thinking. Without patents on DNA, they say, few businesses would invest in the research necessary to develop genetic cures.

"Do I have some theological objection to individuals participating in and benefiting from the economic upside of such research? No," said Kevin Kinsella, president of Sequana Therapies. "But the picture is far more complex than that. Gene discovery is just the first step in a 1,000-mile journey to find a therapy. It's a process that costs us millions and takes years of work. So how much does somebody who gets his arm pricked deserve?"

Kinsella noted angrily that the

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Tribune photo by Ernie Cox

"We basically let Mother Nature do our work for us," says Georgia Dunston, a Howard University geneticist who has helped plan the gene survey proposed by the diversity project.

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Tristan da Cunha islanders who are participating in his company's asthma studies are not "natives running around in grass skirts" but the descendants of British colonists. In exchange for the islanders' blood, he said, his company has promised to give back free drugs developed from the research.

Still, even those scientists who are most enthralled by the wondrous medicine cabinet opened by the foibles of human genetic variation say that serious moral questions will take years.

When a researcher walks tired and dusty into a village with his bag of syringes, who does he ask for permission to collect a population's DNA? The individual donor? The group's religious or political leader? Who owns a *people's*—not a person's—DNA?

And, more important, how can scientists possibly obtain informed consent—as is required by most governments—when they can't explain the profound repercussions of genetic testing to preliterate cultures?

"These are untested waters," said Dunston, the diversity project planner. "Scientists have to start by learning to treat people like people, not scientific subjects. After all, this whole exploration is about sharing what makes us human—scientists are truly part of the experiment in this case."

Dunston described one of the more serendipitous discoveries

of diversity research that convinced her of its ultimate righteousness:

In seeking organ donors for African-Americans, doctors have found that in some cases tissue from whites is a closer match than tissue from other African-Americans.

The reason? African populations are so ancient that they have diverged into the most genetically variable peoples. Hence, the differences between two African-Americans could be greater than those between a white and an African-American, vivid proof that skin color can mask DNA affinities.

"It would be a shame to lose such insights to fears about commercialization of DNA," she said, worrying aloud that the diversity project, whose aim is pure science, is being sullied by the profit-driven motives of pharmaceutical companies. "This is medicine helping tear down old ways of thinking about race."

But some, especially those caught in the middle of the gene hunters, remain deeply ambivalent.

For Pennsylvania's Amish community, whose religious strictures against outmarriage have kept their gene pool unclouded for almost three centuries, the issue boils down to accountability and respect for the sense of ownership kindled by DNA.

"They came, they took blood, they made promises and they never reappeared," said Rebecca Huyard, a medical administrator

in Strasburg, Pa., who remembers how disease researchers from Johns Hopkins University collected hundreds of genetic samples among the farming folk of Lancaster County in the 1970s and 1980s.

"Eventually, people here got fed up with it. They wondered where their blood was going. It was, after all, our blood, our DNA."

Huyard, who is Amish, said she and her devout, buggy-riding neighbors fear that their molecular inheritance—the building blocks of their biological identity—has somehow slipped beyond their control. She hoped that Amish DNA samples weren't being shared without the donors' knowledge. She also bemoaned the lack of awareness about a momentous scientific quest that, however noble, is speeding ahead almost without public debate.

"Now, we don't trust any of them anymore," Huyard said. She added that if diversity researchers showed up again in the silo-studded hills of Amish country, they probably would be turned away politely but firmly at farm doors.

What she didn't know was that several biotech firms have acquired Amish DNA and are interrogating it for clues to everything from Alzheimer's disease to diabetes. That Amish DNA, frozen and cultured in petri dishes, sits alongside thousands of other human cell lines in laboratories and refrigerators around the world.

EVOLUTION'S GENETIC FOOTPRINTS

By studying our genes, scientists are piecing together how the world's populations might have evolved. Using 100 genetic markers found in modern peoples around the globe, geneticists have reconstructed when and from where our ancestors migrated. This data corroborates most archeological evidence and the belief that the first modern humans came from Africa about 100,000 years ago.

The ancient roots of diversity

Scientists have discovered that genetic differences among populations build up over time. Because Africans are the most genetically variable people in the world, experts believe they are the oldest.

KEY Genetic evidence of migration

Where groups migrated

100,000

Years ago they migrated

Archeological evidence of migration



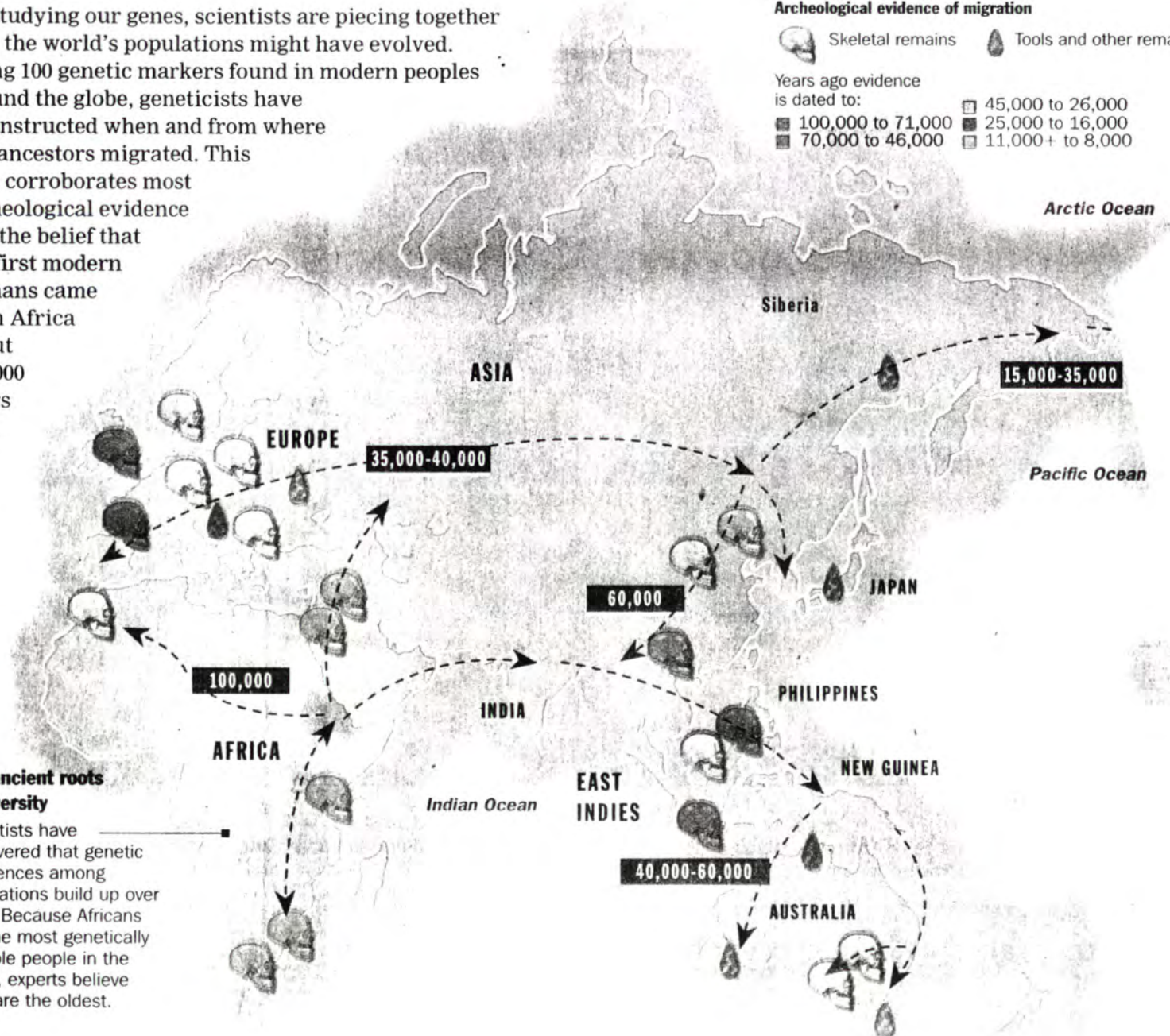
Skeletal remains

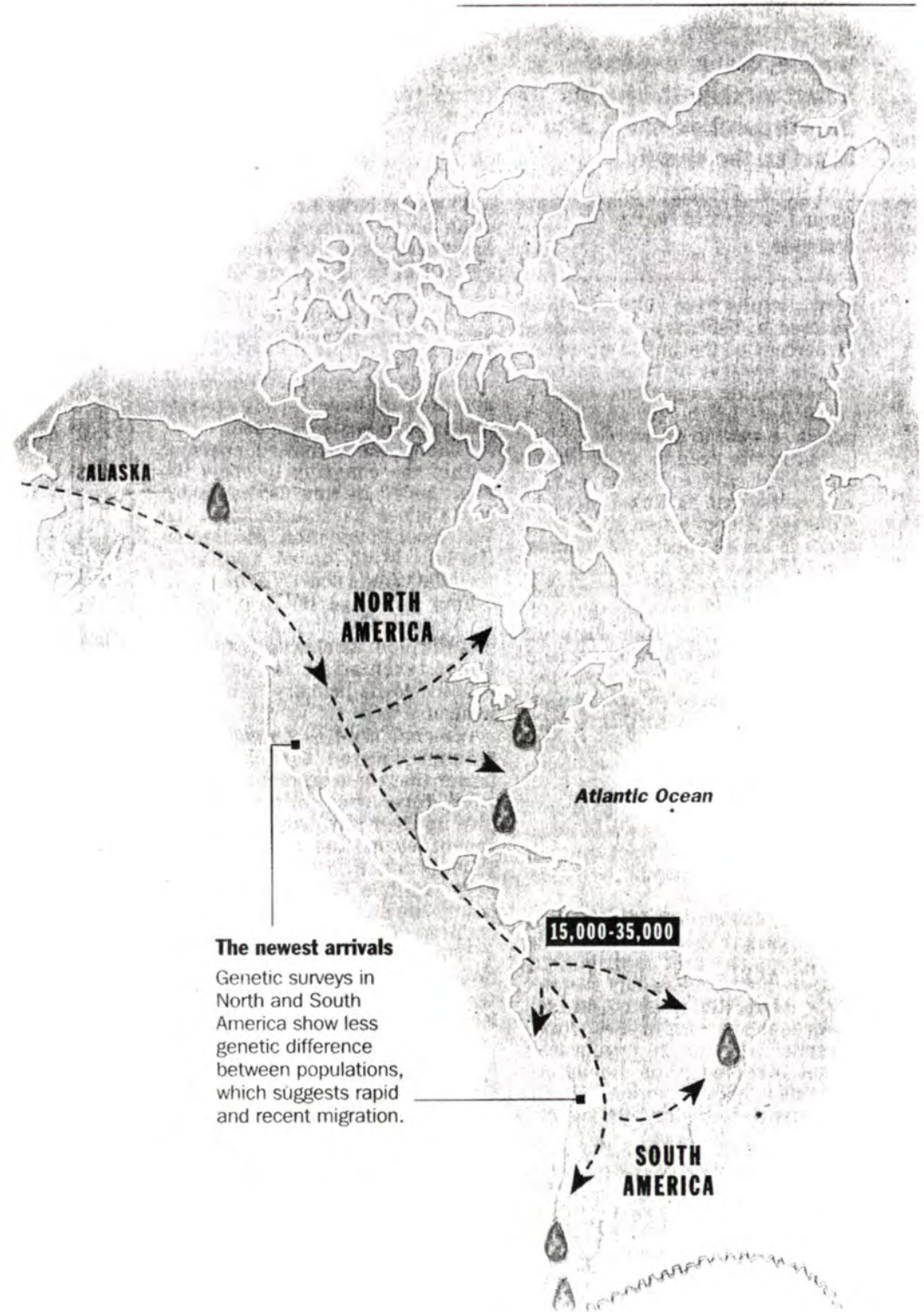


Tools and other remains

Years ago evidence is dated to:

100,000 to 71,000	45,000 to 26,000
70,000 to 46,000	25,000 to 16,000
	11,000+ to 8,000





The newest arrivals

Genetic surveys in North and South America show less genetic difference between populations, which suggests rapid and recent migration.

15,000-35,000

THE HUMAN BLUEPRINT

The 100 genes used to sketch the migration routes of ancient people represent only a small part of the human genome—the 100,000 or so genes everyone shares. These genes are the biological code for who we are, what we look like and how we function.

1 The nucleus of every human cell contains two sets of 23 chromosomes inherited from that person's parents—one set from each.

3 When a DNA strand unravels, it forms a spiral ladder known as a double-helix. There are 3 billion rungs on the ladder, each made up of a pair of nucleotide bases.

2 Each chromosome is made up of a very long (more than 6 feet when unwound) and tightly coiled strand of deoxyribonucleic acid, DNA.

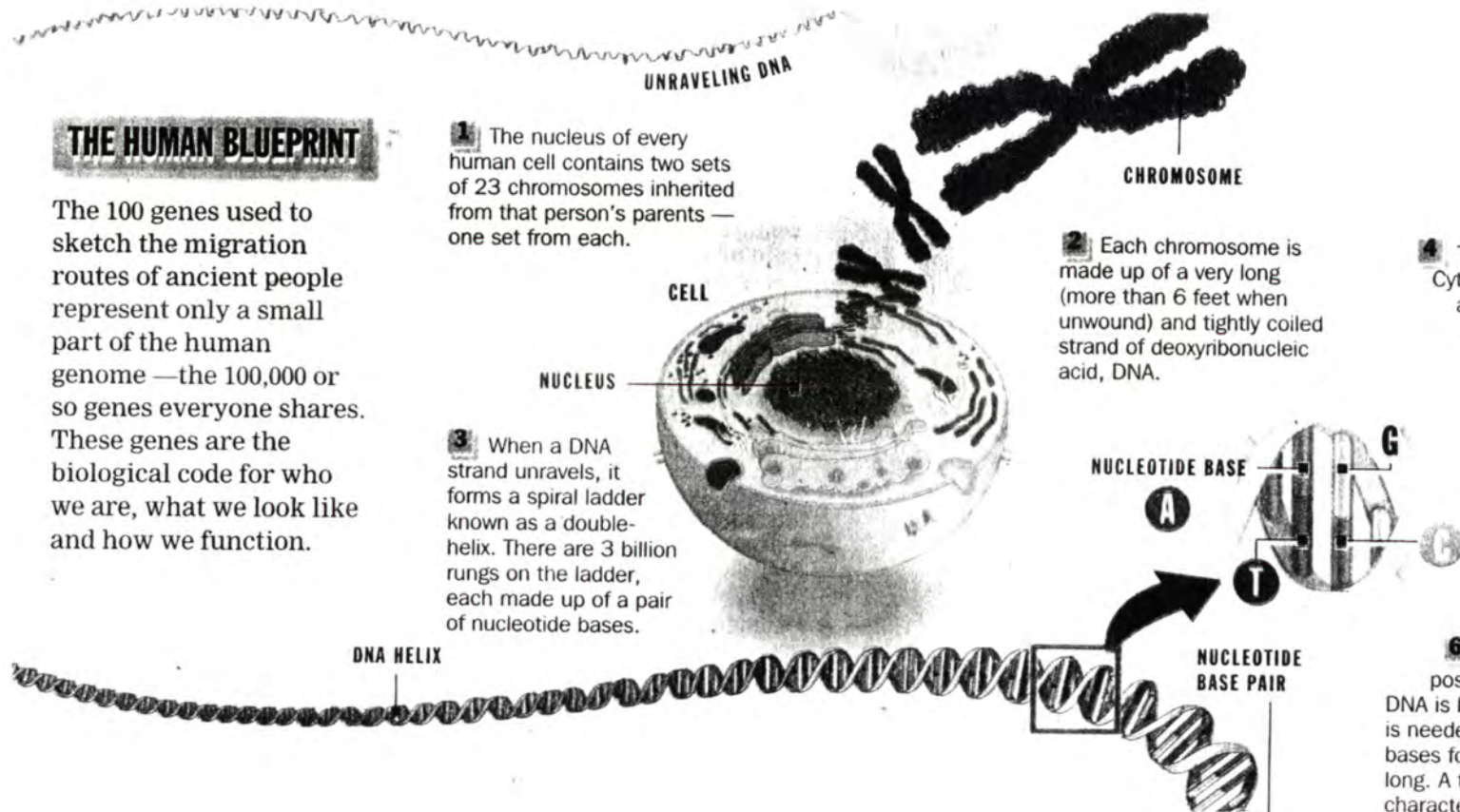
4 There are only four base pairs (Adenine, Cytosine, Guanine and Thymine—abbreviated A, G, C, T) in a strand of DNA and they form only four possible combinations. Adenine only bonds with Thymine (AT or TA) and Guanine with Cytosine (GC or CG).

5 A sequence of paired bases that code for, or are related to, a biological function is called a gene. A gene can contain hundreds or millions of these paired bases.

6 Because each base pairs with one possible base on the opposite strand, when DNA is broken down, or sequenced, only one strand is needed for analysis. In DNA sequencing, the bases form patterns of letters many characters long. A type of breast cancer, for example, is characterized by a specific sequence of TGCA letters nearly 7,000 characters long.

However, of the approximately 100,000 genes believed to exist, only 6,766 have been sequenced. Isolating a gene is difficult because 95 percent of a chromosome's DNA strand has no identified function.

The sheer vastness of DNA makes the technology that reads it especially important. It is even more critical to the Human Genome Diversity Project because without the modern means of sequencing DNA, it would be nearly impossible to tease out the minute differences found in the genetic code among the world's populations.



CRACKING THE CODE

In the late 1970s, scientists developed a technique for sequencing pieces of DNA and identifying genes within it. The discovery revolutionized genetics, but the process was slow and somewhat unreliable. Now computers quickly analyze what scientists used to painstakingly do by hand — an advancement geneticists believe will speed population studies and the rate of gene discoveries (and possible treatments) they might yield.

How automated DNA sequencing works

• Old way

A DNA fragment is sequenced into four columns with its bases represented as black bands on printouts. Scientists analyze the black patterns by manually counting the number and order of bases on the printouts from bottom to top.

Four-column sequencing

Base Base Base Base
A C G T



One-column sequencing

Base

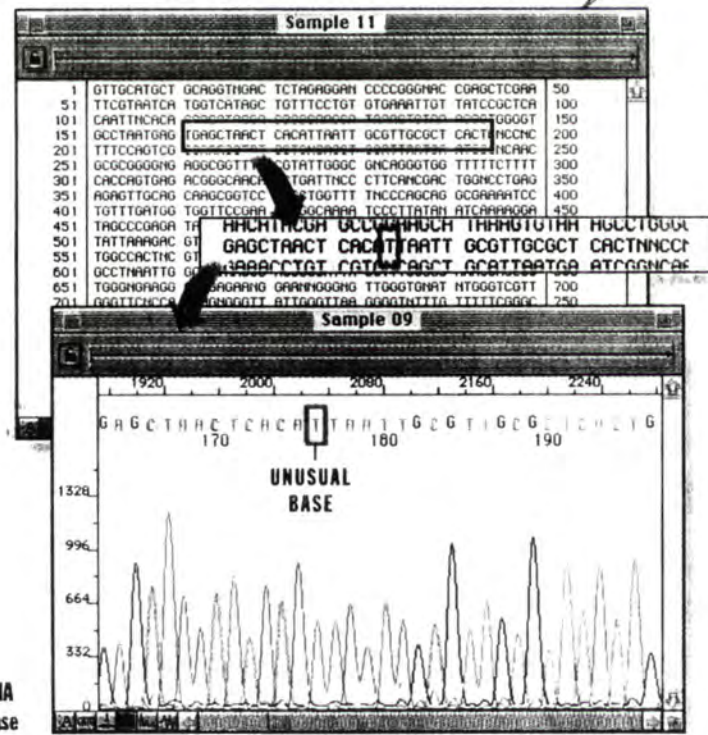


• New way

The bases are consolidated into one column and color coded. A computer interprets and displays them in a more readable top-to-bottom format.



• Computers also automatically count and convert the colors into their corresponding base letters (A, C, G or T) and store the long segments of the data for analysis.



Entire DNA segment sequenced and counted

Section of a DNA segment with unusual base

• If the computer finds an extra, unusual or mutated base in the sequence, it highlights the area and displays the section of 20 or so bases that appear immediately before and after it with their color waves.*

• Highlighted areas may signal the presence of a gene variant, the elusive part of the human blueprint that can code for diseases in some people and resistance to diseases in others. This aspect of computer sequencing technology is what allows scientists to easily and rapidly identify gene markers in large groups.

THE LONG ROAD AHEAD

Although the speed with which vast amounts of DNA can now be sequenced has dramatically increased the number of genes known to scientists, the best technology can break down only 100,000 base pairs a year and one person's 23 chromosomes contain nearly 3 billion base pairs.

Sequenced genes

Genes whose entire function is known.

	1981	1991	1997
579	1,879	6,766*	

*As of April 20

Sources: Ken Weiss at Pennsylvania State University, National Institutes of Health, Mike O'Neill at Perkin-Elmer Applied Biosystems, "The History and Geography of Human Genes," "The Human Dawn," "Genetics and Evolution"

Chicago Tribune/Celeste Bernard, Rick Turna

*By displaying the bases as color waves, scientists can verify the quality of the sequence. Waves that are roughly equal in height indicate the computer is reading the bases accurately.

MAPPING DISEASE TO THE CHROMOSOMES

Inside the cells of all people are 23 pairs of chromosomes that carry the genetic blueprint for how our bodies develop and function. Scientists have identified thousands of genes on the chromosomes that cause, prevent or influence the development of many diseases. Locating these genes has led to new medical treatments. One of the goals of the Human Genome Diversity Project is to expand this library of genes and the knowledge it could provide.

Location of selected disease-causing genes

