

Chen

WHITE HOUSE
WASHINGTON

DATE: 7-4-97

NOTE FOR: The Honorable Rodney E. Slater

The President has reviewed the attached, and it is forwarded to you
for your:

Information ☐

Action ☒

Is this okay
for Slater? ✓
Yes ✓
No —

Thank you.

Staff Secretary
(x6-2702)

cc:

STREET JOURNAL

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RSDAY, JULY 3, 1997

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... 75 CENTS

INSIDE TODAY'S JOURNAL

MUTUAL FUNDS

SECOND-QUARTER RESULTS

- Returns for 5,777 mutual funds
- Stock-fund winners and sinners
- Giant funds shop for bargains
- Tiptoeing into bond funds
- Results for variable annuities
- Lipper's leaders in 23 sectors

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Bicyclists, Riding Congress for Paths, Are Pedaling Uphill

They Vie With Huge Lobbies For Piece of Road Budget; Tipper's Flat-Tire Service

By ASRA Q. NOMANI

Staff Reporter of THE WALL STREET JOURNAL
WASHINGTON — They yearn for free valet parking for bicycles at subway stations. They are bent on bikers having their own freeways, and some even crave bike vending machines at bus stations, hotels and major landmarks.

Ultimately, these bicycle boosters long to change the way Americans commute, and they want the federal government to help pay for it — starting with more bike paths.

That is why Ashley Korenblat, a 35-year-old mountain-bike tour operator from Moab, Utah, finds herself in Sen. Orrin Hatch's office. Decked out in clogs, a billowing skirt and a bear-sculpture necklace, this Little Rock, Ark., native and avid supporter of President Clinton puts aside her political differences to make her pitch to the Utah Republican.

Sen. Hatch isn't available, but two aides listen patiently to the Dartmouth University business-school graduate who

Business Bulletin

A Special Background Report
— On Trends in Industry
And Finance

IT'S FEAST OR FAMINE for restaurants on the Fourth of July.

Gladstone's, a beachfront landmark in Pacific Palisades, Calif., expects to be so busy tomorrow it doesn't bother with theme menus or promos. But Eddie Kerkhofs, owner of Le Dome, a West Hollywood dinner stop for film folks, says, "It's a lost weekend for us" and Bart Mahoney, manager of Wolfgang Puck's trendy new Spago Beverly Hills, says it "means a day off." But Jannis Swerman, manager at Granita, Mr. Puck's Malibu spot, takes the menu by the horns and promotes special fare to show there is business to be had on the holiday.

A view of fireworks can be key. The River Cafe, in New York's Brooklyn borough, tells callers it has no view of fireworks and points them to the Water Club in Manhattan (both have the same owner). There, the evening's tab is as high as \$195 a person, but the river site is so close to the fireworks that "ashes can drip on your head," a manager says. The Fourth is the busiest night of the year at the Sail Loft restaurant on the Charles River in Cambridge, Mass., where the only reservations are for \$75-a-person outdoor tables with a riverside view of the fireworks.

The holiday doesn't even make the National Restaurant Association's list of top dining-out days. But takeout is big.

A BETTER DE-GREASER by summer's end is the aim of joint research.

Channellock Inc., a Meadville, Pa., pliers maker, is funding research that was the senior project of Jennifer Ann Zewatsky, an environmental-studies graduate from nearby Allegheny College. Ms. Zewatsky is working with nontoxic, water-based detergents to replace methylene chloride, a cleaning solvent the firm uses on its tools that releases a volatile organic compound.

The idea is to curb emissions, but the new process could also end up saving money, says Bob Holder, project engineer at Channellock. Since the solvent can be diluted and recycled, it may also be cheaper. One of the problems still being studied is rust that can be caused by water-based cleaners; that may require investing in a rust-inhibiting solution and driers.

THE WRONG CODES can play havoc

Lost Trust

The Boss's Daughter And Right-Hand Man Clash—and She's Gone

At Smith Barney Dimon Asked if Bibliowicz Went Around Him to Weill

A Tiff Over No-Load Funds

NEW YORK — Jessica Bibliowicz and Jamie Dimon go way back. As teenagers, they and their families vacationed together on Long Island's Montauk Point. As young summer interns in New York, they often lunched together and occasionally hit a folk-music club. Eventually they both wound up working for the same company, Smith Barney Inc. Mr. Dimon became chairman; Ms. Bibliowicz ran its mutual-fund unit.

Then their ties became a bit frayed. Just over a year ago, while she was

By Wall Street Journal staff, reporters Leslie Scism and Raghavan and Michael Siconolfi

attending an industry conference in Washington, Ms. Bibliowicz learned from an acquaintance at another company that she had missed out on the job of heading Smith Barney's asset-management operation, a decision Mr. Dimon had made.

This past February, again while on the road, Ms. Bibliowicz learned some more disquieting news. Four managers had been added to Smith Barney's executive committee, including its first woman. But Ms. Bibliowicz, the highest-ranking female chief of a unit, wasn't among those named. An associate read her Mr. Dimon's memo announcing the appointments.

Things like this weren't expected to happen to Ms. Bibliowicz. After all, the 37-year-old executive is the daughter of Sanford I. Weill, the legendary chairman of Smith Barney's parent, Travelers Group Inc. But



thousands of the discount brokerage firm's customers unable to tell whether their trades were completed.

(Article on Page A3)

GM said its U.S. June sales of light vehicles plunged 13.5% from a year earlier, reflecting strikes at two plants and an overall soft auto market. But Ford is expected to buck the industry trend with a narrow sales increase.

(Article on Page A2)

Several ex-Prudential Insurance managers were interviewed by federal investigators about possible obstruction of justice in connection with civil suits alleging fraudulent sales practices. It isn't clear whether the inquiry continued beyond an early stage.

(Article on Page A4)

The Big Board is considering scrapping a controversial, 48-year-old rule that makes it almost impossible for listed companies to leave the nation's largest stock exchange.

(Article on Page C1)

Rockwell unexpectedly said that Chairman and CEO Donald R. Beall will hand over his duties to Don H. Davis, president and chief operating officer, over the next few months.

(Article on Page B6)

General Mills said it is raising the price of its breakfast cereals an average of 2.6%, the first major increase in three years.

(Article on Page B7)

Tobacco foes are trying to preempt cigarette makers with legislation based on conclusions of a panel of health experts that has been sharply critical of the proposed tobacco pact.

(Articles on Page B8)

Guinness and Grand Met said they would consider alternatives to their planned \$19 billion merger, following talks with LVMH Moët Hennessy.

(Article on Page A8)

Markets—

Stocks: Volume 526,784,130 shares. Dow Jones industrials 7795.38, up 73.05; transportation 2787.86, up 43.00; utilities 230.97, up 2.72.

Bonds: Lehman Brothers Treasury index 6856.19, up 24.87.

Commodities: Oil \$20.33 a barrel, up 20 cents. Dow Jones futures index 149.94, off 0.52; spot index 150.56, off 1.07.

Dollar: 114.51 yen, off 0.39; 1.7538 marks, up 0.0068.

control, for the shift. (Article on Page A8)

Clinton won't sign a tax bill that doesn't give low-income workers full advantage of a \$500-a-child credit, the president's liaison to Congress said. While avoiding the word, the aide's statement was the closest the administration has come to threatening a veto of the GOP legislation. (Article on Page C13)

Fighting in Cambodia again broke out between factions led by the nation's co-premiers, this time involving military units at a base near Phnom Penh. No casualty figures were available. The Hun Sen faction accused Prince Ranariddh's group of assembling former Khmer Rouge forces for an attack.

Two freight trains collided in Kansas, killing a crew member and forcing hundreds to evacuate. Two other recent rail accidents have prompted federal regulators to order an industrywide safety review. Some experts argue consolidation and cost-cutting have boosted risks. (Article on Page B4)

Britain's Labor government unveiled its first budget, avoiding big tax increases on individuals and modestly cutting levies on corporate profits in an early test of its priorities. Meanwhile, a court sentenced six men to 35 years each in an IRA plot to cut off London electricity. (Article on Page A8)

Israeli opposition parties filed a no-confidence motion against the Netanyahu government, the second in two weeks, and a Knesset vote is due Monday. The move came as Israeli troops killed a Palestinian and injured dozens in Hebron and Gaza rioting.

A federal judge in New York again ruled Clinton's "don't ask, don't tell" policy on homosexuals in the military is unconstitutional. For the first time, he found the policy violates equal-protection rights with its ban on homosexual acts. (Article on Page B8)

The Army suspended an officer who supervised training of seven drill sergeants charged with sexual misconduct at Maryland's Aberdeen Proving Ground. A base spokesman said he didn't know of any charges against Lt. Col. Martin T. Utzig.

A U.S. Mars landing is to take place tomorrow, the first since 1976, with a new method involving air bags to cushion the unmanned craft's fall. Over the next week a small vehicle is to explore the Ares Vallis site, a vast floodplain, and analyze rocks.

Yeltsin fired Valentin Kovalyov, Russia's justice minister, after a video was widely distributed showing him in a sauna frequented by gangsters. His successor is Sergei Stepashin, a former security chief.

Died: Jimmy Stewart, 89, lanky, slow-talking actor who starred in many of Hollywood's most beloved movies, such as "Mr. Smith Goes to Washington" and "It's a Wonderful Life," in Beverly Hills, Calif.

That is why Ashley Korenblat, a 35-year-old mountain-bike tour operator from Moab, Utah, finds herself in Sen. Orrin Hatch's office. Decked out in clogs, a billowing skirt and a bear-sculpture necklace, this Little Rock, Ark., native and avid supporter of President Clinton puts aside her political differences to make her pitch to the Utah Republican.

Sen. Hatch isn't available, but two aides listen patiently to the Dartmouth University business-school graduate who left Wall Street in 1987 as a bond trader at First Boston Corp. to run a bicycle-making company in Cambridge, Mass. She landed that job after writing a business plan for the founder in exchange for a \$3,000 titanium 21-speed.

Road Gang

"Everybody wants to bike in Utah," says Ms. Korenblat, who now operates Western Spirit Cycling Inc., guiding people through canyons, deserts and mountains. "My phone is ringing off the wall." One aide suggests photographing Sen. Hatch on a bicycle at Dead Horse Point, a Utah park. Ms. Korenblat loves the idea.

With Congress about to dole out nearly \$30 billion in annual highway funds, the nation's trucking, oil, auto and construction lobbies—known around Capitol Hill as the Road Gang—are jostling at the pork barrel. So are lobbyists for gas stations, truck stops and roadside motels, who all want roads, roads and more roads.

Seeking only a fraction of the highway budget are a lot of little lobbies, whose members, like Ms. Korenblat, try to offset with determination what they lack in money and muscle.

'I Like Bike'

"Gearheads" of the bicycle lobby belong to Bikes Belong!, a 10-month-old coalition of bicycle makers, dealers and enthusiasts who have doled out \$211,000 for the cause. About a dozen of its members are on their first-ever lobbying tour of Washington. They are pushing representatives for more bike paths and projects such as valet bicycle parking at a Long Beach, Calif., commuter station, in addition to funding for such proposals as the world's first elevated bike freeway in Los Angeles, crossing the city's busiest streets.

Advocates of "Bike Power" are peddling their message through the corridors of Congress, setting off metal detectors with their "I Like Bike" buttons. Their unofficial slogan: "Save the snails. Save the whales. Save the trails."

But the bike lovers realize they are pedaling uphill, vying for attention from lawmakers who took \$14.4 million in campaign contributions from highway and other big transportation interests in 1995 and 1996. Only \$7,700 of it came from a

Please Turn to Page A4, Column 1

NOTICE TO READERS

The Wall Street Journal won't be published tomorrow, in observance of Independence Day.

The idea is to cur process could also says Bob Holder, p nellock. Since the s recycled, it may als problems still being be caused by wat may require invest solution and driers.

THE WRONG (with workers' comp

There are hund workers-comp insu jobs, and they can Paul Brown, gener Insurance Manag York. Mistakes at small firms, says Inc., a cost-contain N.Y., that ferrets ou of the recovery.

Addiction Resea a substance-abus Brooklyn, got a \$2 rates after staffer insurer as clinic w employees, says Sam Holcombe, risk m. Speedway Corp. ii says a major error the task of auditin the payroll staff, si all jobs is crucial.

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are becoming mo increases, says St sion of McGraw-H dividend boosts r second quarter fell earlier.

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TODAY'S CONTENTS

THE INDEX TO BUSINESSES APPEARS ON PAGE B2

FOUR SECTIONS

Abreast of the Market C2 Leisure & Arts A9

INDUSTRY

FLAT-OUT PITCH: Michelin and

MANAGEMENT: Older directors are target of dissident investors, B1.

ney's office in Newark, which standard policy, declined to comment. The inquiry is believed to stem from the recent massive class-action lawsuit that accused Prudential of misleading practices in sales of life insurance. Under a settlement, Prudential agreed to pay policyholders at least \$410 million.

Prudential spokesman Robert DeFilippo, beyond issuing a statement saying

During the course of the class action, Prudential admitted at least five instances of destruction of documents by employees, though it insisted that there was no intent to interfere with the lawsuit.

The inquiry by federal investigators has run into at least one roadblock. Renwick T. Nelson, a former Prudential staff lawyer, so far has been prevented by Prudential from complying with several

The FBI and prosecutors have interviewed David Fastenberg, a former senior executive at Prudential, who the company said was fired following allegations that he authorized destruction of files containing life-insurance marketing materials. Also interviewed was John Breedlove, a former manager of a Prudential sales office in Cambridge, Mass., who Prudential said was fired following disclosure that his office had destroyed customer records. Both Mr. Fastenberg and Mr. Breedlove have denied any wrongdoing, and their lawyers said federal investigators made clear that they weren't the focus of the inquiry. Mr. Fastenberg has sued Prudential, alleging wrongful termination.

David R. Gross, Mr. Fastenberg's lawyer, and Harry Manion, the lawyer for Mr. Breedlove, said investigators asked about

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Market,

Bicyclists Wheel and Deal for Paths

Continued From First Page

bicycle company, Huffy Corp. of Miamisburg, Ohio, says the National Library on Money and Politics of Washington.

"It's David vs. Goliath," says Thomas Henry, an owner of Landry's Bicycles in Framingham, Mass., as he leaves a Senate hearing room packed with Road Gang lobbyists. "But we are going to ride this one out."

Before fanning out on Capitol Hill, Bikes Belong! members sip apple juice, and hear a session on "How to Make Politicians Jump," led by Charles Gandy, a Texas bicycle lobbyist. This grass-roots lobbying effort was spawned after five days at his Charlie's Fly Fishing, Hitchhiking and Bike Advocacy Summer Camp last year in Dubois, Wyo.

Mr. Gandy explains the ins and outs of the highway bill, the Intermodal Surface Transportation Efficiency Act, which expires Sept. 30 and will determine what portion of dollars go to bicycle causes. He urges bicyclists to exploit the fact that many congressional staffers are likely to be bikers themselves.

"This is Salesmanship 101," Mr. Gandy says. "Relationships matter." While he advises against directly telling lawmakers, "I want to support you in your next election," he does suggest "letting them know what's in it for them."

Wheeling and Dealing

They break into groups and one troops to its first target: Rep. John Olver. The Massachusetts Democrat welcomes them, glances at the clock and, rather than take them into his office, leads them into a cramped space amid staff cubicles. He seems sympathetic to their appeals until Michael Zane, the bushy-bearded owner of Kryptonite Enterprises, a bike-lock maker in Canton, Mass., steps up.

With his shirt untucked, Oakley sunglasses perched on his shaggy hair and a video camera dangling from one shoulder, Mr. Zane waves a half-empty Starbucks coffee cup at the legislator, while making a rambling point about bike paths and filling potholes. Rep. Olver smiles politely and says, "I don't know if I understand you completely."

Outside, a few moments later, Mr. Henry, the Massachusetts bicycle dealer, says, "we could have been more focused." Mr. Zane sighs.

They then head to the office of Rep. Steve Horn. The California Republican

isn't available, but aide Eric Swedlund listens to Linda DuPriest, youth-program coordinator at Specialized Bicycle Components of Morgan Hill, Calif.

"This is about kids, about giving them safe places to ride," she says. "It's not a tree-hugger issue." Mr. Swedlund, himself a bicyclist, says he likes that idea.

Outside, one of the coalition's full-time lobbyists, Noel Weyrich, beams. "You get the gold star," he tells Ms. DuPriest.

That evening, the group hosts a reception for what is unofficially dubbed the "Congressional Bike Caucus," 25 senators and representatives whom leader Democratic Oregon Rep. Earl Blumenauer calls "bicycle partisan." These lawmakers—who have been pushing for more showers on Capitol Hill so they can wash up after lunch-time spins—also want more funding for bicycle trails and facilities.

Minnesota Democratic Rep. Jim Oberstar reminds the 50 attendees that the federal government first shelled out \$10,000 to build experimental roads in 1893 because bicyclists complained about ruts. "Next time that driver wants to run you off the road, tell 'em, 'We're the reason you have this road,'" he shouts to cheers.

Though Congress isn't likely to pass highway legislation until early this fall, 116 House members have signed a letter supporting a bill to increase spending on trails and related amenities. President Clinton proposed a boost in transportation enhancements over the next six years to \$3.6 billion from \$2.7 billion appropriated in 1991. Bicycle trails, paths and facilities accounted for about half of that spending since 1991.

Bike Outings

But the bikers are determined to keep the pressure on. They are threatening to take aim at high-profile Washington folks, including Vice President Al Gore's wife Tipper, Interior Secretary Bruce Babbitt and Supreme Court Justice Stephen Breyer. "We're going to 'out' a bunch of bicyclists," Mr. Gandy says.

Mr. Breyer, for example, was in a hospital room recovering from an accident on his one-speed bike when he interviewed with White House aides for the Supreme Court job, later hobbling out to meet Mr. Clinton. And Mrs. Gore was spotted on a bike with a flat tire that a Secret Service agent unsuccessfully tried to change.

"We've got to get all these big bicyclists out of the closet," Mr. Gandy says.

EXCLUSIVE
NOT AVAILABLE ELSEWHERE



Shown larger than actual size.

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UNITED STATES

THE PRESIDENT HAS SEEN
7-4-97



Back to the glory days?

"American manufacturing has never been in more trouble than it is now." Thus the glum introduction to an official report on competitiveness released in 1990, the last time America hosted a G7 summit. Its moroseness matched the nation's mood. Neurosis about the strength of Japan; gloom about the deficit; woe and decline on every side.

How times change. The country that presides over this year's rich-world gathering in Denver is feeling triumphant, even euphoric. "Is this a wonder economy or what?" asked *Business Week*. "On top of the world" chirped *Newsweek*. Notwithstanding signs of a slowdown in the second quarter of this year, the economy has been growing faster for longer than most economists thought sustainable. Unemployment has fallen well below the rate at which wage pressures have traditionally started to grip. And inflation is nowhere in sight. Producer prices fell for the fifth consecutive month in May, the longest string of declines since the 1950s.

Some back-slapping is in order, for sure. But today's economic success has also unleashed a Panglossian optimism, and that is more dangerous. A growing chorus of pundits, investors and economists argue that the good times are here—for good. They claim that such factors as globalisation and the rise of information technology have

changed the way the economy works, so that old constraints on growth no longer apply. Instead, America can look forward to a prolonged period of prosperity, with both inflation and business cycles tamed.

The stakes in this debate are high. If the new conventional wisdom is correct, America does indeed face a rosy future. If it is not, unfounded confidence could endanger the economy's achievements so far. Unfortunately, it is often difficult to pin down exactly what is supposed to have changed. Believers in the "new economy" speak grandly but vaguely of productivity revolutions or the "loss of corporate pricing power"; they point to tumbling computer prices and the growth of the Internet as indisputable evidence that the economy is dancing to a different tune.

Beyond anecdote, their optimism rests on two main arguments. The first is that America's potential growth rate is much higher than conventional wisdom suggests, because productivity is much higher than official statistics measure. The second is that, regardless of productivity improvements, inflationary pressures are much weaker (or even non-existent). Global competition means that capacity can be pushed harder and unemployment sent ever lower. Do these propositions make sense?

There is some truth to the productivity claim. According to official statistics (and

notwithstanding the small surge in the first quarter of this year), America's productivity growth during the 1990s has been as paltry as it was during the previous two decades, an average rise of around 1% a year. These official numbers have big and well-documented shortcomings. Productivity in services, the largest and fastest-growing part of the economy, is notoriously badly measured.

Moreover, using alternative gauges of productivity gives starkly different results. Edward Yardeni, chief economist at Deutsche Morgan Grenfell, points out that the growth in firms' real sales per employee used to rise in step with productivity growth. But since 1986 or so, and particularly in recent years, they have diverged. In 1995, for instance, real sales per employee rose 10% while non-farm productivity rose only 0.2%. The biggest gains are in new-economy sectors such as high tech and communications. These figures have problems—in particular, the divergence might reflect the outsourcing of production—but they provide some evidence of higher-than-measured productivity growth.

Few economists would disagree that the real economy may be growing faster than official numbers suggest. At issue is whether the discrepancy keeps increasing. Moreover, if America's recent growth primarily reflects rising productivity, it is not clear why unemployment continues to fall. The drop in joblessness suggests that at least part of America's GDP growth comes from more labour input rather than higher output per worker.

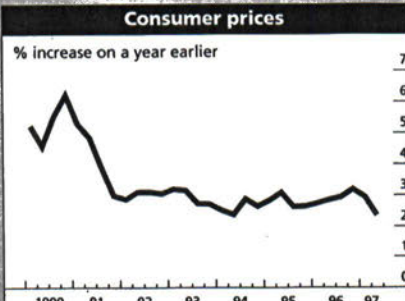
Statistics bear this out: a large part of America's growth in the past year did indeed come from more people working, as well as working harder. Between the first quarter of 1996 and the first quarter of 1997 the number of Americans with a job grew by 2.4%, far more than the traditional annual job-growth rate of 1.4%. Moreover, the average number of hours worked each week also rose by 1.2%, again well above trend. Add growth in employment and hours worked to the official estimate of productivity growth (1%) and you more than account for the 4.1% rise in GDP. (The numbers do not add up exactly because they come from different statistical sources.) This does not prove that there has been no rise in productivity, but simply shows that much recent growth has come from getting more people to work, and persuading them to work longer hours.

And that is exactly what worries mainstream economists. Fast growth based on unusually high employment growth can-

Plenty to show off about



Sources: National statistics; Datastream



*National definitions

not continue forever. At some point, they fear, the unemployment rate will fall below the non-accelerating inflation rate (NAIRU) and wage-inflation will rise. Indeed, many reckon it has already done so.

Moreover, they point out, America's labour force grew remarkably quickly last year, far faster than its population. Several factors lay behind this. A buoyant economy may have lured back some people, particularly women, who had given up looking for work; welfare reform is forcing poorer women, who may have relied on a federal cheque, to find a job; and changes in immigration laws have prompted a sharp rise in the number of Latinos entering the labour force. But these supply increases are probably temporary: once employment growth stabilises, fast job growth would mean bringing the unemployment rate down further, which increases pressure on wages. At that point either corporate profits must be squeezed, or firms must pass on their higher costs through higher prices.

The new-economy crowd insists this is nonsense: inflation is dead, and the concept of a natural rate of unemployment outdated. In the new economy, firms cannot simply raise their prices: if they do, they will quickly lose out in a global market where firms and consumers can choose their suppliers at will. Yet, in fact, the United States is not terribly globalised: imports and exports still make up a relatively small share of GDP. Most of America's output is in goods and services that cannot easily be bought and sold across borders. For the price of a haircut, say, or a meal out, the globalisation argument is irrelevant.

A more subtle argument is that the pressures of globalisation and corporate restructuring have allowed American firms to push capacity further. New techniques for managing inventories, for instance, prevent the kind of involuntary build-up of stocks that used to make for large swings in output. In a more integrated global economy, companies can switch to foreign suppliers more easily. In short, the old speed limits may no longer hold.

There is probably some truth to this; but it would be foolish to push the argument

too far. The capacity of the global economy is not infinite. Much of the weak price pressure faced by American firms comes from the fact that other large industrial economies have been growing sluggishly in recent years: once they pick up, commodity prices, for instance, may be under more pressure than they are now. Moreover, the strong dollar—a factor that has helped depress import prices—need not be a permanent phenomenon. If any of these tempo-

rary fillips subsides, American firms could well find their costs rising fast.

It is more likely, however, that pressure will first occur in labour markets. Historical relationships between unemployment and inflation imply that these pressures should already be evident. It is, of course, true that the NAIRU—estimates of which have never been made with enormous precision—may indeed have fallen: an ageing workforce, greater worker insecurity and the changing nature of employment contracts could all have brought it down. A lower NAIRU, however, is not the same as no NAIRU. More important, the new-economy people forget that overall labour costs have risen more slowly than wages because the cost of non-wage benefits, such as health insurance, has barely budged. This will surely not last for ever.

In short, the optimists have a point, but the danger is in pushing it too far. America's economy is undergoing some striking changes; but it has also benefited from a plethora of temporary (positive) shocks. Cheerfulness is appropriate; euphoria should be held in check.

Shutting military bases

From boots to electronics

INDIANAPOLIS

THE American military establishment has closed two big installations in Indianapolis in the past five years. Walking the streets, you would never know it. Unemployment is only 2.6%. Local fast-food restaurants pay \$6.50 an hour and offer bonuses to attract new employees. Main-Street Indianapolis reflects a booming mid-western economy. It also suggests that closed bases can leave the locals not only unscathed, but sometimes better off.

The Defence Department first set its sights on Indianapolis in 1991, when Fort Benjamin Harrison, an army training camp, appeared on "the list". (The Commission on Base Realignment and Closure selected 97 big installations for closure in four rounds: 1988, 1991, 1993 and 1995.) Some 3,400 active-duty soldiers would be moved elsewhere. Over 1,000 civilian jobs would be lost.

But a gem lay hidden in the murk. The

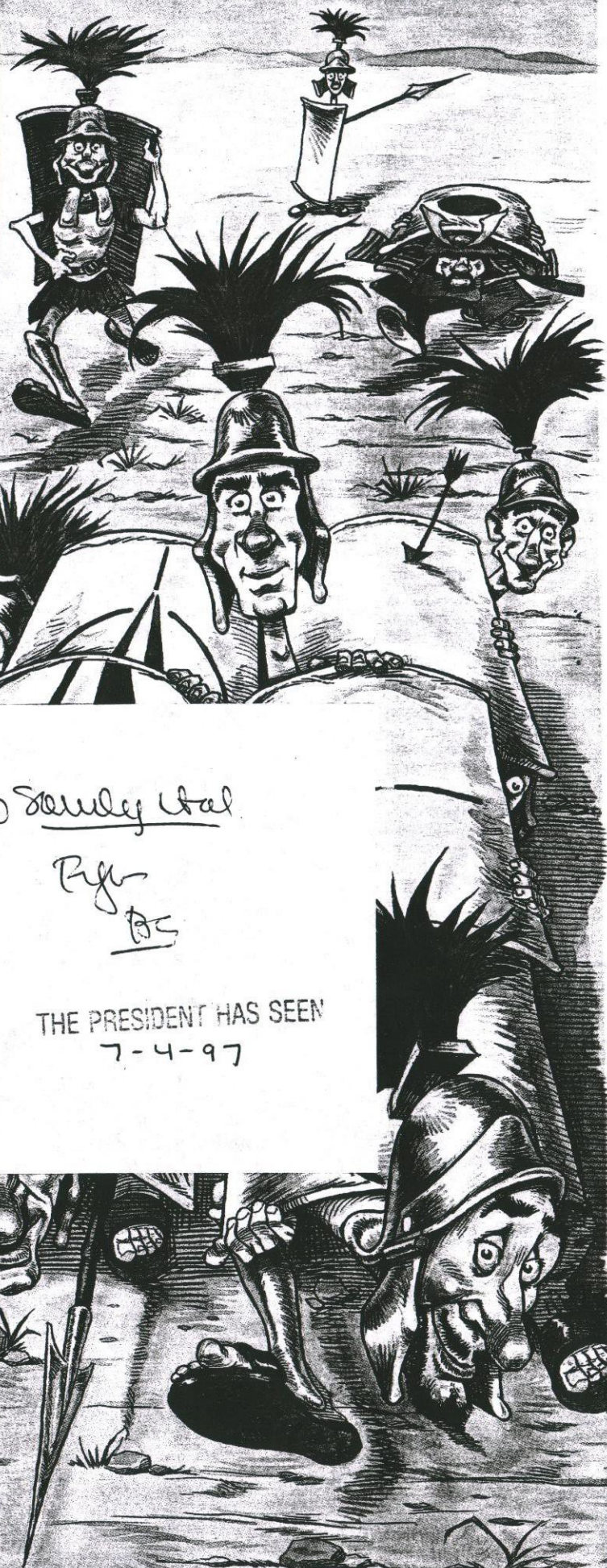


Lots of jobs and a state park, too

The Economist

A SURVEY OF
THE GLOBAL DEFENCE INDUSTRY

Linking arms



To Samuel Udal

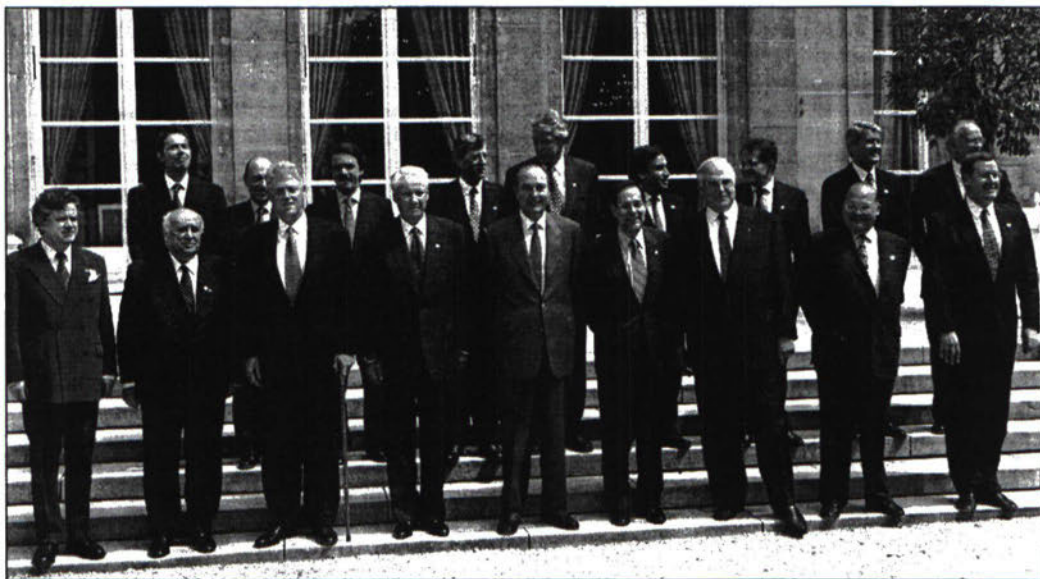
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GLOBAL DEFENCE INDUSTRY



Time for NATO allies to get even closer



Linking arms

THERE are no multinational ABBS, SmithKline Beechams or Unilevers in the defence industry; nor even any IBMS, BPS or Nissans, based in a single country but with a global spread. Defence companies the world over remain determinedly national. Everything about them is home-based: their senior managers, their factories, even most of their shareholders.

Governments still foster "national champions", banning takeovers by foreign firms and protecting home markets from imports. They insist that national security is at stake. Some of their concerns are understandable. A foreign takeover might allow sensitive military technologies, perhaps developed at great expense to the public purse, to escape into the wrong hands.

Governments may also want to maintain a capacity to make certain sorts of weapon so that, in a crisis, they can be sure of supplies; the British still remember that the Belgians would not sell them shells during the Gulf war. But this argument is wearing thin, now that no country—not even mighty America—can afford to develop all its weapons (and all their components) at home. Since the countries in NATO's military structure have agreed to trust each other's armed forces in time of war, it makes sense for them to trust each other to supply arms as well.

Some of the politicians who invoke national security are merely reflecting—or pandering to—popular sentiment. A defence industry, rather like a currency, can turn into a kind of national virility symbol. American generals have been heard to say that it would just not be right to procure a major weapons system from abroad. Crude pork-barrel politics often reinforces such emotions: defence contractors, always keen to point out how many

jobs would be lost if a foreign firm won a contract, have a firm grip on the ears of many politicians.

Despite all this, economic necessity is beginning to wear away the industry's isolationism, forcing companies both to compete and to co-operate across frontiers. Since the end of the cold war, defence budgets have shrunk drastically. The International Institute for Strategic Studies reckons world military spending was \$811 billion in 1996—the lowest since 1966 and 40% below its 1987 peak. In that year armaments industries employed 17.5m people directly (and indirectly many more); by 1995 the figure had come down to 11.1m. America now spends half as much on weapons procurement as it did ten years ago. Home markets are shrinking, but so are increasingly competitive export markets.

It can't go on like this

Slowly but surely, the defence industry is becoming more like any other. With advances in weaponry driven by commercial technologies such as digital communications and microelectronics, there is now more spin-on from the civilian economy to defence than spin-off from it. Weapons factories and research laboratories are less cut off from the mainstream economy than they used to be. To save money, defence ministries are making contractors use cheaper, off-the-shelf commercial components instead of specially designed military ones, and that means defence companies have more foreign subcontractors.

Yet despite such attempts to contain costs, the price of new weapons seems to rise inexorably. A Lockheed Martin F-16 fighter plane, developed in the 1970s, now costs about \$30m. The same company's F-22, currently in prototype, will cost over \$100m apiece. The development of an advanced

While other industries are becoming global, the defence business remains stubbornly national. But not for much longer, says Charles Grant



fighter requires economies of scale that are now beyond any single western country except America. European aerospace companies know that they will never be able to repeat the extravagance of building three separate fighters, as they have done this decade. The development and construction costs of France's Dassault Rafale, Sweden's Saab Gripen and the Eurofighter (the work of a consortium of British, German, Italian and Spanish companies) will run to a total of about \$100 billion.

Nor is it just economics that pushes defence companies together. These days a NATO country is unlikely to fight a war on its own. Its troops—whether keeping the peace or defending Europe—will often be part of a coalition, and joint military endeavours are more likely to work smoothly if the armies involved use similar or compatible equipment. The alliance's generals do not want every country to make its own tank or missile defence system. Outside NATO, too, international armaments co-operation can help to strengthen political ties. America hopes that its defence companies' partnerships in Japan, South Korea and Taiwan will reinforce its alliances with those countries.

The Boeing effect

The main force driving these moves towards globalisation is the defence companies themselves. One, in particular, is set to bring about huge changes: Boeing, which last December announced plans to buy McDonnell Douglas for \$13.3 billion. At present, some 80% of Boeing's revenues come from civil aerospace, and a similar share of McDonnell Douglas's from military aircraft. The European Commission, worried by the effect on Airbus, has

formally objected, claiming that the merger would create a near-monopoly in civil aerospace. But in the long run the EU's competition authorities are unlikely to prevent Boeing from becoming the world's largest aerospace company, with evenly matched civil and military businesses.

Boeing believes that it can succeed in defence by applying the technologies, methods and, especially, the culture of cost-consciousness that it has developed in civil aerospace. Defence contractors had got used to thinking that what matters most in a weapon is performance. That was fine when the Soviet Union was rattling its sabre and the Pentagon did not seem too bothered that weapons programmes usually overran their budgets. But the programme for a "Joint Strike Fighter" (JSF) shows how much American defence philosophy is changing.

The programme aims to achieve huge economies of scale by producing a single aircraft, with variations, for America's Air Force, Navy and Marines—as well as Britain's Royal Navy. A long production run of 2,900 aircraft, combined with the use of off-the-shelf components, is expected to keep the cost down to \$30m a plane. Last November the Pentagon chose Lockheed Martin and Boeing (but not McDonnell Douglas, a third contender) to build prototypes. Boeing had not built a fighter since the 1930s, but its plans for keeping down costs impressed the Pentagon.

Significantly, the man Boeing has chosen to head its future merged defence businesses comes from its civil side. Alan Mulally is convinced that military aerospace will have to emulate its commercial cousin. "Half our civil aircraft are made not by Boeing, but by suppliers and partners in other countries. Nothing can stop the diffusion of technologies around the world," he says. "Military customers, increasingly, are driven by value: talking to the Pentagon these days is like talking to an airline."

Mr Mulally is one of a rare breed: an idealistic arms salesman. "What's really cool about defence is that it will no longer be about defending America, but about making the world safe," he says. "Countries and companies will have to work together, for instance on missile defence. We should be talking not of national security but of global security."

By contrast, Norman Augustine, the chairman of Lockheed Martin, is firmly rooted in the practical politics of Washington, DC. Unlike Mr Mulally, he is not disposed to relax the rules which stop foreign companies from controlling American defence contractors. "We don't always see eye-to-eye with our allies, so it's difficult to be over-dependent on them," he says. When he was a Pentagon official during the Vietnam war, he recalls, some European allies refused to sell America the anti-tank missiles it needed. In 1992 Mr Augustine campaigned successfully to prevent France's state-owned Thomson from buying Vought, a maker of aircraft frames.

Jumbo jealousies

Such attitudes show how hard it will be for defence companies to build cross-border alliances. For Mr Augustine is more internationally-minded than most American defence industry chiefs. Having spent the past few years creating at home a company with annual defence sales of \$20 billion, he is now keen to expand overseas. The obvious next step

Americans ahead

World's top defence companies*

Company	Country	Defence revenues \$bn
Lockheed Martin	United States	19.39
Boeing/McDonnell Douglas	United States	17.90
Raytheon/Hughes/Texas Instruments	United States	11.67
British Aerospace	Britain	6.47
Northrop Grumman	United States	5.70
Thomson	France	4.68
Aérospatiale/Dassault	France	4.15
GEC	Britain	4.12
United Technologies	United States	3.65
Lagardère Groupe	France	3.29
Daimler-Benz Aerospace	Germany	3.25
Direction des Constructions Navales	France	3.07
General Dynamics	United States	2.90
Finmeccanica	Italy	2.59
Litton Industries	United States	2.40
Mitsubishi Heavy Industries	Japan	2.22
General Electric	United States	2.15
Tenneco	United States	1.80
TRW	United States	1.71
ITT Industries	United States	1.56

Source: Defense News

*Based on 1995 figures

is for American and European companies to link up. Rivalry among America's defence giants may provide the catalyst.

Boeing makes much of its profit from its monopoly of jumbo jets. Lockheed Martin worries that those profits may be used to undercut it in the defence business. It would therefore be delighted if Europe's Airbus went ahead with plans for a new super-jumbo, the A3XX, and is talking to Airbus and its principal shareholders—Aérospatiale, British Aerospace (BAe) and Daimler-Benz Aerospace (Dasa).

Boeing does not want to return to making airliners but envisages making parts of the A3XX—as well as collaborating with Airbus on a new military transport aircraft. "Lockheed and Airbus should perhaps get together, and not just on the A3XX," says Manfred Bischoff, Dasa's chairman. "There could be an interest on both sides in establishing a strategic partnership on a broader base, including Airbus and the defence business."

In the long run, it is the JSF programme that will probably shape the pattern of international partnerships. The British government has already paid \$200m towards the development costs, thereby ensuring that the JSF will be small enough to fit into the lift of a British aircraft carrier. BAe, having previously joined the losing McDonnell Douglas team, must now decide whether to throw in its lot with Lockheed Martin or Boeing. Technology pushes BAE



Idealistic Mulally

in the direction of Boeing, whose design for the vertical take-off version of the JSF is close to that of the BAE Harrier. But the politics of the defence industry, notably BAE's involvement in Airbus, incline it to Lockheed Martin. Both American firms are vigorously courting BAE, and not only because of the JSF. As Europe's largest defence company, and a profitable one at that, BAE would make an ideal European partner for either of them.

Mr Mulally says that, if Boeing won the competition for the JSF, it would like to make it an international project. "The concept of

building the JSF will be the same as building the 777," he says. A fifth of the Boeing 777 is built by Japanese partners who share some of the risk. "Just as we give airlines the flexibility to change the interiors of the 777, we will be able to satisfy the various JSF customers by making different models from one production line."

Dasa would be interested in joining the Joint Strike Fighter if it got the go-ahead from Germany's politicians. Mitsubishi Heavy Industries, Asia's largest defence company, is also keen on getting involved in the project. Although politics is bound to temper some companies' enthusiasm for international link-ups, Mr Mulally is surely right to predict more global weapons projects that bind countries together. This survey will examine the forces for and against the globalisation of the defence industry, looking at America, Europe and Asia in turn.



Land of the giants

THE American armaments industry has spent the 1990s transforming itself. After more than 20 mergers and acquisitions, mostly in aerospace and electronics, a small group of powerful defence giants has emerged. Employment in the defence industry has dropped to 2.1m from 3.9m in 1987, but profitability has improved (see chart 2).

With the consolidation nearly complete, three main trends can now be identified. One is that companies have either concentrated on defence or got out of it altogether. At the start of the decade several engineering or electronics conglomerates had relatively small defence units, but firms such as Ford, General Electric, General Motors, IBM, Unisys and Westinghouse have all quit the business. Meanwhile Raytheon and Boeing have become more heavily involved in defence.

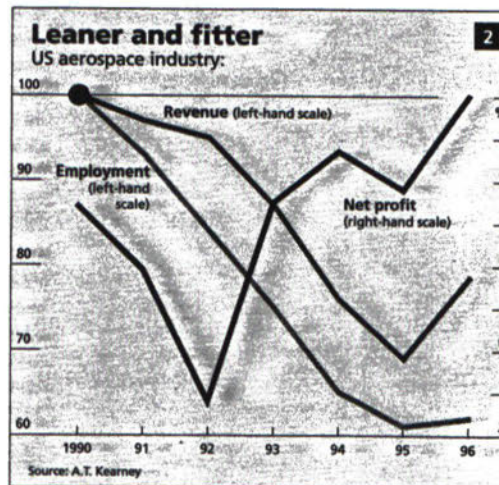
The second trend is that contractors want to get their hands on the companies which specialise in defence electronics, the one sector of the industry that is growing. The Pentagon now spends 45% of its procurement budget on electronics. That is why Raytheon, Lockheed Martin and Loral (subsequently bought by Lockheed Martin) bought units making "black boxes" from the companies that wanted to quit defence.

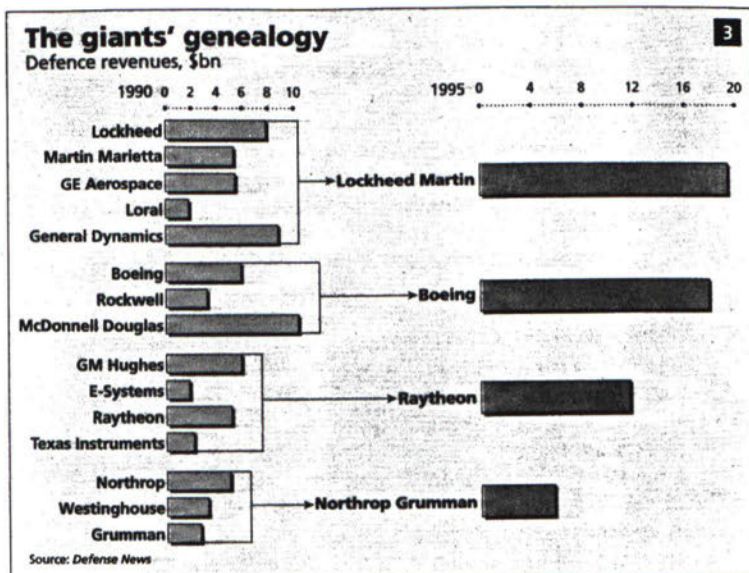
Looking to the future, demand for "plat-

forms"—aeroplanes, ships and vehicles—is likely to fall. For one thing, the missiles that can be fitted to platforms are now so accurate and lethal that an attacking force needs fewer platforms to destroy a given number of targets. For another, platforms themselves are increasingly vulnerable to precision attacks from missiles.

But that does not mean there is no money to be

Why America is out in front





made from building platforms. After all, the platform maker is usually the "systems integrator", responsible for tying together the many parts and subsystems that make up the whole. Being particularly difficult, that job is well rewarded. For instance, Boeing and Sikorsky (part of United Technologies), the systems integrators for the Comanche, a stealthy new scout helicopter, will be paid \$8 billion for making the first six. Thus Boeing's strategy of buying platform makers—McDonnell Douglas and the Rockwell space and defence businesses—rather than electronics firms is probably viable. All the defence giants want to be systems integrators, whether they focus on platforms, or on electronics (like Raytheon), or both (Lockheed Martin and Northrop Grumman).

The third trend is that in this business size is crucial. Larger firms can more readily bear the costs of R&D and bidding for new contracts, as well as the risks of managing programmes that depend on untried technologies. Lockheed Martin's acquisitions have shown that mergers can create huge opportunities for saving money by cutting staff and overheads. And they have shown that the sum of many centres of excellence can be greater than the parts: last year the company swept the board in government competitions, winning, among others, those for the Joint Strike Fighter, the space-shuttle replacement, a satellite system to track ballistic missiles, and an airborne cruise missile.

Lockheed Martin's growing weight in defence electronics spurred Raytheon to buy E-Systems and Chrysler's defence business, and then to bid for those of Texas Instruments and Hughes. "The market redefined what it took to remain a top player; you must adapt or suffer the consequences," says Peter D'Angelo, chief financial officer of Raytheon. "Size is one factor in success, and Hughes brings us critical mass."

Now the received wisdom is that Northrop Grumman, maker of the stealthy B-2 bomber, with defence sales of \$6 billion, is too small to survive. The Pentagon wants no more B-2s, and in the JSF competition Northrop Grumman was teamed with the losing McDonnell Douglas. The company says that it is large enough to remain independent. That

would be more convincing if it had not fought so hard against Raytheon in the battles for Texas Instruments and Hughes.

It was not blind market forces that created three—or, if one indulges Northrop Grumman, four—defence giants. The Clinton administration helped the restructuring along in four ways.

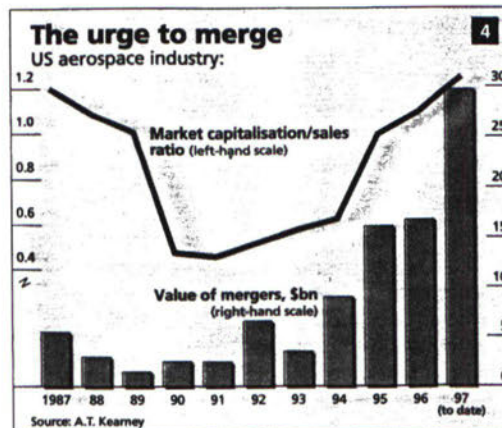
A little help from their friends

The first was exhortation. In 1993 Les Aspin, the then defence secretary, and Bill Perry, his deputy, invited a dozen defence industry chiefs to dinner in the Pentagon. Mr Perry told them there were twice as many of them in the room as he wanted there to be in five years' time, and that the government was prepared to watch some of their firms go out of business. Those present at this event—now referred to as the "Last Supper"—heeded his message.

The second sort of government help was subsidy. For the past four years defence companies have been able to claim reimbursements for the cost of mergers. The rationale for the subsidy is the peculiar pricing system, known as "cost-plus", used for big American defence contracts. Companies agree to supply weapons systems at a price made up of their costs plus a fixed amount of profit. Without such a subsidy, say the companies, they would bear all the costs of a merger, but the Pentagon would reap all the financial benefits. In short, they would have no incentive to restructure.

Take the example of Lockheed Martin and its many mergers. The company claims that it has spent \$2.3 billion on things like closing offices and laying off people. As a result of these economies, it expects to save \$2.6 billion a year, most of which will be passed on to the government. The company reckons that, over a number of years, it will be able to reclaim from the Pentagon "allowable costs" equivalent to half its \$2.3 billion investment.

But surely defence companies would have wanted to merge and cut costs anyway, to adjust to shrinking markets? Lockheed Martin's Mr Augustine thinks not, claiming that without the reimbursements only 20% of the restructuring would have happened. Allowable costs, he says, were a factor in Lockheed Martin's decision to bid for Loral, and in the amount it was prepared to pay for it. Raytheon's Mr D'Angelo also thinks the reimbursements speeded up consolidation in the industry: "Without them the companies would be less efficient, they would export less and the Pentagon



would pay more for its weapons."

The General Accounting Office appears to agree. Prompted by criticism in Congress of these subsidies—tagged as "payoffs for layoffs"—it investigated five of the mergers. Reporting in April, it found that by September 1996 the Pentagon had reimbursed companies for \$179m of their restructuring costs of \$849m, but that it had itself saved \$347m from the cost-cutting, and would in due course save more.

The third way in which the Clinton administration has helped the industry has been through a vigorous export drive. The relationship between arms exports and the health of the industry had never been officially acknowledged—until February 1995, when a presidential directive defined one objective of defence exports as enhancing "the ability of the US defence industrial base to meet US defence requirements and maintain long-term military technological superiority at lower costs."

Last year a new export-finance scheme for defence contractors came into force. For a fee the Treasury will back commercial loans to countries buying American equipment, up to a total of \$15 billion. And this year the government signalled a review of its long-standing ban on the sale of advanced fighters to Latin America, where several countries would like to buy F-16s.

Mr Clinton has also taken to twisting the arms of leaders of countries that might buy. In 1995, for instance, he lobbied the United Arab Emirates' Sheikh Zayed on a potential sale of F-16s, and Germany's Helmut Kohl on the virtues of Lockheed Martin spy satellites—though neither has yet signed a deal. This year William Cohen, the new defence secretary, publicly warned both the UAE and South Korea against buying Russian surface-to-air missiles, rather than America's Patriot system.

Whatever the role of help from high places, America's defence exports have held up well. Since the late 1980s sales have—in money terms—remained constant at \$15 billion–20 billion a year, at a time when other countries' exports (except Britain's) have shrunk. But over the same period America's share of the world market has risen from 25–30% to 40–50%. For many American firms, foreign sales have eased the pain of restructuring.

The government's fourth way of supporting consolidation has been to relax antitrust policy. No defence merger has been blocked since 1992, when the Bush administration stopped Alliant Techsystems buying Olin's ammunition business. The two antitrust authorities, the Federal Trade Commission and the Department of Justice, appear to have backed the Pentagon's pro-merger policy.

This year, however, Raytheon's attempt to buy parts of Hughes and Texas Instruments has triggered a debate on whether the industry has become too concentrated. Raytheon and Hughes combined would control the entire American market for air-to-air missiles. And the only people who make the microchips needed for fire-control radars are Hughes and Texas Instruments. The antitrust authorities are taking their time to vet these mergers, but seem unlikely to veto them. The government's procurement plans for air-to-air missiles probably would not support two separate producers.

Government officials are far less worried about "horizontal integration"—bringing together firms

in similar businesses, which is what Raytheon proposes to do—than about "vertical integration", the acquisition by prime contractors of their suppliers. Noel Longuemare, the Pentagon's deputy procurement chief, says that too much vertical integration could lead to "prime contractors freezing out foreign suppliers or other small firms in favour of their own supplier, or they could try to freeze out rival prime contractors by cutting off their access to the component maker."

Industry chiefs such as Mr Augustine stress the need to be "realistic" in accepting single producers for some sorts of equipment: America already has only one maker of tanks (General Dynamics), one of armoured vehicles (United Defence) and one of bombers (Northrop Grumman). Yet some legislators worry that less competition will mean more expensive weapons. Others fret that, with fewer rival research laboratories, the quality of American technology will suffer.

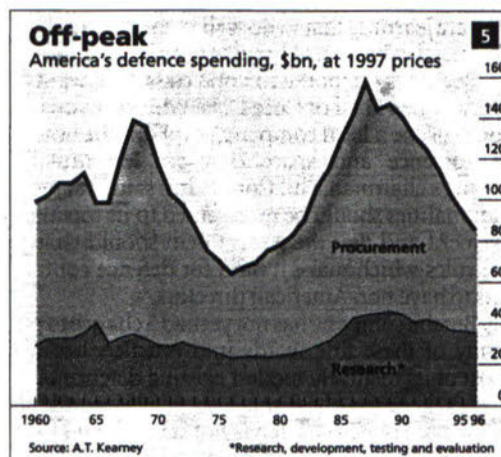
Erik Pages of Business Executives for National Security, a consultancy, thinks that the government will have to start regulating defence companies in the same way as utilities, imposing strict controls on prices and production schedules. "The government will treat defence contractors like privately-owned arsenals, subsidising them to keep open a certain number of production lines and R&D facilities," he predicts.

Sailing on

So far, the American defence industry's urge to merge has hardly touched shipbuilding. The same six shipyards that were making military vessels at the end of the cold war still do. Each of them is lucky enough to have influential congressmen battling on its behalf. When the Navy tried to concentrate production of submarines on one yard, Congress insisted that business be given to a second.

In the long run aerospace companies may take over the making of ships and armoured vehicles. For they have the skills on missiles, electronics, stealth and systems integration that are increasingly important in the manufacture of all types of platform. For instance, the Pentagon wants a prototype "arsenal ship"—a semi-submersible, stealthy barge designed to carry hundreds of missiles; two of the three prime contractors competing to build this are Lockheed Martin and Northrop Grumman.

For the market leaders, defence is not a bad





Psst... want to buy an airborne-laser ballistic-missile zapper?

business to be in. In real terms, defence spending is rather higher than it was under President Carter (see chart 5 on previous page). The industry still employs half a million more people than it did in 1976. It simply got too ambitious in the Reagan years, which launched it into orbit. And now that it is coming down to earth, at least its fall is being slowed by the combination of subsidies, an indulgent antitrust policy and buoyant exports.

But if America's defence giants want to continue to prosper, they must become more international. Within America, the defence budget is static and there is not much left to buy. Buying foreign firms outright runs foul of political sensitivities. However, America's giants are linking up with European and Asian companies in more roundabout ways, such as licensed production, co-development, subcontracting, joint ventures and minority stakes.

Until now, American contractors have tried to be "international" mainly to ensure market access. Thus they have arranged "offset" deals (giving work to local companies) in return for export contracts, but not made much of a long-term commitment to target markets. For example, McDonnell Douglas, which sold fighters and helicopters to a number of countries, seemed offputtingly all-American to some—one reason, perhaps, why it lost several recent international competitions. The smart companies are learning that to do well in foreign markets, they need to be seen to become genuine partners.

Boeing is top of the rhetoric class. "We want to be more like Shell or Coca-Cola. Wherever you are, you must be a local company," explains the boss of the defence and space division, Mr Mulally. Boeing's chairman, Phil Condit, has said that more nationalities should be represented in its top management and that the government should change the rules which make it hard for defence contractors to have non-American directors.

But the company has not yet had a chance to put many of these fine words into practice, because most of its relatively modest existing defence business (helicopters, the future airborne laser and bits of the F-22) is at home. It has not yet integrated McDonnell Douglas. Still, Boeing's leadership of Sea

Launch—a venture to launch commercial satellites from sea platforms, linking Norway's Kvaerner, Ukraine's Yuzhnoye and Russia's Energia—suggests that it is serious about international co-operation.

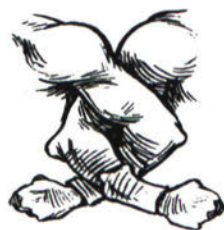
Raytheon, although firmly rooted in Massachusetts, is trying hard to grow global shoots. Its Patriot surface-to-air missiles are made by a joint venture with Dasa and Siemens in Germany. Raytheon's E-Systems subsidiary, specialising in surveillance and intelligence equipment, is supplying South Korea with a battlefield communications system, installed in Raytheon executive jets—and will, in return, invest in the local aerospace industry. In Britain, where the company has teamed up with GEC to bid for an airborne ground-surveillance system, Raytheon has a subsidiary making air-traffic-control radar. Bill Swanson, boss of Raytheon's electronics division, says that, if necessary, it will buy foreign companies in order to be seen as local.

Even after the mergers, however, only 10,000 of Raytheon's 127,000 staff will be outside the United States. And some of its senior managers lack an international outlook, a weakness common to many American defence firms. Dennis Picard, Raytheon's chairman, does not like travelling. Unlike Mr Augustine, for instance, he is seldom seen in Tokyo or Taipei. So although Raytheon has quite large businesses in those places, its profile is low.

How international can you get?

Lockheed Martin is arguably the first American defence contractor to have achieved a genuinely global reach. Last year 18% of its sales were overseas, compared with only 5% (for its precursors) in 1990. In South Korea F-16s are made under licence. Lockheed Martin engineers have helped Taiwan to produce a locally designed fighter, and worked with Japan's Mitsubishi Heavy Industries on developing the F-2, an improved version of the F-16. A joint venture with a local company is supplying Australia with ground-based early-warning radars.

Lockheed Martin is also marketing Russia's Proton rocket for commercial satellite launches, and has been hired by the Argentine government to manage its aerospace company, Fabrica Militar de



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Aviones. Together with Italy's Alenia, Lockheed Martin plans to develop a new light military transport plane. And yet, for all this activity abroad, none of Lockheed Martin's core manufacturing facilities is outside the United States. Of its 190,000 staff, only 6,000 are overseas. The company was shaken by losing a British competition for a maritime patrol aircraft last year. It thinks it lost because it was seen as foreign, and knows that it has to become more international. Mr Augustine wants strategic

partners in Europe but has yet to find them.

Lockheed Martin's, Boeing's and Raytheon's search for partners is made more difficult by the sheer difference in size between them and any European defence company. Their defence sales (after the present round of mergers) are, respectively, \$19.5 billion, \$18 billion and \$11.5 billion. Those of Europe's largest defence contractor, BAE, are \$6.5 billion. And as the Europeans have dragged their feet over restructuring, the gap has grown.



Divided continent

THE American defence industry has restructured; the Europeans have merely talked about restructuring. True, the European companies have had to contend with a host of built-in disadvantages: their market is fragmented because governments feed contracts to national champions, while total spending on military procurement and R&D in Western Europe is only 60% of the figure in the United States.

Instead of going for big cross-border mergers, Europe's defence companies have established joint ventures in particular business areas—such as Matra Marconi Space (France's Lagardère and Britain's GEC) in satellites, Thomson Marconi Sonar (France's Thomson and GEC) and Eurocopter (Aérospatiale and Dasa). These ventures offer some technological synergies and economies of scale, but each component is run as a separate operating company. They have not concentrated production on their most efficient sites.

Besides, these joint ventures are tiddlers compared with their American competitors. Matra BAE Dynamics, Europe's largest missiles group, has annual sales of \$1.5 billion; the new Raytheon will sell \$5 billion-worth of missiles a year. America now has five prime contractors for warplanes and helicopters, while Western Europe has ten; America has four missile companies, Western Europe 11.

What single market?

It would be easier to put together pan-European companies if there were more pan-European weapons programmes. But every country wants something different. France quit the Eurofighter project in 1985 because its partners wanted an aircraft too large for a French carrier. The recent plans for Britain, France and Germany to build a common Multi-Role Armoured Vehicle have stalled because France wants a vehicle with a large gun, whereas the other two need troop carriers.

The European Union cannot promote a single market in armaments as it can in other areas. Article 223 of the Treaty of Rome allows governments to exempt defence firms from EU rules on mergers, monopolies and procurement, on the ground of "national security". Not that abolition of the article would quickly lead to a unified armaments market; but the fact that governments are not even thinking about scrapping it shows Europe's distance from such a market.

The French defence industry has in itself become a major obstacle to cross-border rational-

isation. Most of the leading French firms are state-owned, which means they did not restructure in the way that British and German companies did earlier in the decade. This makes them poor marriage partners. Last year Dasa pulled out of plans to merge its missiles business with that of Aérospatiale because of doubts over its prospective partner's viability.

President Jacques Chirac's priority has been domestic consolidation. Thus he has cajoled Dassault, which is privately controlled, to merge with state-owned Aérospatiale. The government's many hesitations over the privatisation of Thomson-CSF, Europe's biggest defence-electronics firm, have delayed pan-European alliances in that sector.

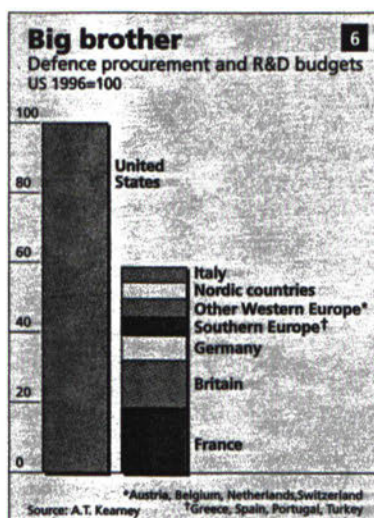
French firms' difficulties with foreign alliances are well illustrated by Giat, the state-owned maker of tanks, artillery and ammunition. Many of its staff have civil-service status, which means they cannot be laid off. Giat is still recovering from winning a contract to supply 436 Leclerc tanks to the United Arab Emirates. Having failed to cover against the rise of the dollar, it lost Ffr6 billion (\$1 billion) on the deal.

Under new management, led by Jacques Loppion, Giat has curbed its losses. It is on target to reduce its staff by 25% over two years, thanks to natural wastage and transfers to other parts of the civil service. But Mr Loppion has had to abandon plans for a joint venture in ammunition and artillery with BAE's Royal Ordnance: his workers cannot be transferred to a partly-private entity without parliamentary legislation—and there is little prospect

Europe needs to put its own house in order



Giat's Leclerc tank: big guns, big losses



of that or of privatisation. But Mr Loppion is working with a group of British and German companies, including GKN and Krauss-Maffei, to create an R&D and marketing partnership for components for the next generation of armoured vehicle.

Europe's governments and defence companies now face a choice. They could simply carry on as before, leaving the industry fragmented, but encouraging some joint ventures. Nothing awful would happen immediately, but European companies would slowly fall behind. In due course the leading firms would go bust, or need infusions of state aid, or become subcontractors to the Americans.

A second option, popular with some of France's more unreconstructed Gaullists, would be to combine pan-European consolidation with a large dose of *préférence européenne*, in the hope of strengthening the European industry. Most European governments are already biased in favour of weapons made in their own country or, if nothing suitable is available, made in Europe. But they would still be loth to give up the freedom to buy arms where they want. European budgets are insufficient to finance a full range of weapons programmes, and some American technology is too good not to buy.

The third way, which is now beginning to command a consensus, is for the European industry to consolidate, but to remain open to transatlantic alliances. However, most of the companies think that they need to restructure among themselves, to create larger entities, before they can form partnerships with any of the American giants.

C'est magnifique, mais...

John Weston, chairman of BAE Defence, has a plan for a single European company, "Eurosace", that would take over the assets of BAE, Dasa and Aérospatiale-Dassault—and later, perhaps, those of other companies. At a minimum, Eurosace would cover civil aircraft, warplanes and missiles. The obvious ownership structure would be to give each of the three founding firms a third of the capital, but Mr Weston is against that. "If decision-making required the unanimity of all three, they would tend to act as proxy national shareholders," he says. "The new European company should be owned directly by a distributed international shareholder base." To preserve the new company's independence, no shareholder would be allowed to own more than, say, 15% of the stock, and shareholders would be forbidden to act in concert. The governments would retain golden shares for emergency use. Eurosace should rationalise manufacturing and R&D facilities, says Mr Weston, but it would have to have a headquarters, directors, R&D and manufacturing in each country.



If BAE has thought more than most about the globalisation of the defence business, that may be because 87% of its sales are overseas. Some 9,000 of its 43,000 employees are based outside Britain. Mike Turner, head of exports and of its commercial business, proclaims his commitment to putting an end to BAE in its present form. "We must be part of a larger entity, hopefully in Europe, and then with the Americans."

European companies give BAE's scheme a cautious welcome, but worry that it could be a ploy for the British firm to dominate its weaker partners. For Dasa's Manfred Bischoff, the Weston plan is "economically an ideal solution, but it will be hard to establish on the basis of today's and tomorrow's political realities." If there were direct shareholders, the British or the French or the Germans would end up with the most shares, which might be politically difficult.

"We need to go step by step, from Airbus to military aircraft and then to missiles, defence electronics and maybe space, to test whether we can handle the political questions and get people to work together," says Mr Bischoff. And he foresees problems with regional specialisation: "If Eurocopter concentrated production at its most efficient site, would the country without a factory still be willing to support future helicopter programmes?"

The French are the most cautious about creating a "Eurosace". Aérospatiale is even dragging its feet on the plan to make Airbus a fully-fledged company. "In the long run it is necessary to regroup European military aerospace if our companies are not to become subsidiaries of American firms," says Jean Fournet, a director of the Délégation Générale des Armements (DGA), which runs French procurement. "But we prefer a restructuring which is not necessarily the complete restructuring asked for by Mr Weston." He points to the problem of different shareholding structures in the three companies: BAE's shares are widely dispersed, Dasa's are held in large blocks and Aérospatiale is still state-owned.

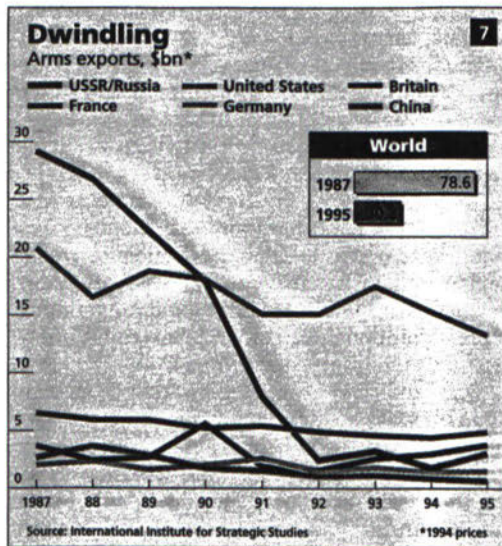


Weston has a plan

Mr Weston's scheme would need firm political support to have much chance of success, and France is not the only place where that is lacking. Britain's Conservatives, when in government, supported the idea of pan-European alliances, but said it was the companies' job to get on with it. The new Labour government has yet to take a view. No one from either

party has suggested changing the law laying down that foreigners cannot own more than 25% of BAE or Rolls-Royce. Under Mr Weston's proposal, that law would have to go.

To the extent that Germany has a policy in this area at all, it appears to be thoroughly muddled. Last year BAE and Dasa proposed to take over STN, a naval-electronics firm, in a 50-50 joint venture. The German defence ministry issued a warning that STN should remain under German control. But this year it has allowed BAE to buy 49% of STN, with Rheinmetall taking the rest. Yet it has also let it be



known that Siemens's defence business, which is up for sale, should go to a German owner.

An exasperated Mr Bischoff reckons that the nub of the problem is the lack of a European common foreign and defence policy. He accepts that the Europeans cannot wait until they get one before rationalising their defence companies: the Americans would sweep the board. But he cautions: "We companies cannot run too far ahead of what our customers, the governments, are thinking, or we lose them."

A common European defence industry, no less than a common currency, would call for political leadership at the highest level. But the chiefs of the European companies have never been invited to a "Last Supper" to be told to merge—and the chances are they never will be.

The bright side

Despite the difficulties, the European defence industry is probably heading for a radical restructuring. Governments that insist on slashing procurement budgets cannot ignore the laws of economics forever. Germany's procurement budget is less than half what it was ten years ago, which means that Dasa's defence business—although drastically rationalised—is losing money. Governments all over Europe will have to think hard about the future of the arms industry.

More positively, Airbus probably is on the way

to becoming a real pan-European company, and thus a model for defence firms to follow. Dasa announced in May that 30% of its missiles company would be sold to Matra BAE Dynamics, and that its satellite business would fuse with Matra Marconi Space. GEC and Italy's Finmeccanica, which is due to be privatised, are talking about teaming up in defence electronics.

The election of a left-wing government in France will delay the privatisations of Aérospatiale and Thomson-CSF. Before too long, however, the Socialists are likely to see the logic of pan-European restructuring and thus the need for privatisation. Both Alcatel and Lagardère, which had been competing to buy Thomson-CSF, are ready to renew their suit. Each of them has agreed, in the event of winning Thomson-CSF, to form a defence-electronics alliance with GEC.

Encouragingly, most of the large pan-European weapons projects are making progress, however slowly. The Eurofighter has flown and will be built. There are similarities with the F/A-18E/F, the US Navy's new fighter: both are large, non-stealthy aircraft of the same generation, and both will cost about \$50m apiece. But the Eurofighter outscores the American plane on performance.

Europe's first common naval programme—the British-French-Italian "Horizon" air-defence frigate—almost sank because of a row over its radar. But under a compromise, the British ships will get a more powerful system than the Italian and French frigates. Such co-operation does cut costs: Britain's defence ministry says it is saving £500m (\$820m) by using a missile system already developed by France and Italy, and the same again through joint development of other parts and systems. Thus its 12 frigates will cost £4.5 billion, instead of the £5.5 billion an all-British programme would cost.

Size is not everything, even in defence. As in any business, there will always be niches for small firms to exploit. For example, Messier-Dowty, an Anglo-French venture, is the world's leading supplier of landing gear for military aircraft. Much European equipment, particularly in the "mid-tech" range, remains competitive. BAE has sold nearly 800 of its Hawk light fighters to 17 countries. Germany dominates the market for diesel submarines, which America does not make. By concentrating on such niches, the Europeans are, just about, maintaining their share of the arms export market. That may give them a few years to get organised—but not many.



Home alone

LAST January, at a forum organised by the Pentagon in Washington, DC, the bosses of 15 Japanese defence companies joined their American peers. The same group is due to meet again this autumn, to draw up proposals on how to expand co-operation between the Japanese and American defence industries. The upshot may be an end to the ban on exports of Japanese defence equipment, which would allow Japanese firms to supply components to America's defence giants.

The Japanese defence industry is the most high-

tech in Asia. It enjoys an annual procurement budget of about a trillion yen (\$8 billion), nearly as large as those of Britain or France, of which almost 90% is spent at home. It makes armoured vehicles and warships, as well as many kinds of radar and missile. The one gap is in aviation: Japan has had to build its fighters, jet engines and military helicopters under licence. But the Japanese have learned a lot from licensed production and the gap is starting to close. Kawasaki Heavy Industries is developing a locally designed reconnaissance helicopter, the OH-

Japan's defence industry is large, capable and high-tech—but isolated



x, and Mitsubishi Heavy Industries (MHI) is the lead contractor on the F-2, a modern fighter that has entered production.

Japan's defence industry has been nourished by the country's strength in many civil technologies. For example, composite materials have been used in fighter wings, and ceramic components in vehicle engines. Other dual-use technologies at which Japanese industry excels include integrated microwave circuitry, electro-optics and speech recognition. This "spin-on" of commercial technologies to military applications is made easier by a Japanese peculiarity: the country does not have defence companies as such, only industrial conglomerates for which defence is one of many activities. Thus at MHI, which last year had military sales of nearly \$3 billion, defence usually accounts for less than 20% of turnover. At NEC, which produces state-of-the-art command, control and information systems, only

Raytheon's Patriot, they insist on making most of the components locally.

Japanese defence companies are learning fast, but American and European firms need not fret about being overtaken—at least not yet. This is because Japan's special security situation has left it rather cut off from the globalisation of the defence business. Since 1967 Japanese governments have maintained a ban on exports of defence equipment. That means shorter production runs, and therefore more expensive weapons. It also stops Japanese firms joining international programmes, because components made in Japan could not be exported to the partner country.

The export ban is one reflection of a powerful strain of pacifism in public opinion. Another is the fact that companies which make armaments go out of their way to disguise the business they are in. Even the vocabulary of defence is different from other countries': Japan has not an army, but a Self-Defence Force.

The price of self-sufficiency

The long-running saga of the F-2 fighter plane (formerly the FS-X) shows up the defence industry's weaknesses. In the early 1980s Japan wanted to develop its own fighter, but America, anxious to prevent it from becoming self-sufficient in defence technology, put pressure on the government to desist. The compromise reached after much argument provided for a "co-development", based on the Lockheed Martin F-16, for which America would supply 40% of the parts. The Japanese agreed to share any new technologies derived from the joint programme. They then refused to hand over know-how on phased-array radar and composite wings, which they said did not—and the Americans said did—come from the programme. At American insistence they eventually transferred the technology.

The F-2 has suffered huge delays and is still not in service. It will perform rather better than an F-16, but at about \$80m it will cost more than twice as much. Despite help from Lockheed consultants, MHI and its Japanese partners seem to have had trouble with design and systems integration.

"Although we are skilled copycats, we are not yet so good at the creativity and originality that design and systems integration require," says Keiichi Nagamatsu, secretary-general of the defence committee at the Keidanren, the federation of Japanese industries. There are reasons, he says, why Japanese weaponry is not always of the highest quality: "Our companies have not faced the competitive pressure of export markets. And Japan has not had any practice at warfare since the JDA was founded."

Perhaps because the companies cannot export or join international programmes, their culture is thoroughly domestic. At MHI, for instance, some of those running defence production do not travel, do not speak English, and say they would not dream of talking to foreign companies unless the government told them to. Constant rows over technology transfer have put some Japanese companies off the idea of partnership with Americans, and reinforced the ethos of techno-nationalism.

The government's official line is that Japan must continue to develop a full range of military technologies, including fighter aircraft, so that, if



Honorable F-2, at \$80m apiece

\$700m of sales (2.5% of the total) are military, though that figure excludes dual-use components.

The government, the civil service and the engineering companies have treated a capable defence industry as a national priority. The belief of many members of the elite that, if Japan is to be rich and strong, it must learn to make its own defence equipment, has been dubbed "techno-nationalism" by Professor Richard Samuels of the Massachusetts Institute of Technology. "Strength in military technology and the defence industry means a stronger military capability; it is a deterrent [against attack]; and it gives us more bargaining power in negotiating over imports of equipment or licensed production," says Atsushi Oi, director of the procurement division of the Japan Defence Agency (JDA)—Japan's equivalent of a defence ministry.

The governments of most big industrial countries encourage arms production and high-tech R&D, but Japan takes this policy to expensive extremes. For example, its decision to develop its own short-range air-to-air missile, rather than import America's Sidewinder, may have quintupled the cost, according to some estimates. "In the United States, weapons are judged by three criteria: performance, cost and delivery date," says Mr Samuels. "In Japan, by far the most important thing about a weapon is learning how to make it." So when the Japanese build a weapon under licence, such as

Second line of defence

8

Top defence companies, outside US and Europe, 1995

Company	Country	Defence revenue, \$bn
Mitsubishi Heavy Industries	Japan	2.22
Kawasaki Heavy Industries	Japan	1.51
Mitsubishi Electric	Japan	1.05
Israel Aircraft Industries	Israel	1.02
NEC	Japan	0.71
Denel	South Africa	0.70
Ishikawajima-Harima Heavy Industries	Japan	0.55
Toshiba	Japan	0.49
Hindustan Aeronautics	India	0.37
Tadiran	Israel	0.37

Source: Defense News

supplies of advanced equipment are cut off, it will be safe. But some officials in the JDA and the Keidanren believe that, in the long run, economics will force the Japanese defence industry into international ventures. Japan's procurement budget is unlikely to rise, and the country will not be able to afford an "F-3" to replace the F-2. "The choice will be

between an off-the-shelf fighter or participation in an international programme," says Mr Nagamatsu.

The Keidanren is lobbying for a relaxation of the export ban, at least for parts destined for jointly-produced weapons. Some dual-use goods, such as silicon chips and liquid crystal displays, are already exported to American contractors. In April a policy panel of the ruling Liberal Democratic Party proposed changing the export rules. That may be linked to the growing belief among policymakers that Japan needs a ballistic-missile defence system. Since it could not make one itself, they would rather it joined an international programme than bought a system off-the-shelf.

Public opinion does not appear to favour lifting the export ban, but it might be even less enthusiastic about the tax increases that would be needed to pay for another indigenous fighter. Politicians could probably sell more liberal export rules by saying that without them the security relationship with America would suffer.

If America were to pull out of East Asia, and China looked menacing, Japan might shift resources into building a stronger, autonomous defence industry. But it seems much more likely that, in the long run, Japan's defence companies will dip their toes into global markets.



An open-and-shut case

JAPAN is not the only Asian country trying to build a modern weapons industry. Nor is it the only Asian country to worry about the strength of America's long-term commitment to the region, and about a possible threat from China. That insecurity, combined with steady economic growth, explains why East Asia is the one part of the world where defence spending is rising. Countries such as South Korea, Thailand, Singapore and Malaysia are spending more both on imported weapons—East Asia's share of the world's arms imports has doubled over the past ten years, to a quarter—and on the creation of local arms industries.

Taiwan and China, both keen to develop weapons industries, have chosen different routes. China, enjoying a huge home market, wants to be fully autonomous in armaments production. Taiwan, like many other states in the region, is trying to build a weapons industry on the basis of an open economy and a workforce skilled in information technology. It feels it does not have the time or the money to become self-sufficient in weapons.

Taiwan's arms industry began with licensed production of American weapons, such as F-5 fighters, frigates and Patriot missiles. Now the country has graduated to designing some weapons on its own. Its tanks are exported to Latin America, and its air-to-air and anti-ship missiles work well. The pride of Taiwan's industry is the Indigenous Defence Fighter (IDF), a modern, lightweight jet built by the state-owned Aerospace Industrial Development Corporation (AIDC). The IDF entered service this year, several years ahead of the advanced fighters that India, China and Japan are working on.

AIDC builds the IDFs in Taichung, south of Tai-

pei, in a factory that looks as well-equipped and efficient as most western aircraft factories. During the design phase Lockheed Martin supplied 100 consultants, but now that the plane is in production only 30 remain. "They are not allowed to pass on technical data," says General Tsai Chuen-Huei, AIDC's chairman. "But they review our work and tell us if we make a mistake."

Equipped with modern radar, inside-helmet displays and fly-by-wire controls, the IDF can intercept an enemy aircraft beyond visual range. But there are worries about the fighter's performance. Its twin engines are under-powered because America would not release modern engine technology. And the range is only 300 nautical miles with external fuel tanks. So a project which has cost Taiwan perhaps \$10 billion in all—even though the cost of producing each IDF is only \$20m—may not increase the island's security all that significantly.

Taiwan's government appears to have learned its lessons from the IDF. It now puts less emphasis on self-sufficiency and more on getting the best weapons from wherever it can. Having reduced its order of IDFs from 250 to 130, it has bought 150 F-16s and 60 Dassault Mirages. About half the procurement budget is now spent on imports.

That does not mean Taiwan has abandoned plans for building a strong defence industry. It wants to work with as many foreign firms as possible, to strengthen its technological base and tighten political ties with the West. It insists on offset deals in return for purchases. Thus Taiwanese factories make parts for Lockheed Martin F-16s and C-130 transporters, Dassault executive jets, Sikorsky helicopters and McDonnell Douglas airliners. The gov-

Taiwan looks outwards, China inwards



ernment was delighted when Lockheed Martin chose Taiwan as a maintenance centre for East Asia.

Unfortunately for Taiwan, international politics limits its ability to join global alliances. Few big foreign firms would risk making a public commitment to Taiwan by forming a strategic partnership with AIDC: they would not want to incur China's wrath. It is no coincidence that Lockheed Martin, which does not sell airliners to China, is more active in Taiwan than Boeing, which does.

China has a record of bullying western countries into cold-shouldering Taiwan. France, having sold Mirages and La Fayette frigates to Taiwan, promised China it would stop; Germany reneged on promises to sell Taiwan submarines, which it needs more than anything else; and Britain has never sold weapons to Taiwan because, says one official, "our commercial interests in China are more important." The United States allows the state of its relations with China to determine how much of Taiwan's shopping list it will supply.

Lone giant

China, just across the Taiwan Straits, has the world's largest armed forces and, measured by numbers employed, the world's biggest arms industry. All the statistics on China's defence industry are dubious, but the lowest plausible estimate is that it employs 3m people in 1,000 factories. Apart from Japan, China is the only Asian country capable of making almost the entire range of weaponry.

The Chinese industry already has pockets of excellence, such as its multiple-warhead strategic nuclear missiles, or the highly accurate M-9 and M-11 ballistic missiles that it fired into the sea off Taiwan last year. Paul Godwin, a professor at the National War College in Washington, DC, believes that China is capable of having the continent's most advanced industry 20 or 30 years hence. For now, however, he describes the bulk of China's defence industry as "the most backward in Asia".

In the 1980s China exported much cheap, low-tech weaponry, but the Gulf war taught many governments the virtues of more sophisticated equipment. China cannot offer high-tech weapons, which is why its arms exports are now only about \$1 billion a year, a third of what they were ten years ago. Its main customers are Myanmar, Iran, Pakistan and several African states.

For the moment China, unlike Japan and Tai-

wan, is largely cut off from western military know-how. The West does not allow its arms companies to operate in China because it does not want to aid the defence industry of a country it does not trust. Both America and the European Union impose arms embargos. However, Europe's stance is softening: Britain has sold "defensive" radars and France has called for the EU embargo to be lifted.

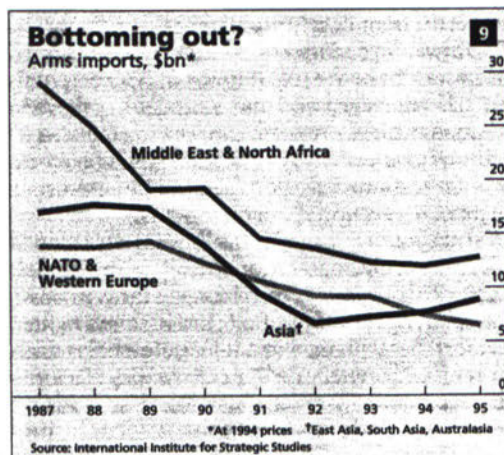
China's isolation is partly self-imposed. The nationalist ideology which stresses self-reliance in arms production is even stronger in China than in Japan. And not without reason: the Chinese were left in the lurch when Russia cut off co-operation on weapons manufacturing in 1959, and again when America did the same in 1989, after the Tiananmen Square massacre. China accepts that it has to learn particular military technologies from abroad (machine tools from a McDonnell Douglas airliner factory ended up in one making missiles), but it is generally reluctant to work with foreign partners.

No part of the government appears to have a firm grip on the sprawling defence industry. There is little co-ordination and much duplication. In the research laboratories near Beijing, where new weapons are developed, standards are high and pay is good. But the state-owned companies that do the manufacturing—mostly in central China, away from the booming consumer industries of the coastal belt—are hugely inefficient and have problems with quality control. These companies have won some autonomy but suffer from inadequate capital, poor management and a steady migration of their best workers to the private sector.

China's defence industry is weak in command, control, computer and communication systems, known collectively as "C4". It is working on advanced cruise missiles, a satellite positioning system and airborne early-warning radar, but does not yet have any of them. It has built two modern destroyers, but is stuck now because America will not supply their gas-turbine engines. It has made fighter aircraft but its advanced model, the J-10, under development since the mid-1980s, has yet to fly.

China's government has now turned to Russia as the best available source of foreign technology. It has bought 72 Su-27 fighters—and plans to build more under licence—as well as Russian Kilo submarines. But with a limited procurement budget (estimates range from \$2 billion-5 billion a year), it cannot splash out on imports. Besides, Russia, being itself backward in C4, is not the ideal partner. It now insists on being paid mostly in hard currency rather than soft running shoes, and is unwilling to sell its best equipment.

In the long run, China's armaments industry does have great potential. Any country that is quarrelling with so many neighbours has a strong incentive to master high-tech weapons manufacturing. So long as the economy grows rapidly, the government can spend increasing sums on R&D and imported technology. China has proved that, if it concentrates resources on a particular objective, such as building ballistic missiles, it can succeed. But for the time being its defence industry is inferior to that of Taiwan, Japan or Russia. And that gap is likely to grow—unless China joins the rest of the world in an increasingly global arms business.



A new Atlantic alliance?

THE globalisation of arms production will be shaped by political geography. Across the Atlantic, within the NATO area, alliances and technology transfers will come thick and fast. Asian countries such as Japan, South Korea and Taiwan will in due course join this web of inter-dependence, provided they remain closely allied with America. Russia and China, for now, will remain apart: NATO governments cannot yet trust them not to pass know-how to the wrong people, or to use it against the West.

The next stage of this globalisation will involve alliances between American and European companies. The benefits are potentially huge: shared technologies, cheaper new weapons, less risk of protectionism, more chance of competitive tendering, more common equipment for NATO forces and stronger political ties among the allies.

Dasa's Manfred Bischoff, a champion of such alliances, thinks it inevitable that NATO members will come to depend on each other for military supplies and technology. He points to the jet-engine manufacturers, in their civil business, as a model for the defence industry to follow. Each of the big three companies is linked with a transatlantic partner. General Electric has a successful joint venture with France's Snecma; Pratt & Whitney has an alliance with Dasa; and Britain's Rolls-Royce has bought Allison, an American firm.

Transatlantic misapprehensions

But Mr Bischoff worries that the Americans may think they can have their cake and eat it—making alliances to secure access to foreign markets while insisting on protecting their own. He relates indignantly that when General Dynamics wanted Dasa engines for Abrams tanks, they had to be made under licence in America. The Pentagon insists that virtually all the foreign weapons it buys are made by American companies in America. "Partnerships must be based on the respect of equals," he says.

Deep down, the Europeans know that until they get a move on with restructuring their industry, they cannot claim to be the Americans' equals. They are right, though, to argue that American attitudes often discourage partnerships. For instance, Lockheed Martin's Norman Augustine has said that the "two-way street" in transatlantic trade should not cover only armaments. America has a competitive advantage in arms and should export them, he says. Europe is good at making things like wine, whisky and marmalade which it can sell to America.

There may be some economic truth in Mr Augustine's jibe, but politically it is not realistic to suggest that the free world should simply hand over weapons production to America. The Europeans believe that this would constrain their ability to manage national, or indeed European, foreign and defence policies.

As things stand, there is not much of a two-way street in armaments. In 1995 America imported \$500m-worth of European arms, but exported \$3.1 billion-worth to Europe. To most Americans, those figures are proof of their technological superiority;

to most Europeans, they reveal American protectionism. There is truth in both explanations.

Paul Kaminski, the Pentagon's retiring procurement chief, did his best to encourage America to join international programmes and to buy foreign weapons. But congressmen and the armed forces often undermined his efforts. Thus the army went behind Mr Kaminski's back to cut off money for the Medium Extended Air Defence System (MEADS), a joint American, German and Italian venture for missile defence, although funds were later restored.

A smaller defence budget seems to have made Congress determined to ensure that all of it is spent at home. It has seldom understood Mr Kaminski's argument that international projects can save money, thus allowing more weapons to be developed and creating American jobs. Congress still passes laws with "domestic source requirements", specifying that certain items have to be made at home. For example, the Commerce Department, concerned by the success of British-made Martin Baker ejector seats in America, has set up an inquiry which may lead to source requirements on such equipment.

Under American law, any defence contractor bought by a foreign firm has to be run by a "proxy board" of Pentagon-approved American citizens. Any contact between the parent and its company, such as visits, is strictly limited. France's Matra, which in 1988 bought Fairchild, a maker of avionics and satellites, found the experience deeply frustrating. "When we saw the management going wrong we could not step in to put it right," recalls François Heisbourg, a senior vice-president of Matra. "We could hire and fire but were not allowed to tell the board what the strategy should be." Not surprisingly, Matra sold Fairchild in 1994.

American rules on technology transfer and export control also make joint projects and collaboration difficult. The Pentagon will not release the source codes for the software of its military technology, even to close allies such as Britain. And any weapon containing American parts requires re-export approval from the American government. The point of this rule is to prevent high-tech equipment getting into the wrong hands—but it has been used for commercial advantage. When Swedish Gripen were competing against American F/A-18s for a Finnish order, the Pentagon stopped them being fitted with American missiles. That encouraged Finland to buy F/A-18s.

The Europeans, for their part, are far from blameless. Their penchant for protecting their own markets from each other—let alone from the Americans—makes it that much harder to build a transatlantic armaments market. And until the European companies get together, most of them will be too small to link up with American firms except as subcontractors. The delays in restructuring Airbus are unfortunate. Not until Airbus is run like any other company will BAE and Dasa let it make the A3XX.

In the end, even defence must globalise



Bischoff: alliance-minded





Boeing's Joint Strike Fighter—in more than one sense

And only then will Lockheed Martin agree to become its partner. It does not help that the French are sometimes a little paranoid about American intentions. "We are not interested in alliances with the Americans. The Europeans are too small and would become suppliers of spare parts," says Jacques Loppion, chairman of Giat. He points to the dangers of becoming dependent on America, which he thinks is aiming for total global leadership.

For all the evident barriers on either side of the Atlantic, there is not much doubt that international co-operation on armaments will increase. Those who invoke national security to oppose interdependence are often doing no more than appeal to pork-barrel politics or national pride. Defence budgets in Europe and America are continuing to shrink. Mr Kaminski points out that America could not afford to develop MEADS if foreign governments were not paying nearly half the cost.

Encouragingly, too, the leading American contractors are changing their attitude. They may, as Mr Bischoff says, try to have their cake and eat it. But they also believe that, unless America opens its doors, there is a real danger of Euro-protectionism. Last year they persuaded Congress to pass legislation empowering the Pentagon to overturn some "domestic source requirements".

Boeing's Alan Mulally is sincere in his desire for international partnerships: his company is taking a 40% stake in Aero Vodochody, a Czech maker of light attack jets. And even in France, people such as the DGA's Mr Fournet and Matra's Mr Heisbourg think that—once European firms have restructured—there will have to be transatlantic alliances.

Such alliances will require common projects, which in turn depend upon common requirements. William Cohen, America's new defence secretary, is committed to supporting the few common projects already under way. America, France, Germany, Spain and Italy have developed MIDS, a digital communication, navigation and identification system for vehicles or aircraft. Mr Kaminski intervened to block a rival system favoured by the US Air Force, and MIDS is now in production.

Another transatlantic project, based on a common British and American requirement, is for a reconnaissance vehicle that would carry sophisticated surveillance equipment. Two transatlantic teams—one consisting of Lockheed Martin, BAE, General Dynamics and Vickers, the other of GEC, Texas Instruments, GKN and United Defence—will

compete for a contract worth about \$5 billion.

Then there is the Joint Strike Fighter, which the Pentagon estimates will cost \$210 billion. The Netherlands, Denmark and Norway have already declared their interest in buying into the programme as "associate partners". Germany needs a replacement for its Tornado bombers and may take part when it has found the funding for Eurofighter. In the long run the JSF may become a huge collaborative venture for America and its allies—if only because, come 2020, it may be the only advanced fighter being built in the western world.

Companies are driving this globalisation, but governments also have a part to play. The Clinton administration should try harder to convince Congress of the virtues of international collaboration and the vices of protectionism. It should push for a relaxation of the rules on proxy boards, on technology transfer and on the re-export of American parts.

The EU, for its part, should revise the Treaty of Rome's article 223, to show it is serious about a common armaments market. Europe's politicians should encourage defence firms to link up, and give them some help by agreeing on common rules for exports. The Joint Armaments Co-operation Organisation, recently set up by Britain, France, Germany and Italy to manage common programmes, should champion pan-European tendering.

A job for NATO

There is only one body that can oversee the creation of a transatlantic armaments market, and that is NATO. It already has a Conference of National Armaments Directors (CNAD), which is supposed to harmonise procurement requirements. But CNAD has achieved little. It has spent years arguing over four competing systems of airborne ground surveillance. The armaments directors lack the clout with their governments that would enable them to strike deals on common requirements.

Norman Ray, the NATO official who chairs CNAD, sensibly argues for a new, high-level forum that would bring together policymakers from defence, foreign and trade ministries. Such a forum could promote a transatlantic market by drawing up common rules on exports, technology transfer, state aid and shareholdings. It could co-ordinate research programmes and hammer out common requirements for new weapons.

The forum should encourage some division of labour among the allies. For instance, it may not make sense for the Europeans to devote part of their scarce resources to a new transport plane, such as the putative Future Large Aircraft, or to spy satellites, when America's industry is already strong in those areas. Similarly, there may be areas of European strength—for example, some of the avionics that GEC successfully exports to America—where the Pentagon could save money by pruning R&D.

Once this forum was established, non-NATO countries with advanced defence industries and reliable democracies—such as Japan, Australia, South Africa and Israel—could join. In the long run, who knows, Russia or even China might qualify for this global armaments club. But that would be a question of politics rather than economics. In the weapons business, politicians will always have a say.

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VP

Bowles

such laws, if only to protect themselves from malpractice suits. All this suggests it would be an abdication of moral duty if human beings did not at least make the attempt.

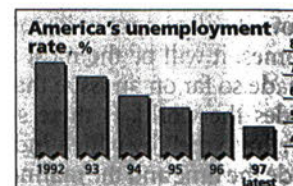
The burden of such laws should be that assisted suicide is a last resort. It should be there for people who insist on it; they should have the freedom to make their own choice. But before embracing that option, doctors and politicians should consider other ways to shore up the dignity and self-determination of the individual. Patients should be fully informed about what is being done to them. They should receive the best care possible, including palliative treatment, a dimension of terminal care that is often scandalously neglected:

and this in turn will require, in America, a proper effort to extend health coverage to the uninsured. Patients should be able to determine where they die, at home, in a hospice or in hospital. And, most fundamental, they should have the right to refuse medical treatment, either at the time or through advance directives such as "living wills".

Of course, it could be argued that refusal of treatment is often tantamount to a wish to die sooner. It could be argued, too, that an injection by a doctor could bring about the same result more painlessly and quickly. But this choice, like the choice of suicide itself, is a special thing: a decision that must belong to individuals and their consciences.

Bill Clinton's golden moment

VP/SUB - FYI
DC



Use it, don't lose it

EVERY host likes to show off; and few have more chance than Bill Clinton at the opening this weekend of the Summit of Eight. Resplendent in his re-election and in his new youthful haircut, backed by the Colorado mountains and the sweeping western skies, the president will be in his element. Best of all, though, is the fact that he presides over an economy (see page 27) that is now the wonder of the world.

America is now in the seventh year of an orderly expansion, growing at an annual average rate of 2.5%, with no significant downturn in sight. Unemployment stands at around 4.8%; yet, astonishingly, there are no signs of inflation. The stockmarket is at an all-time high; Americans are being paid more, and they expect to hand their prosperity on to their children. That old ghost, worker insecurity, seems to have drifted away. To the perplexity and envy of the Denver summiteers, America, with over 12m new jobs since 1991, now seems to be an unstoppable job-creating machine.

The president's bit

How much of this should their host seize credit for? The summiteers will want to know, in case there are lessons they can carry back home. Some American advantages, it is true, will be hard to replicate. Its people are more entrepreneurial than Europeans, more willing to move in search of work, harder-working when they get there, and less bothered by social inequality. They can raise money in the country's deep capital markets and sell to a huge single domestic market united by a common language. Yet even natural advantages can be squandered; it is not so long since America was pronounced in deep economic decline. In many ways, it is economic management, even of Bill Clinton's haphazard variety, that has restored America's health.

From the mid-1970s onwards presidents pushed for deregulation in areas from telecoms to road haulage; the result has been higher productivity and growing markets. Awkward trade unions have not been tolerated, and even Democrats have seldom contemplated social mollicoddling of the sort that has inflated labour costs in Europe. Labour-market flexibility, although traditional, has also been encouraged by government policy. Mr Clinton pursued the trade pacts that have brought new jobs and competition; since the passing of the

North American Free-Trade Agreement in 1993, America's exports to Mexico have risen by a third. Against his voracious instinct to interfere, the president has left Alan Greenspan at the Fed to manage monetary policy with finesse. And lastly, by embracing the principle of lowering budget deficits, Mr Clinton has allowed long-term interest rates to fall too, encouraging business to invest in new plant, new tools and shiny new computers on a scale barely dreamt of elsewhere.

Booms and their uses

The question that remains is whether he, and Americans in general, are making the most of these extraordinary times. Economic booms bring governments more revenue, as well as more breathing space. These can be frittered away, or they can be used to tackle deep-seated problems and invest in future growth. America at present, like the proverbial summer grasshopper, is doing more frittering than stockpiling.

Sensible long-term ideas are not lacking. Already, extra revenue in state treasuries is easing the pain of getting welfare mothers into jobs. It could be used, too, to subsidise education experiments such as charter schools and school vouchers, or testing to uniform national standards; it could be used to reconstruct and stimulate the inner cities, or to expand the programme of tax credits for poorer working Americans. As the European visitors to Denver will not hesitate to point out, 13% of American families remain in poverty while the country booms; and although their numbers are falling at last, the gap between rich and poor, skilled and unskilled, remains far wider than a civilised country should accept.

Yet the omens are depressing. America still clings to some bad economic habits, including a failure to save—the private savings rate, at a dismal 5%, is one of the lowest among the rich countries—and a tendency to think short-term rather than provide for the future. Recent congressional behaviour has been typical. Trade pacts have fed the boom; yet extension of fast-track authority to admit Chile to NAFTA has been languishing for months. Fiscal discipline has restrained interest rates; yet the budget deal which has just been agreed contains tax cuts unbacked by explicit spending cuts, and throws to the wind the few sensible entitlement reforms which Congress had been contemplating. This is a budget which, far from in-

The right to choose to die

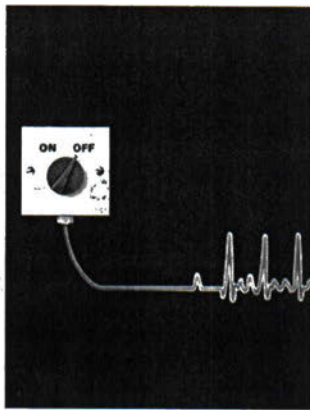
ALMOST a year ago, America's Supreme Court decided to rule on whether the constitution includes the right to request a doctor's help to commit suicide. Any day now, it will announce its conclusion. When it comes, it will be the most important ruling made so far on an issue that increasingly divides the world. Is there such a thing as a "right to die", by which individuals may decide the time and the manner of their deaths? By extension, should people have a right to enlist the help of others when they cannot kill themselves? And should this issue, so fraught with considerations of individual conscience, suffering and belief, ever be brought before a court at all?

The phrase "right to die" is misleading. What people really wish to establish is something related to that, but different: individual control, as far as is possible, of the process of dying. Such a wish has been made urgent as a direct consequence of certain advances in medicine (see pages 21-24). People may be kept alive, hooked up to respirators or dialysis or feeding tubes, more or less indefinitely; or they may be subjected, when old and resigned to death, to invasive operations. Rather than suffer this fate, or go through the agonising pain that may occur in terminal illness, patients in developed countries increasingly want to die sooner. Increasingly, too, doctors and nurses help them to do so in spite of existing laws that make assisted suicide a crime; and in practice they are not convicted. What remains unclear is whether assisted suicide should be declared acceptable and legal; and to what extent the practice, with all its grey areas, can be regulated in a way that protects the vulnerable and guards against abuse.

Freedom and its dangers

Western religions have an answer, and it is uncompromising: it is wrong for individuals to end the lives that God has given them. The classic liberal position, which is that of *The Economist*, starts from a different premise. Individuals have a right to self-determination, and this includes—perhaps, naturally culminates in—the right to cut short one's own life.

Liberals should, however, recognise two qualifications. The first is one of principle. Men are not islands: in every life, other people's interests are involved. It is often argued, by those of a paternalistic frame of mind, that these interests are also the state's, which has a stake in preserving the lives of its citizens. There is something in this: the state should defend its population from aggressors, for example. In individual cases, however, the notion is offensive. A state has no property right in an individual, as if he were a mere payer of dues and taxes. His life—including whether or not he believes in God—is his own business. With one proviso: that it is also the business of



his relatives and, especially, his dependants. The reason that suicide, assisted or not, gives liberals pause is that it rarely, if ever, leaves others undamaged. Weighing the individuals' interests against those of others is arguably much trickier for suicide than, say, for freedom of speech.

Assisted suicide introduces a new set of difficulties. Most crucially, it brings another person into the case. Here, the initiative to end a life is transferred from the subject to someone else, typically to a doctor or a nurse. But it remains uncertain under what conditions an individual "right to die" can be transferred. Most of the few existing assisted-

suicide laws rely on the principle of active and informed consent to a procedure that may, or will, lead to death. But the questions of what constitutes consent, where the initiative remains and, most of all, how those no longer able to speak for themselves might be included, have still not been resolved. Most laws also require that the patient should be terminally ill: yet this definition is almost too broad to be useful. Should a suicide be assisted when a patient is a certain distance from death, or when he has simply given up hope?

Such practical difficulties may not be insuperable; indeed, in most cases, they are apparently worked out to the satisfaction of all parties. Yet even where the criteria for assisted suicide seem to be met satisfactorily, the moral difficulties do not disappear. A request for help in suicide—as opposed to cessation of treatment—means that the provider, rather than omitting to cure the patient, is required actively to kill him. It is often argued that the distinction between curing and killing is blurred in any case: doctors frequently prescribe increasing doses of opiates which, as well as relieving pain, will advance the death of a patient. Yet here intent is decisive. A doctor who intends primarily to relieve pain is not killing his patient, even if death is the result. On the other hand, a doctor who sedates his patient as far as coma in order to cause death by starvation is intending to end a life. And the danger is that, in times when health care must be rationed, this second intention—even if unacknowledged—may come to play a greater part in medical decisions.

Nonetheless, as the rich world's population grows older, help in dying will be increasingly requested. How, then, can it be adjudicated? Courts are not the ideal forum for settling debates of conscience. Even legislatures are tricky places in which to devise rules for what will remain an essentially private practice. It would take an extraordinary law that could disentangle, in every case, the motives of mercy from those of easy disposal. In the Netherlands, where legislation has been in place for the longest time, some researchers seem to have found disquieting signs of slippage. But many doctors want

vesting in future growth or helping the poor, favours the rich with cuts in capital-gains and inheritance taxes: devices likely to fuel the already giddy stockmarket and to bring the country just what it needs least, a consumer-spending boom.

There are other clouds on the horizon. The population is growing older and more dependent. An ever-tightening labour market, especially for skilled workers, may eventually

put pressure on wages. Other industrialised countries will start to grow again, putting up commodity prices. If, added to these, America's fiscal management begins to wobble, the country will start to lose its attraction as a model for the world to emulate. And Bill Clinton (by then either on the Little Rock golf course, or in disgrace) may well lament that when he had his golden moment, he mostly basked in it.

Cheer up, Europe

Most Europeans won't be too disappointed by the modesty of this week's work in Amsterdam

IT WAS a crabby week in Europe, culminating in a half-agreement in Amsterdam which, far from drawing a nice clear map of the European Union's future, left a vista of blank spaces on a dog-eared document and scowls on the faces of many of the continent's leaders (see page 51). The crabbiest of issues—though it was not originally meant to have been on the Amsterdam agenda at all—was Europe's planned single currency, the euro. An argument between France and Germany did not quite ruin the occasion. Indeed, the euro still, on balance, looks likely to arrive on time, in 1999. But the way it will be managed looks ever more dubious.

As for the non-euro parts of the meeting, it became embarrassingly plain how much harder it is for 15 countries, rather than the dozen that last fixed up a new plan for Europe—at Maastricht in 1991—to agree on a path forward. And adding to the mood of crabbiness was the realisation that the pair that have previously driven the European idea, France and Germany, are no longer in synch, and not just over the euro. Helmut Kohl, Germany's chancellor, has lost much of his authority; and France's new Socialist prime minister, Lionel Jospin, does not yet seem to have decided quite what sort of Europe, let alone what sort of euro, he wants.

The saddest conclusion to be drawn is that the new French government has no idea how to slay the monster of unemployment that is blighting much of the continent and has given the EU such a bad name. It is not the struggle to create a euro that has put 18m EU citizens out of work, but the failure of governments, France's in particular, to deregulate their economies, privatise state behemoths and free their labour markets. All the talk in Amsterdam about co-ordinating labour policies was mere waffle. If the European club is to recover its prosperity, those measures, not arguments over whether the euro should be hard or soft, are what matters.

In any event, the emerging shape of Europe is looking rather different from the edifice imagined by the leaders of France and Germany five years ago. A future EU now promises to be a lot less grand. The single market is a huge success, but other vehicles for "ever closer union" are stalling. A joint defence identity is still a dream. The idea of joint foreign policy has failed to go far, though it was agreed in Amsterdam that once a shared policy has been unanimously accepted, some aspects of its implementation could then be decided by majority vote among the EU's members. A common policy on immigration, visas and asylum will gradually be arranged, but again only by unanimity. Border controls within the Union (except in Britain and Ireland) will fade. But, signifi-

cantly, speedy integrationists seem to have failed in Amsterdam to win a system whereby those keenest to form inner clubs within the EU will be able simply to ignore objections from laggards like Britain. If the Union expands to, say, 20 members over the next five years or so, it will be harder still for the integrationists to create even the kernel of a United States of Europe.

What this all means is that the supranationalists, especially with France and Germany newly at odds, are on the defensive. Yet, at the same time, it will plainly be far from easy to bring in at all quickly even the most promising candidates: Poland, the Czech Republic, Hungary, perhaps Slovenia, perhaps Estonia. The Union's operating procedures—the way voting weights are decided, the number of EU commissioners per member, and so on—will have to change. Yet, after spending fully 18 months on precisely those issues, the Amsterdam summeiteers failed pathetically to reach conclusive agreement. Instead, in a classic prevarication, they decided to adjust the mechanisms—once applicants come close to joining.

Ode to modified joy

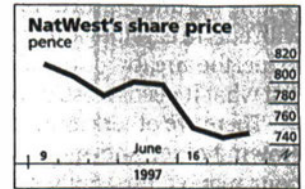
But at least those applicants can, by the end of the year, start negotiating in earnest. Indeed, step back from Amsterdam and you see much to cheer about in Europe. For all its hiccups and slip-ups, the continent is groping forward. Its market, the biggest in the world, is getting bigger and freer. The Union is still on course to absorb swathes of the continent that, less than a decade ago, were in the suffocating grip of communism. NATO, the military organisation that already clasps most of the EU's members together, is poised to expand too, with formerly neutral states as well as ex-Soviet satellites already linked in partnership.

The continent as a whole, whatever the disappointments that have followed the fall of communism, is slowly becoming safer, richer and more hopeful. Even countries as rough as Russia, Romania and Bulgaria are moving in the right direction. The Balts look a bit less vulnerable, the Caucasus a bit less chaotic, the Balkans a bit less bloody. The United States is still engaged. The mood in Western Europe remains likely to reflect the prospects for the single currency, and there will be much gloom if it fails. But it is becoming plainer that the euro's postponement or failure would not, whatever Mr Kohl says, be a war-or-peace matter in the eyes of most Europeans. Europe has plenty to occupy itself with for some time to come. The modesty of Amsterdam was recognition of that.



Those two capitalisms, again

The travails of NatWest highlight the difference between Britain's famously impatient investors and the rest of Europe's famous patience



EVEN the casual observer must this week have noticed that not all is well with Britain's banks. Yes, millions of Britons have been cheerfully bribed by building societies to let these bodies shed their mutual status and turn into banks. But NatWest, Britain's biggest bank by assets, is meanwhile facing a spot of bother. After warning of falling profits, and in the wake of a mix-up in March in the pricing of some options, it is being forced by unhappy shareholders to reconsider its strategy of building a global investment bank in tandem with its retail business. Martin Owen, the head of the investment-banking division, NatWest Markets, has obligingly fallen on his sword. The talk now at NatWest is of transferring capital to the safety of the high street (see page 71).

In banking, however, things are seldom entirely what they seem. It seems that NatWest is being punished for weak management. Those mispriced options, which lost the bank £77m (\$124m) before being detected, were certainly evidence that some of the bank's internal controls were inadequate. But weak management is not the whole explanation for NatWest's troubles. The bank is also the victim of a strategic predicament—and an accident of geography.

NatWest's predicament is the same as that of most other commercial banks around the world that are trying to barge into the big league of investment banks. In many rich countries the high street is overcrowded and the banks' traditional business of lending at interest is becoming less profitable. Many commercial banks have therefore tried to enter businesses—trading and selling securities, asset management and the provision of merger advice—that seem destined to grow along with the globalisation of the world economy and its

financial markets. But this sector, although undoubtedly lucrative, is already occupied by powerful American houses such as Goldman Sachs, Morgan Stanley and Merrill Lynch. These firms benefit not only from a history of specialisation but also from readier access to the mighty capital markets of their home country.

Does it make sense to combine commercial and investment banking in a single entity? There may be no single answer. In America Bankers Trust and J.P. Morgan transformed themselves from commercial into investment banks. In Britain Lloyds has latterly been content to remain on the high street while NatWest and Barclays have tried to do the splits. On the continent of Europe many of the big universal banks think they can master both trades. Germany's Deutsche Bank has spent a fortune trying to build a global investment bank around Deutsche Morgan Grenfell in London. Arguably, it is not the strategic choice that matters so much as staying power and the quality of the strategy's execution.

Which, of course, is where that accident of geography comes in. Unlike most European banks, British banks happen right now to be earning good profits on the high street, making the returns from the investment-banking operations of NatWest and Barclays look feeble by comparison. And this is a comparison that Britain's famously impatient but now also active shareholders are indeed disposed to make. Deutsche Bank, by contrast, plods expensively on. One day, this may win Deutsche a place among the best of the world's investment banks. If that unlikely event occurs, there will be hymns to the virtue of "patient capital". But in the meantime, just think how much money its shareholders will have lost.

Artists' royalties

A "right" too far

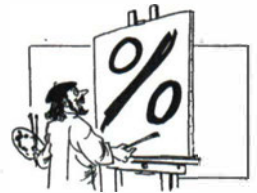
AMONG the many wonders of London is its ability to keep hold of the market for products such as wine and fine art, which Britain itself does not make conspicuously well. But nothing lasts forever. Britain's art dealers are up in arms about two pieces of Euro-harmonisation which, they say, will damage their business. It is hard to join their indignation about Britain having to raise value-added tax on art sales to European levels. But they are right to object to the fact that Britain is being asked to adopt a law known as the *droit de suite*. This law, with all due trans-channel respect, is daft.

Nine European countries and one American state have adopted the *droit de suite*, which says that whenever a work of art such as a painting is sold by one collector to another, a share of the price the buyer pays should go to the artist or, for 70 years after the artist's death, to his heirs. The sentiment that

inspires the *droit de suite* was evident in the posters that announced its introduction in France in 1920. They showed a ragged widow and her daughter staring at a well-lit painting hung in the window of a shop. "That's one of Daddy's paintings," whimpers the impoverished child.

The image of the penniless artist starving in his garret makes for great opera but terrible legislation. The law may have been intended to stop artists from starving, but most of the 3% levy on art sales collected in France goes to half-a-dozen families whose famous names already keep them well stuffed. And even if the facts were otherwise, the principle behind the law would still be misconceived.

Defenders of the *droit de suite* sometimes point to the royalties that accrue to sales of books and recorded music. This misses a vital distinction. Works of graphic and plastic art are



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two

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SCIENCE AND TECHNOLOGY

Sustainable arguments

HARARE

Conservationists are coming round to the idea that trading in rare plants and animals may help to preserve them

SAVE the whales. Save the elephants. Save the rhinos, bears, tigers and vicunas, too. And don't forget the mahogany trees. Strategies to save these threatened species, and scores of others, were hotly debated and voted on at the tenth meeting of the Convention on International Trade in Endangered Species (CITES) that has been held in Harare over the past two weeks.

The CITES conference brought together more than 1,500 participants—from animal-rights activists and dedicated conservationists to big-game hunters and buttoned-down, briefcase-toting delegates—from the 136 countries that are signatories to the CITES treaty. And when the votes were cast, the whales were indeed protected from legalised whaling. All five proposals by Japan and Norway to end the strict international moratorium on it failed to muster the needed two-thirds majority. But such blanket protection may soon be a thing of the past, for the real argument at Harare revolved around elephants—which were as legally mollicoddled as whales were until the meeting, but are now open, in some circumstances, to legitimate trade.

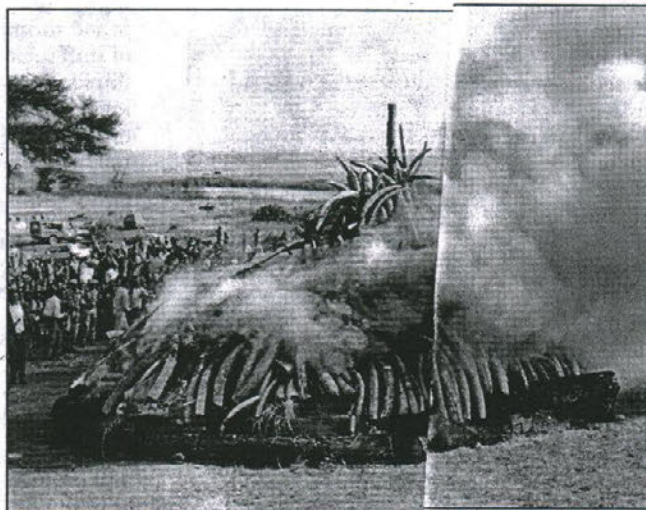
Tusk force

The elephant question is a microcosm of a bigger one—the question of when protection should give way to “sustainable use”. And the answer that emerged at the conference is “generally as soon as possible”.

Sustainable use means that people should be able to use any species of plant or animal for their benefit, as long as such use leaves enough of the species intact for its continued existence. Use it or lose it. As far as Zimbabwe, Botswana and Namibia were concerned, they wanted to use their elephants. Now, they can.

The reason sustainable use has appeal to conservationists is that a species has an economic value, a little motive for people to conserve. Elephants may appear valuable but not to the subsistence farmers who must live alongside them. To these farmers, elephants are a menace who destroy their crops and sometimes kill

This may sound perfectly but



Don't burn it. Sell it

it has taken a long time. CITES started in 1973, in Washington, DC, as an attempt by America to provide legal backing for its denunciations on trade in endangered species. Then was that any such threatening. The best way to ensure survival of a species was thought to be a park, protect it and let it thrive the doctrine of “strict enforcement”. Unfortunately, in most cases, it did not work.

Elephants were, in fact, an exception to this failure. Where enforcement worked—as it did in Botswana and Namibia—elephant populations did increase. Less well-governed countries remained rife. Since 1989, when the African elephant in Appendix I of its treaty

(thus making all trade in the animal and its parts illegal), nearly 100 tonnes of ivory has been seized. As a result of this traffic, Africa's elephant population dropped from 1.2m in 1979 to just 600,000 today.

According to the strict-enforcement strategy, the way to deal with this is to post more armed guards to shoot the poachers. But according to the principle of sustainable use, if the people who live in the elephants' range can benefit economically from the beasts, they will value them and stop any poaching themselves.

In Zimbabwe, this has started already. The pioneering Community Area Management Programme For Indigenous Resources (Campfire) channels money paid by big-game hunters to the rural poor who live in elephant habitats. Hunters will pay as much as \$12,000 to kill an elephant and in Zimbabwe's Campfire areas all of this fee

goes to the communities where the hunt takes place.

The success of Campfire has brought about a doubling of the elephant's range in Zimbabwe to 30% of the country. Zimbabwe's elephant population is thriving and is now estimated to be around 66,000. Botswana and Namibia have followed similar policies and their elephant populations have also grown. It is widely accepted that these countries have too many elephants and that expensive population-control measures, including culling, will soon be necessary—hence the desire to establish a legitimate trade in elephant products.

And what goes for elephant tusks should go for rhino horns, bear gall-bladders, vicuna wool and mahogany planks. Indeed, by this logic, CITES's most important tool is a listing in Appendix Two, which allows regulated trade, not Appendix One, which makes all trade illegal.

The theory of sustainable use was, in fact, a cornerstone of almost all the arguments at the conference. Indeed, the organisation's original mandate has been usurped. Far from preventing trade in rare species, CITES and most other conservation groups now want to design better ways to regulate that trade and to monitor its effects. Banning it was not merely futile, but counter-productive.

Is competition red in tooth and claw?

EXTINCTION is not caused only by the hunting of economically valuable animals and plants. The principal reason why species become extinct is that their habitat is destroyed. But an important subsidiary reason, ecologists have long reckoned, is the introduction of foreign organisms that compete with native species. Work by Ted Case of the University of California, San Diego, (who is himself an ecologist) suggests they may be wrong.

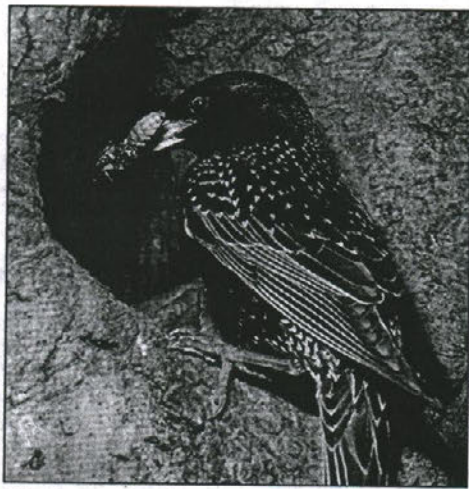
Ecological theory proposes two ways in which introduced species could cause problems for native ones: competition and predation. The damage caused by predation is well established. Cats, dogs and rats have probably exterminated more species of vertebrate than direct human activity. But the idea that native species might simply be shoved aside by newcomers is less well established, so Dr Case decided to examine it.

He collated information on bird introductions to more than 70 islands, ranging from the tiny (the Juan Fernandez archipelago in the South Pacific) to the massive (Australia). What he found suggested, at first sight, that he was on to something. The number of successfully introduced species (473) was similar to the number of species that had become extinct (367), as would have been expected if the newcomers were chucking the natives out of their ecological niches.

But, by digging a little deeper, he found that there was less to the story than met the eye—for most of the extinctions pre-dated the introductions and so could not have

been caused by them. That, however, opened up a second possibility—that the introduced species were thriving because the niches they required were now uncontested. But even this turned out to be false. According to Dr Case's analysis, most of the new birds prefer to occupy territory that has been modified by man—such as grasslands, gardens and parklands—rather than slumming it in natural habitats.

He therefore concludes that the balance of numbers of introduced birds and native extinctions reflects the relative abundance of natural and unnatural habitats. If losses of natural habitat roughly equal the amount of unnatural habitat created, then extinctions and successful introductions might be expected to balance too. So habitat destruction and not competition seems to be to blame for most extinctions here, as well.



Moving to foreign parts

The solar system's past Eggbeaten

WASHINGTON, DC

IF YOU are an historian of such things, the solar system is a difficult place to understand. First, it seems to have formed in conditions that were both infernally hot and terrifically cold. Chondrites (meteorites that are generally recognised as leftovers from the solar system's earliest days) are made of beads of rock known as chondrules embedded in a matrix of compacted dust. The chondrules were once molten. But the dust seems to have accreted at temperatures close to absolute zero.

Then there is the problem of the earth. It appears to be made of the wrong stuff. Vol-

tile elements (especially nitrogen and oxygen) are rarer in its rocks than they should be if it condensed from the same material as the sun. So, indeed, are some non-volatile ones (such as calcium and aluminium).

But the earth's composition is relatively normal compared with that of Pluto. This object, the smallest and most distant that is generally regarded as a proper planet, has somehow acquired twice the amount of rock that theory suggests it should have. That theory, therefore, must need a tweak. At the American Astronomical Society's recent meeting in Winston-Salem, North Carolina, Frank Shu of the University of California, Berkeley, tried to provide one.

Dr Shu and his colleagues are perfectly happy with the big picture conceived in the 18th century by Pierre Laplace, and subsequently revised over the years. This is that a

long time ago (the current estimate is 4 billion years) a cloud of gas and dust condensed into the sun, the planets and the asteroids. Their tweak is to suggest that when this mixture was condensing it was given stir by what they call a cosmic eggbeater.

This "eggbeater" was the early solar magnetic field. Recent theory has already given this field a starring role in the formation of the solar system. Calculations suggest (and some spectacular pictures taken by the Hubble space telescope have recently confirmed) that when stars form their magnetic fields cause huge jets of matter to shoot out from the stellar poles. This slows down the spin of a condensing gas cloud and allows the condensation to continue without the whole thing being whirled apart by centrifugal force.

Dr Shu, however, thinks that magnetic fields can have more subtle effects than acting merely as astronomical sling-shots. He believes they can explain something the current theory is not easily able to—how the gas and dust that did not end up in the sun formed itself into planets.

It is generally agreed (and, once again the Hubble confirms) that the early stage of star formation results in a spinning disc of stuff surrounding the proto-star. Dr Shu thinks that as the proto-sun rotated, its magnetic field churned up the inner edge of this disc as if by a giant eggbeater. Material inside the disc, protected as it was from the young sun's intense radiation, would have been whisked into fluffy balls of dust rather like soufflés.

The eggbeater effect would, however, also have tossed some of these dustballs out of the disc and into the full glare of solar radiation. Here, they would have melted into beads of molten rock (ie, chondrules) and these would have been carried away from the sun by a constant stream of outward-flowing gas that the eggbeater would also have produced.

How far the beads were carried could explain another of the solar system's oddities. The chondrules in meteorites are curiously regular in size. They are rarely smaller than one or larger than two millimetres across. According to Dr Shu the reason for this is now apparent. Larger beads would have dropped back into the disc immediately, and would eventually have been swallowed by the sun. Smaller beads would have been swept away so fast that they would have ended up in interstellar space. Only the medium-sized chondrules would have rained back into the disc at the proper place to end up inside bigger objects.

Once there, the story goes, they would have joined their cold, fluffy counterparts to form the rocky equivalent of snowballs with stones in them. Most of these rockballs would then have collided and merged to form planets, but some would have remained small. It is these that now rain to

THE WHITE HOUSE
WASHINGTON

July 1, 1997

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MEMORANDUM FOR THE PRESIDENT

FROM:

SAMUEL BERGER

SUBJECT:

Reply to Letter from Cardinal Law Requesting
Approval for Direct Flights to Cuba

Purpose

To reply to a letter from Cardinal Law of Boston requesting approval to charter an aircraft to fly U.S. Catholics directly to Cuba during Pope John Paul II's visit there in January 1998.

Background

At the request of Cardinal Ortega in Havana, Cardinal Law would like to organize a pilgrimage of American Catholics to attend open-air masses and other activities in Cuba during the Pope's visit. He seeks approval for direct flights to and from Cuba -- banned since Cuban MiGs shot down two U.S. civilian aircraft in international airspace 16 months ago. He notes that the pilgrimage, under his personal leadership, would bring the American and Cuban Catholic Churches and people closer together.

The proposed reply at Tab A reiterates that the ban on direct flights was established after the shutdown and notes that it has not been lifted because Cuba has not taken responsibility for that lawless act. (The prohibition has not been written into either regulation or law.) The reply notes that the historic nature of the Pope's visit to Cuba may warrant an exception, if not a broader review of current policy on charter flights, and that an interagency working group will explore that possibility soon.

RECOMMENDATION

That you sign the reply at Tab A.

Attachments

Tab A Proposed Reply

Tab B Incoming Correspondence

Copied
Berger
COS
Podesta

cc: Vice President
Chief of Staff

THE WHITE HOUSE
WASHINGTON

Dear Cardinal Law:

Thank you for your letter requesting approval for a direct charter flight for American Catholics to travel to Cuba during the visit of Pope John Paul II in January 1998.

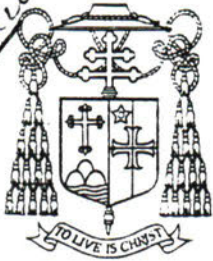
As you know, direct flights to Cuba were suspended after the Cuban government lawlessly shot down two U.S. civilian aircraft in international airspace in February 1996. Since then, passenger and humanitarian flights to Cuba have been required to fly through a third country. Unfortunately, the Cuban government's failure to accept responsibility for the shootdown and to forswear the use of force against civilian aircraft continues to cast doubt on its willingness to observe international law and safe aviation practices.

I have asked the relevant agencies to review your request in light of the special circumstances you describe. I will ensure that you are advised of the results of this review as soon as it is complete.

Sincerely,

A handwritten signature in dark ink, appearing to read "Bill Clinton", with a long horizontal flourish extending to the right.

Bernard Cardinal Law
Archbishop of Boston
2101 Commonwealth Avenue
Brighton, Massachusetts 02135



CARDINAL'S RESIDENCE
2101 COMMONWEALTH AVENUE
BRIGHTON, MASSACHUSETTS 02135-3192

4138

May 22, 1997

President William Jefferson Clinton
The White House
1600 Pennsylvania Avenue
Washington D.C.

Dear Mr. President,

As you know, the Holy Father, Pope John Paul II, is making an historic pastoral visit to the Church in Cuba in January 1998. The Archbishop of Havana, Cardinal Jaime Ortega, has asked me to lead a pilgrimage of Catholic faithful from the Boston area to join the Catholics of Cuba during that visit of Pope John Paul II. It is our hope that the presence of a group of Catholics under my leadership would contribute to the bonds that tie the Catholic Church of our country to the Church in Cuba.

From previous experience in visiting Cuba and in donating medicines to Caritas Cuba, I am well aware of the restrictions placed by the United States on Americans who wish to travel to Cuba. I write to you now to ask if you personally would approve my request that I might bring a group of Catholic faithful on pilgrimage to Cuba during the time of the Pope's visit. I would propose that we fly directly from Boston to Santiago Cuba by charter. After celebrating Mass with the Pope and the Cuban bishops there, we would proceed by the same charter to Havana where we would participate in the closing ceremonies of the papal visit. Once the Holy Father had left Cuba, then our pilgrimage would return from Havana directly to Boston.

I am convinced that a pilgrimage of this type would bring only benefit to those participating in it and only appreciation for your administration in giving permission for us to bring this about. Everyone would benefit by such a carefully planned and executed spiritual journey that would bring American and Cuban Catholics together with the Holy Father.

Asking God to bless you, I am,

Yours sincerely in Christ,

Archbishop of Boston

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MAY 27 1997

Looks like fun is just beginning

Are we having fun yet? Indeed, we are. But not nearly as much fun, dear reader, as I suspect we're fixing to have before it's all over.

The "character issue" is about to be turned against its creators. All the Arkansas-based elements of the so-called Clinton scandals, you see, are falling to pieces even as they merge into one.

Thanks in no small part to the ruthlessness, desperation and sheer political incompetence of Kenneth Starr, Whitewater, Troopergate and the pathetic inventions of little Paula Jones all stand in danger of being revealed for exactly what they are: elements of an elaborate hoax concocted years ago by "dirty tricks" operatives determined first to stifle Bill Clinton's candidacy, then to cripple his presidency by demonstrating what God-fearing Arkansians on the Fruitcake Right always thought they "knew" but were never able to prove about his intimate life.

Let's take the fair Mrs. Jones first, since her story is basically the simplest, probably an accidental byproduct of the larger effort, and seems to be falling apart the fastest.

According to recent articles by Stuart Taylor Jr. in *Legal Times* and Jane Mayer in *The New Yorker*, Jones' accounts of her allegedly horrifying encounter with Clinton have not only changed greatly over time, but also varied greatly according to her audience.

The selfless Jones and her husband also appear to have accepted a \$1,000 gratuity from the producers of Rev. Jerry Falwell's scabrous video, "The Clinton Chronicles." This, despite elaborate and repeated denials of pecuniary motive by her and her lawyers.

Jones' former lawyer, Danny Traylor, now says she never said anything to him about any "distinguishing characteristics" of the presidential wazoo. (Why do I keep thinking there's got to be a "666" in here somewhere?) The friend to whom Jones first confided the naughty version of her alleged encounter admits that the details have grown more lurid with each retelling.

Two new witnesses have emerged to say that Jones told them an entirely benign story about how thrilled she'd been by Clinton's warmth and friendliness.

Assuming she met him at all, it sounds like the only thing Jones got exposed to was the standard Clinton Charisma Treatment: a firm grip on the elbow, direct eye contact and 30 seconds of undivided personal attention.

Gene Lyons



It's been known to confuse people a whole lot more sophisticated than Paula Jones.

It's beginning to look as if people who actually knew Clinton, and thus would have known better, got the G-rated version. The raunchy, self-dramatizing, X-rated revenge fantasy that replaced it may have emerged only after it began to dawn upon Poor Little Paula that her schoolgirl crush was unrequited. The governor was never going to call.

Next, of course, came "Troopergate" and the smell of money. A great deal of money, it appears, in the imaginations of the nasty little band of character assassins who dreamed it up. In *The New Yorker*, Bill Clinton's old Oxford rival, Cliff Jackson, is said to admit that the former members of the governor's security team who told lubricious tales to *The American Spectator*, the *Los Angeles Times* and the *Democrat-Gazette* hoped to score a huge book contract.

As a defendant in Jones' lawsuit, Trooper Danny Ferguson has been telling a very different story than the one in the *Spectator*. In a bizarre attempt to discredit him, Jackson told *New Yorker's* Mayer that Ferguson refused to sign a release turning over his part of Troopergate to the media for anything less than a cool million.

So tell us, Cliff, how much cash did the others want? How much did they get? Who paid? Did they pay taxes? I have reason to believe we'll be getting answers to many of those questions soon enough. The pressure's on.

Some of these boys don't appear to be handling it real well. Also, a few tenacious, skeptical reporters are now on the job, as opposed to the credulous ninny who swallowed the troopers' whoppers last time around.

Meanwhile, Trooper Ronnie Anderson's affidavit, also reported in *The New Yorker*, sounds exactly right. In a sworn statement taken by White House attorneys in 1994, Anderson admits that he "confirmed stories concerning Clinton's marital infidelity, even though he knew those stories 'to be untrue,' or had no firsthand knowledge of the events."

Anderson couldn't debunk every story the troopers told. But he characterized most as "nothing more than old fish tales, with little, if any, basis in fact."

Anderson's statement squares with the knowledge, or lack thereof, of every Arkansas journalist I know. Zesty rumors about Clinton's sex life have circulated in Little Rock for as long as he's been in public life. As an island of relative sophistication in a sea of sex-obsessed fundamentalists, it comes with the territory.

Overheated women have been trying to trip Clinton and beat him to the floor throughout most of his adult life. That, too, comes with the territory, especially for, a handsome, charismatic figure like the president. That he's been as blameless as Ozzie Nelson few believe. My point, however, is that nobody knows, and certainly not the troopers.

Anybody who's been around Clinton when a ticklish personal issue came up has seen his eyes go as blank as a stuffed bobcat in a wildlife diorama and watched him edge carefully away. Anybody who thinks he'd let someone like Trooper Larry Patterson in on his intimate secrets would believe anything.

Did you know, by the way, that Patterson's been hitting the right-wing militia lecture circuit? According to the *Detroit News*, he and Larry Nichols of "Clinton Chronicles" fame recently regaled a Michigan audience with accusations that President Clinton has long been involved in such crimes as drug-smuggling and murder. Do you suppose Kenneth Starr knew that when he started sending FBI agents out to ask women about their sexual relationships with Clinton on the say-so of Patterson and his chums?

Women, that is, with husbands, families and children. American women being grilled about their sex lives by government agents. All at the behest of Starr, who commented with characteristically prissy arrogance in the wake of the *Washington Post's* stunning revelation that it's certainly not his fault with whom the president chooses to associate.

Even Starr's staunchest defenders have gone silent. As I say, I have a strong feeling that the fun is only beginning.

Gene Lyons is a Little Rock author. His columns appear every Wednesday.

Outgoing lawmaker takes \$69,500 job

BY CYNTHIA HOWELL
ARKANSAS DEMOCRAT-GAZETTE

Rep. Ed Thicksten, D-Alma, was hired Tuesday as executive director of the new Cooperative Education Services Coordinating Council.

Thicksten, 49, is an 11-term legislator who can't run for re-election next year because of term limits.

In his new post, Thicksten will receive an annual salary of \$69,500 plus a \$500-a-month car and travel allowance.

His contract is for two years with

a provision for an annual review. His employment took effect immediately.

He will simultaneously complete his legislative term.

The coordinating council was established by Act 1810 of 1997, a 22-page Arkansas Department of Education appropriation bill. The act was sponsored by the Joint Budget Committee, of which Thicksten was co-chairman.

The act creating the council appropriates almost \$10 million of

state money to operate the council in the 1998 fiscal year and almost \$11 million for the second year of the biennium. The salary for the director will come from that appropriation.

The primary responsibility of the coordinating council is to work on behalf of the 15 existing educational service cooperatives in developing programs and activities to benefit the cooperatives. The council is eligible to get money

See THICKSTEN, Page 3B

Continued from Page 1B

from state and federal governments, school districts and other public and private sources.

The coordinating council may assist the cooperatives in the purchase of commonly needed supplies and equipment.

It also is charged with assisting in the development and implementation of distance-learning classrooms in each of the cooperatives and in Pulaski County, which is the only one of the state's 15 counties not served by a cooperative.

While the coordinating council is new, the 15 educational cooperatives have existed more than 12 years.

They provide services to their member school districts, including staff training, instructional assistance, and purchasing.

Mike Hargis, director of the Arch Ford Education Service Cooperative in Plumerville and chairman of the coordinating council, said Thicksten's employment on behalf of cooperatives and school districts will provide a source of institutional memory in the legislative process.

Besides working with the Legislature and the governor's office on behalf of schools and the council, Thicksten's responsibilities will include preparing the council's annual budget and generating ideas and funding for statewide instructional and technological offerings.

The act creating the council specifically states that the coordinating council, composed of the directors of the state's 15 cooperatives, is not a state agency, board or commission, and the council members are not entitled to compensation or per diem expenses for service on the council.

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THE PRESIDENT HAS SEEN

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Does Anyone Remember Tibet?

Now that Hong Kong has been formally incorporated into the People's Republic of China, the international community would be well advised to study China's subjugation of Tibet.

The turnover this week proceeded with impressive ceremonial decorum: Jiang Zemin talked of Hong Kong's "return to the Motherland." Prince Charles referred to the guarantees of Hong Kong's autonomy made in the Joint Declaration and Basic Law that henceforth will govern Hong Kong under China's system of National Regional Autonomy. Commentators spoke of how Beijing ought not tamper with Hong Kong's "magic."

Nowhere was mention made of the "17-Point Agreement for the Peaceful Liberation of Tibet" of 1951, by which Tibet was incorporated into the People's Republic of China under the same system of National Regional Autonomy now being applied to Hong Kong. Tibet was putatively guaranteed political and cultural autonomy. Instead, the agreement became the pretext by which Beijing seized control of the Tibetan plateau.

Mao's annexation of Tibet was an event of seismic proportions in the history of Asia, a conquest that altered the regional balance of power and advanced China's hegemonic ambitions. Occupied Tibet comprises more than one-fourth of the land mass of the People's Republic of China. Tibet is the riverhead of Asia's waters, the source of the Yellow, Salween, Yangtze, Brahmaputra, Mekong, Irawaddy and Ganges rivers. China has already taken some \$50 billion worth of lumber from eastern Tibet. Central and western Tibet have enormous mineral resources, including the earth's largest uranium deposits. Tibet's 6 million people are spread over 2.5 million square miles of mountain terrain. Hong Kong's 6 million residents are clustered in a cosmopolitan port. Tibet gave China vast territory and resources; Hong Kong will provide capital and trade.

The annexation of Tibet gave China, for the first time in history, a continuous border with Burma, India, Bhutan, Nepal, Ladakh, Kazakhstan and East Turkistan (now called Xinjiang Province). Tibet no longer serves as a neutral buffer state between Asia's two greatest powers; soon after the 1959 flight of the Dalai Lama, the Chinese People's Liberation Army stationed troops along the Indian border and claimed large portions of territory, an action that resulted in the 1962 Sino-Indian War. With Tibet locked behind an iron curtain, the economies and cultures of the entire Himalayan region have been marginalized and imperiled.

When Mao sent troops into Tibet in 1949, he also assigned cadres to "modernize" the region. The Tibetans initially cooperated, until the Chinese began to usurp traditional leadership, which led to revolt and armed conflict. There was no media coverage of the 1959 Chinese annexation of Tibet and the state-sponsored famine that followed; details of the carnage were collected from refugees who escaped on foot over the Himalayas to asylum in India and Nepal. To this day, journalists, diplomats and tourists can visit Tibet only under severe restrictions.

Hong Kong is a media and financial capital filled with fax machines, cameras and telephones. With the world watching, and presumably negotiating deals, Beijing will consolidate its gains in Hong Kong by steps, even as it did in Tibet without the world watching, from 1949 to 1959. The Politburo already has announced that public assembly and speech in Hong Kong will be curtailed for reasons of "national security." Politburo propaganda officials already hover over Hong Kong's newspapers, magazines and TV stations. Self-censorship will be the trade-off for survival.

When Beijing briefly relaxed its control of Tibet in the mid-1980s, Tibetan Buddhism and ethnic pride rebounded, as did demands for cultural and political rights. In 1987, '88 and '89, troops opened fire on Tibetan demonstrators. Photographs and eyewitness accounts of the slaughter came from tourists, several of whom were arrested and harassed. During a 1989 demonstration, PLA troops shot a Dutch bystander. She nearly died but managed to escape to Hong Kong, where she showed her wounds at an international press conference. (Could that happen now?)

The administrative and military facilities throughout the Tibetan Autonomous Region, the Inner Mongolian Autonomous Region, Ningxia, the Wei Autonomous Region, and Xinjiang, the Uigher Autonomous Region, are identical and report directly to Beijing—hardly a representation of genuine regional autonomy. A pervasive security force of the People's Armed Police and the People's Liberation Army is present. Arbitrary arrest, detention, torture and summary execution are routine instruments of state control.

Given that Beijing has consistently violated the terms of National Regional Autonomy in other autonomous regions, policy-makers in the free world must keep a vigilant watch on Hong Kong. It is, at this point, impossible and impractical to isolate China. Thus it is all the more important to compel China to uphold its agreements to honor treaties and respect the law of nations.

The writer, a consultant to Refugees International, has worked for many years with Tibetan refugees in India and Nepal.

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Senators Concerned About WWII Monument Site

Associated Press

Nineteen senators have expressed concern about the proposed location of a World War II monument, saying its effect on the Mall has not been adequately considered.

The senators, led by Bob Kerrey (D-Neb.), said the approval process for the monument should be halted until the completion of additional studies on visitor impact, traffic flow and how the monument design would impact the Mall area.

The monument has been proposed for an area now occupied by the Rainbow Pool at the opposite end of the Reflecting Pool from the Lincoln Memorial. It would require moving the Rainbow Pool as well as uprooting nearby trees.

"The Rainbow Pool site is perhaps the most famous historically open space our nation has and is surely one of the most hallowed," the senators wrote Interior Secretary Bruce Babbitt on Monday.

They continued, "Certainly the pro-

cess for approving a drastic permanent remodeling of the National Mall warrants ... at least an environmental assessment so that the impact on the Mall and the city can be assessed."

Kerrey said no traffic or visitor studies or environmental impact assessment had been conducted before the Interior Department and several other agencies approved the site in 1996.

The proposed monument is under review by the National Planning Commission and the Commission on Fine Arts.

12 Foundations Push Conservative Agenda \$210 Million Given Over 3 Years

By Stephen Barr
Washington Post Staff Writer

A dozen politically conservative foundations spent \$210 million in a three-year period on efforts to reshape national policy debates and push Congress and state legislatures toward the right, according to a study released yesterday.

The study by the National Committee for Responsive Philanthropy, a watchdog group that serves as an advocate for the poor, said the 12 foundations spent \$79.2 million between 1992 and 1994 on think tanks and advocacy groups and \$88.9 million to support scholarships and college programs that train conservative thinkers.

During that time, the conservative foundations also awarded \$16.3 million to law firms and media outlets championing smaller government and less economic regulation of the marketplace, the study said. The remainder of the \$210 million went to support a network of regional and state-based think tanks and to groups working to revamp the social views of religious and charitable organizations.

The study provides a statistical window on what has been reported in more anecdotal terms—that the foundations spend considerable sums to finance a policy movement dedicated to conservative goals. The report also implicitly suggests that liberal and mainstream groups have not kept pace with conservatives in expanding their revenue bases and clout.

The study examined the grant and funding patterns of the Lynde and Harry Bradley Foundation of Milwaukee; the Earhart Foundation of Ann Arbor, Mich.; the Charles G. Koch, David H. Koch and Claude R. Lambe foundations of Wichita, Kan.; the Philip M. McKenna Foundation of Pittsburgh; the JM Foundation of New York; the John M. Olin Foundation of New York; the Henry Salvatori Foundation of Los Angeles; the Sarah Scaife Foundation of Pittsburgh; the Carthage Foundation of Pittsburgh, and the Smith Richardson Foundation of Greensboro, N.C.

The money handed out by the 12 foundations represents a small slice of the estimated \$11 billion awarded by the nation's nonprofits last year. Some critics of the study dismissed it, contending the 12 were not as influential as such groups as the Ford Foundation, the Pew Charitable Trust and the John D. and Catherine T. MacArthur Foundation.

The study "seems silly" and "is trying to make this into some big conspiracy," said Robert Pambianco, of the Capital Research Center, which tries to discourage corporations from giving charitable donations to nonprofits that support liberal or anti-business policies.

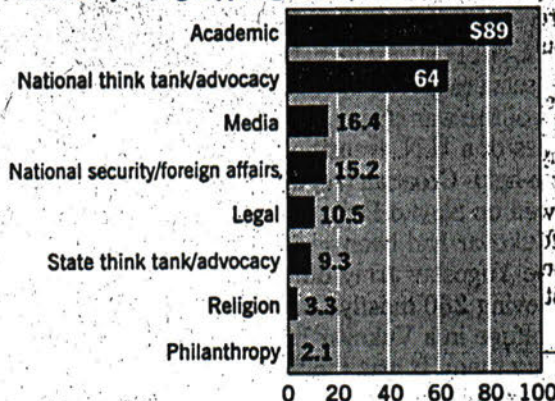
But the study contends that while most U.S. foundations distribute their money to communities and neighborhood projects, these 12 foundations pursue an agenda aimed at influencing Washington's budget and policy priorities.

"Two-thirds of their grant dollars went to organizations and programs pursuing policy agendas based on the privatization of government services, deep reductions in federal anti-poverty spending, industrial deregulation and

FOUNDATION DONATIONS

The 12 conservative foundations studied by the National Committee for Responsive Philanthropy gave \$210,539,617 in grants to support conservative policy objectives from 1992 through 1994.

General operating support grants by sector, in millions



Top academic grant recipients

University of Chicago	\$10,352,411
Harvard University	9,670,652
George Mason University	8,554,171
Yale University	5,957,374
Claremont McKenna College	3,068,500

Top think tank/advocacy grant recipients

Heritage Foundation	\$8,979,952
American Enterprise Institute	6,934,945
Free Congress Research and Education Foundation	5,097,200
Cato Institute	3,927,557
Citizens for a Sound Economy	3,795,000

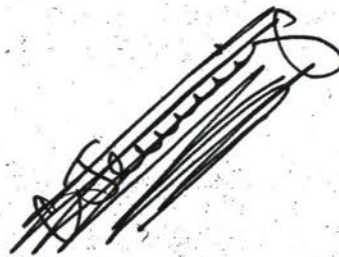
SOURCE: National Committee for Responsive Philanthropy

the transfer of responsibility for social welfare to state and local government and the charitable sector," the study said.

The foundations have financially strengthened a number of think tanks, including the Heritage Foundation, the American Enterprise Institute, the Free Congress Research and Education Foundation, the Cato Institute and Citizens for a Sound Economy, the study found.

During the 1992-1994 period, the Heritage Foundation received almost \$9 million in 42 separate grants. The funding has helped Heritage "deliver a stream of policy products to key audiences on a timely and efficient basis," the report said. In 1995 alone, Heritage analysts conducted 200 briefings on Capitol Hill and appeared on more than 500 radio talk shows, the study said.

The National Committee for Responsive Philanthropy was founded in 1976 with the goal of making charitable organizations more accountable and accessible to the disadvantaged. It successfully lobbied against a House Republican proposal that sought to curb political advocacy by nonprofit groups that receive federal grants.



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Central America opens for business

SAN JOSE

The countries of the poorest region on the American continent are at long last learning how to co-operate

SHIPPING goods across borders in Central America has long been a nightmare. Corruption and paperwork were obstacles enough; often, neighbouring countries did not even bother to keep adjacent customs houses open at the same time. This did not matter much a decade ago, when the main trade was the clandestine shipment of arms to fuel civil wars. But today, with the region at last at peace, legitimate commerce is booming. And leaders of Central American countries are getting their customs services to work together.

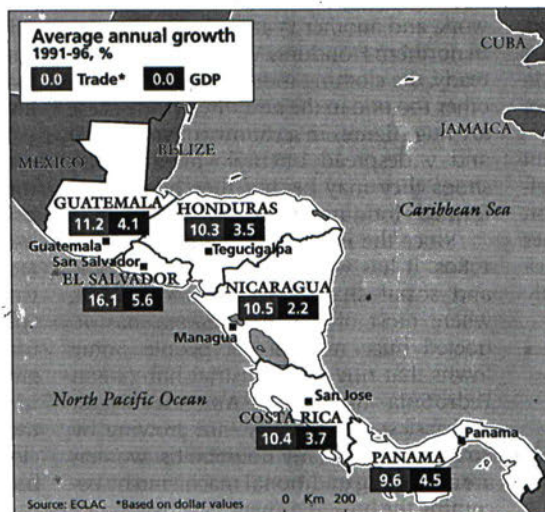
Co-operation of that sort is fostering something of a Central American revival. The region has long had a few common institutions but they had little more than symbolic value. The talking shop known as the Central American parliament has little power; the Central American peso is used only for book-keeping. An attempt to create a common market in the 1960s failed because it discouraged imports.

Central America's newest attempt at integration is different and, compared with other sorts of regional bonding around the world, unusual. It concentrates not just on free trade but on common microeconomic policies such as deregulation and harmonised taxes. Rather than look to libertarian economists from the University of Chicago, as reformers farther south have done, the Central Americans take inspiration from Harvard University's business school and INCAE, a like-minded local one.

Michael Porter, a Harvard professor who has become the region's economic guru, peddles the comforting notion that Central America may be able to by-pass the sweatshop stage of development and leap quickly from poverty to northern standards of productivity, social protection and environmental sensitivity. That is too optimistic. Mr Porter may be right to think that the region should concentrate on microeconomic reforms that boost productivity, which can raise living standards. But

most of the reforms he and his acolytes are pushing are still in the planning stages. Their benefits will be fully felt only if the region creates a single market. In the meantime, sweatshops have become important to at least one Central American economy (see next story).

Nonetheless, Central America is integrating faster and further than ever before. Peace has prepared the way. A decade ago, the FMLN, Latin America's strongest left-wing guerrilla movement, was poised to



conquer San Salvador, El Salvador's capital. Nicaragua was being run, with the help of the Soviet Union, by the Marxist Sandinist movement, under Daniel Ortega. Neither organisation has disappeared, but both have made at least a grudging peace with capitalism. In May, Guatemala's guerrillas became the last in the region to lay down their arms.

Peace is already paying a dividend. The region's economy is growing at 3%, not a spectacular rate but higher than the dismal performance of the 1980s. El Salvador, the region's most avid reformer, has been growing at an average annual rate of nearly 6% this decade. Exports within the region doubled between 1991 and 1995, to more than \$2.8 billion. Total exports leapt from \$8.6

billion to \$14.1 billion during the same period. Both internal trade and exports are still growing at rates of nearly 25% a year.

Trading freely with each other is something the Central Americans have always found hard. The common market to which all countries in the region bar Panama belong has been riven by dissension since its founding in 1963. Costa Rica, the region's richest economy, worries about being flooded with goods from poor neighbours. In 1995, El Salvador unilaterally liberalised trade with the rest of the world. Its neighbours accused it of breaking ranks and briefly raised their tariffs. Eventually, they followed El Salvador's lead.

Partly because regional trade is a fraught issue, the Central Americans co-operate on other things. In December 1995, five Central American governments (Panama again stood aloof) agreed to a common agenda of microeconomic reforms "to create a business climate in which productivity, private investment and trade could operate in conditions similar to those of the most-developed economies." If they mean it, the Central Americans will be venturing where their counterparts in the European Union dare not tread. Spurred by monthly seminars led by INCAE, which acts as a sort of reform secretariat, ministers are devising common strategies to deregulate, attract investment, reform their pension schemes and, more conventionally, to join electricity grids and telecoms networks, and to build roads.

Mr Porter, an apostle of globalisation, does not neglect trade; indeed, his prescription depends on it. Without competition, the Central Americans have no hope of building the world-class companies they dream of. Yet their trade policies are erratic. They are desperate for freer trade with the United States and aggrieved at their exclusion from the North American Free-Trade Agreement (NAFTA). They have banded together to end it. When President Bill Clinton went to Costa Rica last month on his first visit, Central American presidents brashly proposed a free-trade agreement even more liberal than NAFTA. Mr Clinton quietly promised a vague "NAFTA parity" in return for Central American co-operation in cleaning up sweatshops. Disappointed, the Central Americans decided to delay by two years a reduction in their common external tariffs.

Liberal trade is essential if Central America is to shake up its own enterprises,

THE AMERICAS

many of which are used to dominating their markets. Despite the wobbles, there are some signs it is working. Federico Bloch, a Salvadorean who controls all the airlines that matter in the region, has assented to an open-skies agreement with the United States that will pit him against the big American airlines.

None of this goes far enough. Without free trade, the efficiency improvements wrought by microeconomic reform will be blunted. For all their talk of "sustainable development" and shielding the poorest from the pain of reform, Central America's leaders have not worked out how to soften the blow. Nor have they avoided the woes of other Latin American economies. Several countries run trade deficits that they can sustain only because they get aid and remittances from abroad.

Crime is soaring and economies are not growing swiftly enough to absorb ex-guerrillas, returned refugees and the young people who join the labour market. Voters are beginning to cast ballots for opposition parties that promise to "humanise" (slow down) reforms. The pacific but still left-wing FMLN recently won San Salvador's municipal elections and now represents over half of El Salvador's city dwellers. Moises Naim of the Carnegie Endowment, a think-tank, says that, unless leaders dampen expectations that reform will soon bring widespread prosperity, they may face a violent backlash later.

The threat of backlash is an argument for boosting the region's still puny and inefficient investment in health, education and social services. It argues, too, for further reform—to transform Central America from an economic alliance into a truly common market.

Honduras

99% perspiration

SAN PEDRO SULA

IT IS their fastest-growing industry, yet many Hondurans watch it with unease. As in much of the developing world, the clothing industry is bringing the benefits of industrialisation but also its woes.

Admirers trumpet the industry's "massive job creation" and point to the push it gives other industries, like building and banking. Detractors see other things: the sweatshop conditions for (mostly young, female) workers and the indifference of the Honduran authorities to their plight. They also wonder whether the sweatshops are really helping the economy, since the service Honduras supplies is cheap labour to finish clothes designed and largely produced elsewhere. Honduras was—until Nicaragua recently supplanted it—Central



Overworked, underpaid

America's poorest country, but can it do no better than this?

The dynamism of the industry is not in doubt. Output rose last year by 45%; at \$1.8 billion, clothing exports are Honduras's most valuable after coffee and bananas. Already 11 industrial parks—in effect, free-trade zones—housing 155 factories are at work, and another 15 are being built, most in northern Honduras. With 74,000 jobs already, the clothing industry could add another 100,000 in the next three years. These are huge figures in a country of 5m people and widespread unemployment. Sweatshops they may be, but they have transformed Honduras.

Since the industry took off in the late 1980s, it has wrought large demographic and social change. The northern coast, where most of the factories are, has attracted huge numbers of people. Some towns that ring the industrial hub of San Pedro Sula—itsself Central America's biggest and fastest-growing city—are growing by 80% a year. In many households, women are affronting traditional machismo by becoming the bread-winners.

The politics of trade is giving sweatshops an extra lift. Honduras is a big clothing exporter to the United States, thanks partly to the Caribbean Basin Initiative, which allows some clothing to enter duty-free. That has drawn foreign manufacturers. South Koreans in particular have moved to Honduras to exploit its access to the American market.

Honduras woos them with promises of low wages and rents, tax breaks and easy repatriation of profits. South Koreans own only about 40 clothing factories, but they employ at least half the workforce. Girls working in the American factories usually say they are well treated. Korean employers have acquired a notorious reputation for abuses of all kinds.

Necessity, runs a Honduran saying, has

a dog's face. In the worst sweatshops, women work 16-hour days with a single half-hour break. Some work 80 hours a week without overtime pay or take work home at night and at weekends to fulfil their quotas. Their bosses routinely shout at them, occasionally strike them to speed their work and may send them home for talking on the job. Women are sometimes summarily sacked if they get pregnant or join trade unions. And the pay is miserable: about 29 American cents an hour.

What hope there is for improvement comes from the United States. American trade unionists, fearful for their own jobs, have started to press for better conditions in Honduras. The Senate recently invited Hondurans to testify about their brutal working conditions. The White House is sponsoring an initiative to persuade manufacturers to let Honduran human-rights groups and churches monitor conditions in their Honduran factories. The Gap, a trendy chain of shops that makes its own clothes, has signed on. The campaign could become fashionable.

Colombia

Phoney peace

BOGOTA

A BUNCH of bandits with no agenda and no future. That is how many in the press, politics and the army portray the Revolutionary Armed Forces of Colombia, or FARC. But there is plenty of life yet in the country's main guerrilla movement.

On June 15th, in the southern jungle town of Cartagena de Chaira, the FARC freed 60 soldiers it had held hostage for nine months and ten marine cadets kidnapped early this year. And it did it in style. After the army failed to find the captives,

Wary partners in the South Atlantic

BUENOS AIRES

IN ALMOST every respect, Argentina and Britain get along swimmingly, as they have for most of the past two centuries. British Airways does a roaring trade between the two countries, and is talked of as a possible buyer of Aerolineas Argentinas, a local airline. This month HSBC, a British banking group, bought Banco Roberts, which (despite its English name) is Argentine. And Argentina recently displaced Mexico as Britain's most important Latin American market after Brazil.

All would be well but for an otherwise unremarkable cluster of islands—called the Falklands by the British and the Malvinas by the Argentines. Fifteen years ago, a Conservative British government fought a war to recover the islands after a ten-week Argentine occupation. Their fate remains a sore point.

The advent of a Labour government with a vast majority stirred Argentinian hopes that Britain's policy might change. That was unrealistic, as Argentinian officials admit. Britain still says Falklanders have the right to decide which flag flies over the islands. Until they decide otherwise, it will be Britain's. To secure that right, Britain will keep its 2,000-strong garrison on the islands, at an annual cost of over £70m (\$115m).

Thanks to revenues from fishing licences, Falklanders are no longer poor folk dependent on a dying sheep-farming industry. Finds by oil companies exploring the South Atlantic could make them richer still. Falklanders might then shoul-

der some of the cost of their own defence.

Argentina, though, is mellowing. Since 1982, dictatorship has given way to an increasingly robust (if still imperfect) democracy. That has made Argentina's Falklands policy less uncompromising. In 1989, President Carlos Menem renounced the use of force in pursuing Argentina's claim. Earlier this year, he proposed that Argentina and Britain should share sovereignty.

To Argentines, that sounded radical. Most still believe the islands are theirs (as they are taught at school). And the 1994 constitution claims full sovereignty. But 50% of Argentines now say that sharing sovereignty would be bearable, up from 34% in 1990, according to Estudio Mora y Araujo, a polling firm. Roberto Alemann, Argentina's finance minister at the time of the war, has given the sovereignty-sharing idea powerful conservative backing.

After any settlement "the islanders would scarcely notice the difference," says Argentina's foreign minister, Guido Di Tella. He points out that Argentina's provinces have autonomy over (some) internal affairs. Mr Di Tella has tried to charm the islanders, sending them Christmas presents and lunching (in Britain) with members of the Falkland Islands council. "I am beginning to like them," he told a United Nations committee on June 16th at its annual debate on the islands.

That feeling is not mutual. The islanders remain distrustful of Argentinian intentions. At their insistence, Argentinian

passport-holders are still banned from visiting or trading with the Falklands (except for rare visits to war graves by relations). Mr Di Tella calls that "an oddity", comparable only to the stand-off between the two Koreas or Taiwan and China. When next month he meets Robin Cook, Britain's new foreign secretary, Mr Di Tella will renew his efforts to start talks on the islands' status.

He will be rebuffed. Even so, it is hard to imagine the Falklands remaining aloof from Argentina for ever. Argentina's privatised oil industry is perhaps the most efficient in Latin America, and much of it is based in Patagonia, opposite the islands. If oil is discovered offshore, the pressure for greater economic co-operation will be strong. Reconciliation will take much longer.



President Ernesto Samper made two big concessions: he allowed mediation by the International Red Cross and ordered a reluctant army to withdraw for 32 days from 13,000 square kilometres (5,000 square miles) of territory around Cartagena de Chiriquí.

Unsurprisingly, the rebels turned the event into a propaganda coup. Before 150 journalists and a score of diplomats, the leader of the FARC's southern front made a rare public appearance, the national anthem was played and Russian-made helicopters on loan from the government ferried the hostages to be reunited with their families. The army's withdrawal gave the guerrillas total, if temporary, control of one of Colombia's biggest cocaine-producing regions. The army hopes to reoccupy the area starting on June 23rd.

This month's negotiations between government and guerrillas were the first since 1991, prompting talk of a lasting peace. Mr Samper has said that he is "willing, should

the conditions be given, to open a new door for peace in Colombia". General Manuel José Bonnet, the army's commander, has said that he too hopes for peace, adding ominously that "to find peace, one must first defeat the agents of violence."

In fact, the hostages' release looks more like a setback. For the army, it is the latest of a string of humiliations that invite revenge. Since the FARC captured the soldiers last August by storming an army base deep in the Amazon jungle and reducing it to rubble, the guerrillas have triumphed in a series of encounters. At San Juanito, barely 60 kilometres from Bogotá, 16 men were killed and eight were wounded when a unit of 40 soldiers was overwhelmed by the rebels. Some soldiers reportedly blew themselves up with grenades rather than surrender.

The guerrillas have been in control of up to half the country in the past year, though they have pulled back in the north. Candidates in the municipal and general elections to be held over the next year have

already been threatened with attack.

The army wants to hit back. Even as the FARC was releasing hostages last weekend, it launched an attack in the north that killed 15 guerrillas and two soldiers.

Mr Samper's beacon of peace flickers only faintly. To strike a deal with the rebels would mean giving in to at least some of their demands: land reform above all, plus the disarming of paramilitary groups and "democratic change". Some of this would infuriate the army and Colombia's powerful right wing. Mr Samper, weakened by corruption scandals and a sickly economy, had wanted the hostages freed to boost the popularity of his Liberal Party before presidential and congressional elections next May, but he is loth to provoke the armed forces further. Right-wing paramilitary groups, which hate both the rebels and the government, have said that, like the FARC, they will attack candidates who campaign on their turf. Peace will have to wait.

How can you value opportunities in China if you can't identify these coins?



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In Utah, Interior Dept. Is Betting on a Dry Hole

Monument's Future May Hang on Turn of Oil Drill

By Tom Kenworthy
Washington Post Staff Writer

DENVER—Last September, President Clinton stood on the rim of the Grand Canyon and, rhetorically linking arms with great conservationists like Theodore Roosevelt and Harold Ickes, erected a protective cordon around 1.7 million acres of canyonlands in southern Utah.

Lauding "God's handiwork" in the magnificent red-rock canyon country, Clinton by executive proclamation established the Grand Staircase-Escalante National Monument. "Today we are keeping faith with the future," Clinton said at that ceremony. "We are saying very simply, our parents and grandparents saved the Grand Canyon for us; today we will save the grand Escalante canyons and the Kaiparowits Plateau for our children."

Just nine months later, the Clinton administration is on the verge of taking something of a riverboat gamble on the monument's future. Officials in the Interior Department, betting that dozens of oil and gas leases that predated creation of the monument are virtually worthless, are poised to give Conoco Inc. the green light to proceed with exploratory drilling in the heart of the monument atop the Kaiparowits Plateau.

The officials believe the odds are heavily in their favor that Conoco's exploratory wells will come up dry and that the oil giant and others holding what are known as "valid existing rights" to drill for oil and gas on 108,000 acres of federal land within the monument's boundaries will go away and allow their 10-year leases to expire.

Conoco is pushing for drilling approval on five leases that otherwise will expire next fall. On one, the Utah state director of the federal Bureau of Land Management has determined there would be no significant environmental impact from exploratory drilling, and will act on Conoco's drilling application early this month. The oil company is also close to beginning drilling on a section of state-owned land on the Kaiparowits Plateau.

Though the Interior Department has only limited tools to prevent the drilling—and the presidential proclamation establishing the monument specifically recognized valid existing rights—the Clinton administration's acquiescence to Conoco has angered environmentalists. At the very least, they say, the Interior Department could temporarily suspend the leases, an action that would stop the clock on the lease expirations and block any drilling in the monument pending completion of an over-

all resource management plan for the Grand Staircase-Escalante. That plan is scheduled to be completed in about 2½ years.

"That would essentially freeze us as of this date," said Scott Groene, of the Salt Lake City-based Southern Utah Wilderness Alliance. The BLM, he said, "is setting a terrible precedent by allowing oil and gas work before completing the management plan for the monument. . . . If they hit oil and go to development, we will lose a slew of wilderness to the inevitable network of roads that will follow. If the Interior Department is not willing to stop a speculative well, it is not likely they will find the backbone once Conoco starts making claims of potential riches."

Groene said a lease suspension also would provide additional time for Conoco and the Clinton administration to pursue a possible trade of the company's oil leases in the Utah monument for leasing credits in deep water fields in the Gulf of Mexico.

Conoco broached such a trade in talks earlier this year with Interior Department officials, who were cool to the idea because of legal, technical and political complications, said John D. Leshy, the department's solicitor. Among the problems: Any such interstate trade would require congressional

approval; establishing equal value would be tricky because the Utah deposits are speculative while the Gulf of Mexico field is rich and proven; and it could cost taxpayers a bundle if Utah—entitled to 50 percent of royalties on domestic wells—were given a share of offshore royalties that typically go entirely to the U.S. Treasury.

"I told them the odds we would be interested [in a trade] are low," Leshy said.

He and other department officials say the exploratory drilling planned by Conoco will have little appreciable impact on the natural resource values of the Kaiparowits, particularly compared with a huge coal mine that had been proposed and was one of the spurs to Clinton's creation of the monument.

"This is a far different scale," said Leshy. "It's only an exploratory well . . . and even if they made a major commercial find, the overall impact on the monument compared to the proposed mine, well I think there's not much comparison."

At the BLM's regional headquarters, officials predict there is little chance that the drilling on the Kaiparowits will succeed. Over the last four or five decades, dozens of exploratory holes have been drilled without success within what is now the monument area.

"We are dealing with a highly speculative thing that's a real long shot," said Don Banks, a spokesman for the BLM.

But Bob Irelan, Conoco's regional director for exploration and production, said the company will be drilling to 14,000 feet, deeper than previous attempts, and he believes there is a good chance of finding a major oil field. "We think there's a huge source," he said. "This is big enough you just can't walk away from it. It could be billions of barrels of oil."

Irelan bristles at any suggestion Conoco is using the threat of drilling within a national monument to bludgeon the administration into a profitable trade for Gulf of Mexico oil riches.

"We're not trying to create money because the monument is there," he insisted. "My company is not in the habit of being confrontational. We like to do things that make sense."

Sometime next fall, Conoco and the Interior Department should have a fair idea whether the future of the Grand Staircase-Escalante National Monument is likely to include commercial oil production.

"Their worst nightmare is my dream," Irelan said. "Their fingers are crossed that it is a merciful dry hole."

The Washington Post

WEDNESDAY, JULY 2, 1997

THE PRESIDENT HAS SEEN
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THE WHITE HOUSE

WASHINGTON

'97 JUL 1 AM 10:00

July 1, 1997

MEMORANDUM FOR THE PRESIDENT

FROM

: MIKE McCURRY

MME

~~Do~~ just cover
+ figure new

SUBJECT

: QUESTIONS FROM GEORGETOWN'S MAGAZINE

Georgetown University's Alumni Magazine is doing a story on Georgetown's Rhodes Scholars. They are trying to interview all of their Rhode Scholars and would greatly appreciate it if you could write down a few words to be included in the piece.

The following questions will be asked of all Georgetown Rhode Scholars. You do not have to answer all of the questions. The magazine would be extremely pleased if they got even a couple of sentences from you. (OR I CAN TAPE RECORD A FEW THOUGHTS.)

* *Why were you interested in pursuing the Rhodes Scholarship?*

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McCurry
COS

* *How did your Georgetown education prepare you for success during the interview for the Rhodes Scholarship?*

Spelt to

* *What were some of the challenges and highlights of your experience at Oxford?*

* *How did your experiences at Georgetown and as a Rhodes scholar prepare you for a career in public service?*

If you would like to participate in this piece, it would need to be completed by the first week in August.

THE WHITE HOUSE
WASHINGTON

DATE: 7-4-97

NOTE FOR: The Honorable Robert E. Rubin

The President has reviewed the attached, and it is forwarded to you for your:

Information ☒

Action ☐

The Honorable Robert E. Rubin
Secretary
Department of the Treasury
15th Street and Pennsylvania Avenue, N.W.
Washington, D.C. 20330

Staff Secretary
(x6-2702)

cc:

UNITED STATES

THE PRESIDENT HAS SEEN
7-4-97



Back to the glory days?

"American manufacturing has never been in more trouble than it is now." Thus the glum introduction to an official report on competitiveness released in 1990, the last time America hosted a G7 summit. Its moroseness matched the nation's mood. Neurosis about the strength of Japan; gloom about the deficit; woe and decline on every side.

How times change. The country that presides over this year's rich-world gathering in Denver is feeling triumphant, even euphoric. "Is this a wonder economy or what?" asked *Business Week*. "On top of the world" chirped *Newsweek*: Notwithstanding signs of a slowdown in the second quarter of this year, the economy has been growing faster for longer than most economists thought sustainable. Unemployment has fallen well below the rate at which wage pressures have traditionally started to grip. And inflation is nowhere in sight. Producer prices fell for the fifth consecutive month in May, the longest string of declines since the 1950s.

Some back-slapping is in order, for sure. But today's economic success has also unleashed a Panglossian optimism, and that is more dangerous. A growing chorus of pundits, investors and economists argue that the good times are here—for good. They claim that such factors as globalisation and the rise of information technology have

changed the way the economy works, so that old constraints on growth no longer apply. Instead, America can look forward to a prolonged period of prosperity, with both inflation and business cycles tamed.

The stakes in this debate are high. If the new conventional wisdom is correct, America does indeed face a rosy future. If it is not, unfounded confidence could endanger the economy's achievements so far. Unfortunately, it is often difficult to pin down exactly what is supposed to have changed. Believers in the "new economy" speak grandly but vaguely of productivity revolutions or the "loss of corporate pricing power"; they point to tumbling computer prices and the growth of the Internet as indisputable evidence that the economy is dancing to a different tune.

Beyond anecdote, their optimism rests on two main arguments. The first is that America's potential growth rate is much higher than conventional wisdom suggests, because productivity is much higher than official statistics measure. The second is that, regardless of productivity improvements, inflationary pressures are much weaker (or even non-existent). Global competition means that capacity can be pushed harder and unemployment sent ever lower. Do these propositions make sense?

There is some truth to the productivity claim. According to official statistics (and

notwithstanding the small surge in the first quarter of this year), America's productivity growth during the 1990s has been as paltry as it was during the previous two decades, an average rise of around 1% a year. These official numbers have big and well-documented shortcomings. Productivity in services, the largest and fastest-growing part of the economy, is notoriously badly measured.

Moreover, using alternative gauges of productivity gives starkly different results. Edward Yardeni, chief economist at Deutsche Morgan Grenfell, points out that the growth in firms' real sales per employee used to rise in step with productivity growth. But since 1986 or so, and particularly in recent years, they have diverged. In 1995, for instance, real sales per employee rose 10% while non-farm productivity rose only 0.2%. The biggest gains are in new-economy sectors such as high tech and communications. These figures have problems—in particular, the divergence might reflect the outsourcing of production—but they provide some evidence of higher-than-measured productivity growth.

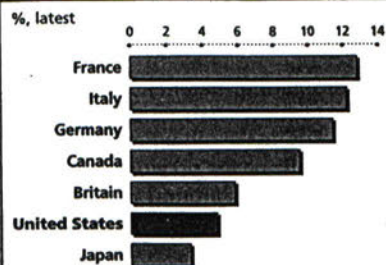
Few economists would disagree that the real economy may be growing faster than official numbers suggest. At issue is whether the discrepancy keeps increasing. Moreover, if America's recent growth primarily reflects rising productivity, it is not clear why unemployment continues to fall. The drop in joblessness suggests that at least part of America's GDP growth comes from more labour input rather than higher output per worker.

Statistics bear this out: a large part of America's growth in the past year did indeed come from more people working, as well as working harder. Between the first quarter of 1996 and the first quarter of 1997 the number of Americans with a job grew by 2.4%, far more than the traditional annual job-growth rate of 1.4%. Moreover, the average number of hours worked each week also rose by 1.2%, again well above trend. Add growth in employment and hours worked to the official estimate of productivity growth (1%) and you more than account for the 4.1% rise in GDP. (The numbers do not add up exactly because they come from different statistical sources.) This does not prove that there has been no rise in productivity, but simply shows that much recent growth has come from getting more people to work, and persuading them to work longer hours.

And that is exactly what worries mainstream economists. Fast growth based on unusually high employment growth can-

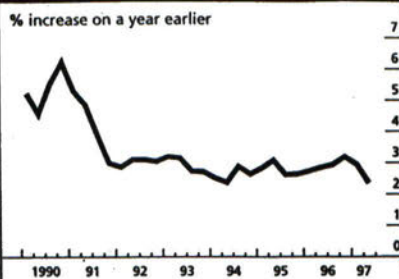
Plenty to show off about

Unemployment rates*



Sources: National statistics; Datastream

Consumer prices



*National definitions

not continue forever. At some point, they fear, the unemployment rate will fall below the non-accelerating inflation rate (NAIRU) and wage-inflation will rise. Indeed, many reckon it has already done so.

Moreover, they point out, America's labour force grew remarkably quickly last year, far faster than its population. Several factors lay behind this. A buoyant economy may have lured back some people, particularly women, who had given up looking for work; welfare reform is forcing poorer women, who may have relied on a federal cheque, to find a job; and changes in immigration laws have prompted a sharp rise in the number of Latinos entering the labour force. But these supply increases are probably temporary: once employment growth stabilises, fast job growth would mean bringing the unemployment rate down further, which increases pressure on wages. At that point either corporate profits must be squeezed, or firms must pass on their higher costs through higher prices.

The new-economy crowd insists this is nonsense: inflation is dead, and the concept of a natural rate of unemployment outdated. In the new economy, firms cannot simply raise their prices: if they do, they will quickly lose out in a global market where firms and consumers can choose their suppliers at will. Yet, in fact, the United States is not terribly globalised: imports and exports still make up a relatively small share of GDP. Most of America's output is in goods and services that cannot easily be bought and sold across borders. For the price of a haircut, say, or a meal out, the globalisation argument is irrelevant.

A more subtle argument is that the pressures of globalisation and corporate restructuring have allowed American firms to push capacity further. New techniques for managing inventories, for instance, prevent the kind of involuntary build-up of stocks that used to make for large swings in output. In a more integrated global economy, companies can switch to foreign suppliers more easily. In short, the old speed limits may no longer hold.

There is probably some truth to this; but it would be foolish to push the argument

too far. The capacity of the global economy is not infinite. Much of the weak price pressure faced by American firms comes from the fact that other large industrial economies have been growing sluggishly in recent years: once they pick up, commodity prices, for instance, may be under more pressure than they are now. Moreover, the strong dollar—a factor that has helped depress import prices—need not be a permanent phenomenon. If any of these tempo-

rary fillips subsides, American firms could well find their costs rising fast.

It is more likely, however, that pressure will first occur in labour markets. Historical relationships between unemployment and inflation imply that these pressures should already be evident. It is, of course, true that the NAIRU—estimates of which have never been made with enormous precision—may indeed have fallen: an ageing workforce, greater worker insecurity and the changing nature of employment contracts could all have brought it down. A lower NAIRU, however, is not the same as no NAIRU. More important, the new-economy people forget that overall labour costs have risen more slowly than wages because the cost of non-wage benefits, such as health insurance, has barely budged. This will surely not last for ever.

In short, the optimists have a point, but the danger is in pushing it too far. America's economy is undergoing some striking changes; but it has also benefited from a plethora of temporary (positive) shocks. Cheerfulness is appropriate; euphoria should be held in check.

Shutting military bases

From boots to electronics

INDIANAPOLIS

THE American military establishment has closed two big installations in Indianapolis in the past five years. Walking the streets, you would never know it. Unemployment is only 2.6%. Local fast-food restaurants pay \$6.50 an hour and offer bonuses to attract new employees. Main-Street Indianapolis reflects a booming mid-western economy. It also suggests that closed bases can leave the locals not only unscathed, but sometimes better off.

The Defence Department first set its sights on Indianapolis in 1991, when Fort Benjamin Harrison, an army training camp, appeared on "the list". (The Commission on Base Realignment and Closure selected 97 big installations for closure in four rounds: 1988, 1991, 1993 and 1995.) Some 3,400 active-duty soldiers would be moved elsewhere. Over 1,000 civilian jobs would be lost.

But a gem lay hidden in the murk. The



Lots of jobs and a state park, too

THE PRESIDENT HAS BEEN
7-4-97

Copied
Matthews
LOS



NATIONAL ENDOWMENT FOR THE HUMANITIES

WASHINGTON, D.C. 20506

Sylvia
Let Howard know the
letter his report
up to him - also he
should be fully advised
to support this - it's going
back at Penn as a proj.
and probably could give
it a lot of kick -

BC

THE CHAIRMAN

June 16, 1997

William Clinton
President of the United States
White House
Washington, D. C.

Dear Mr. President:

Congratulations on the successful launching of your initiative on racial reconciliation. It is a brave and much needed effort. Your speech in San Diego touched upon the right themes and sounded the right notes. While cheering you on, I would like to give you the benefit of a few of the things that I have learned from the NEH's three-year project, "A National Conversation on American Pluralism and Identity." My lengthy report on that project will emerge from the GPO in July. You have an earlier draft, but I would be glad to send you a copy of the final version now if it might help in the conceptualization of your initiative.

I like very much the use of the term "conversation" to describe what you hope to stimulate among the American people. Conversation implies an exchange that is civil, in which the participants are equals, and in which there is as much listening as talking. I also like your clear realization that this is a multipolar issue. Race is no longer simply a black-white divide. The blurring of racial categories is a friend of reconciliation, of course, but we should also be completely aware that race is a cultural concept and not a genetic one.

From my reading of the polls, and from an intense involvement over the past four years with various organized and unorganized groups of citizens, I know that Americans are worried about the way society seems to be fragmented now along several different fault lines, but they worry particularly about fragmentation growing out of racial, ethnic, linguistic, religious and nationality differences. They may not put this at the top of their list of worries when the pollster calls, but that is because it doesn't seem to be the same sort of immediate issue as jobs, education or crime.

Should
get to
how. P.D.
Hinks

The President
June 16, 1997
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In addition, race is an emotional mine field that most people are not willing to tiptoe into, lest they touch some unseen tripwire. Given the opportunity, however, people will talk about "difference" with great relish. If they feel secure enough, they will also reveal their resentments and fears. Americans generally do not have a lot of opportunities to talk to people who are very different from themselves.

I would urge you to continue doing what you did in the San Diego speech: ~~emphasize what we share as Americans.~~ The life-enriching powers of pluralism cannot be appreciated by people who feel that social cohesion is being threatened by "others" or who feel that their "culture" (the atmosphere of values, traditions, and expected behavior that gives shape to their lives) is being replaced by some "foreign" culture. That is why Pat Buchanan struck such a responsive chord in 1996 when he told audiences that he wouldn't let "them" take America away from "us."

I have a three-fold notion of the dynamic American identity, a notion that has evolved over the last four years. The core of the American identity is to be found in our commitment to a democratic political system and to equal individual opportunity. We are fundamentally a political idea. As Gordon Woods argues in his pathbreaking book, The Radicalism of the American Revolution, the commitment to democratic political ideas led to a democratic social order that profoundly altered the society that existed in the eighteenth century American colonies. In any case, when pressed to answer the question, "what do we share as Americans," almost everyone will mention the political system or the Constitution or individual rights or some version of the idea of democracy. I think that is a wonderful thing.

Beyond civic nationalism, most Americans think that there actually are some common traits of character that arise from historical experience in America. Not everyone exhibits these, of course, but they are thought to be typically American. Frequently mentioned are such things as self-reliance, optimism, tolerance of differences, self-improvement, pragmatism, the lack of deference, and so on.

In addition to the values that flow from the Declaration of Independence and the Constitution, and the universalistic values that govern our collective life, there is also a realm of life recognized by ordinary Americans in which it is perfectly ok for particularistic identities to operate, identities that may derive from group membership or some parochial involvement. We all have multiple identities, or multiple layers to our individual identity. Our collective life should be lived in accordance with universal values that apply to everyone equally as individuals without any identity modifiers. In our personal lives, however, there is room

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for identities that we may share with smaller subsets of Americans. Race, gender, ethnicity, religion, and other partial identities belong in this personal realm.

I emerged from the NEH project thinking that the tension between individualism and community in American life is probably the most important "contradiction" in our culture. As Seymour Martin Lipset has recently documented again, we are the most individualistic among the industrialized nations. If we don't learn to think of individualism and community as two parts of a single whole, we are going to continue to have trouble with social cohesion and with figuring out how and when to respond to the needs of community, and especially to the needs of the most vulnerable among us.

I notice that Speaker Gingrich seems to be staking out the territory on the starkly individualistic side of the complex individual/community relationship. In the near term, that is a strong rhetorical position. I would hope that part of the conversation might be to encourage people to think about the ways one can only realize one's full potential as an individual through the group. Indeed, I believe that the individual and his various group identities are mutually dependent.

The idea that our individual identity is learned from our interactions with the various groups and communities to which we belong comes from Hegel and is fundamental to the thinking of John Dewey and numerous other observers of the human scene. It is also a commonplace to say that our own individual fates depend greatly on the fate of our community. The mutuality and simultaneity of the group and the individual is real, but it is a bit harder to explain than the mythic American lonely hero. That will take some creative thought.

Now, a couple of warnings. America is getting more diverse. It is ok to say that. On the other hand, to try to motivate people to move to a more conciliatory racial position by projecting an America in which whites are in the minority risks stimulating a backlash. Many white Americans are feeling threatened anyway. They may well respond with intolerance rather than pragmatism when confronted with the increasing racial complexity of the population. All the ballyhoo about the "new majority" seems to me to invite repressive public policies intended to prevent the new majority from coming about. Indeed, any hint that group rights (American Indians always being an exception) are a good thing threatens everyone in a pluralistic society because it implies limited access to the common life of the nation, be that common life economic or political or cultural.

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Affirmative Action is also a challenge to the universalistic and individualistic principles that are part of the American mindset. That is why quotas and set-asides get so little support among the public. On the other hand, people are aware that the members of some groups suffer from discrimination because of their group membership. This contradiction is the reason that the polls tell us both that Americans don't like Affirmative Action and that they would support government activity to insure equal opportunity.

Affirmative Action either has to be redefined in the public mind so that it means what it was originally intended to mean (aggressive efforts to insure non-discrimination, and perhaps to overcome the lingering effects of past discrimination, as in the very popular Head Start program), or another term must be found to cover the sort of equal opportunity efforts that the public will support and that the society so clearly needs. Opening up education so that it can really serve as the route to equal opportunity must be a central part of the effort of racial reconciliation.

As long and tedious as this letter is, it only ripples the surface of a subject that is oceanic in its importance and contains subtly dangerous currents. I wish you well in the reconciliation effort and think you are courageous to undertake it. As always, I stand ready to help.

Respectfully,



Sheldon Hackney

cc: Ellen Lovell, Office of the First Lady

WE.

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HU 010



THE WHITE HOUSE

WASHINGTON

July 4, 1997

Dear Sheldon —

Thank you for your excellent letter
on the Reconciliation, as well as calling the
"One America" initiative. I am eager to read your
report and to share it with the Advisory Board.
I hope we can utilize your experience and insight
in the work ahead.

Sincerely

Bill Clinton

Honorable Sheldon Hackney
National Endowment for the Humanities
1100 Pennsylvania Avenue, N.W.
Washington, D.C. 20506

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