

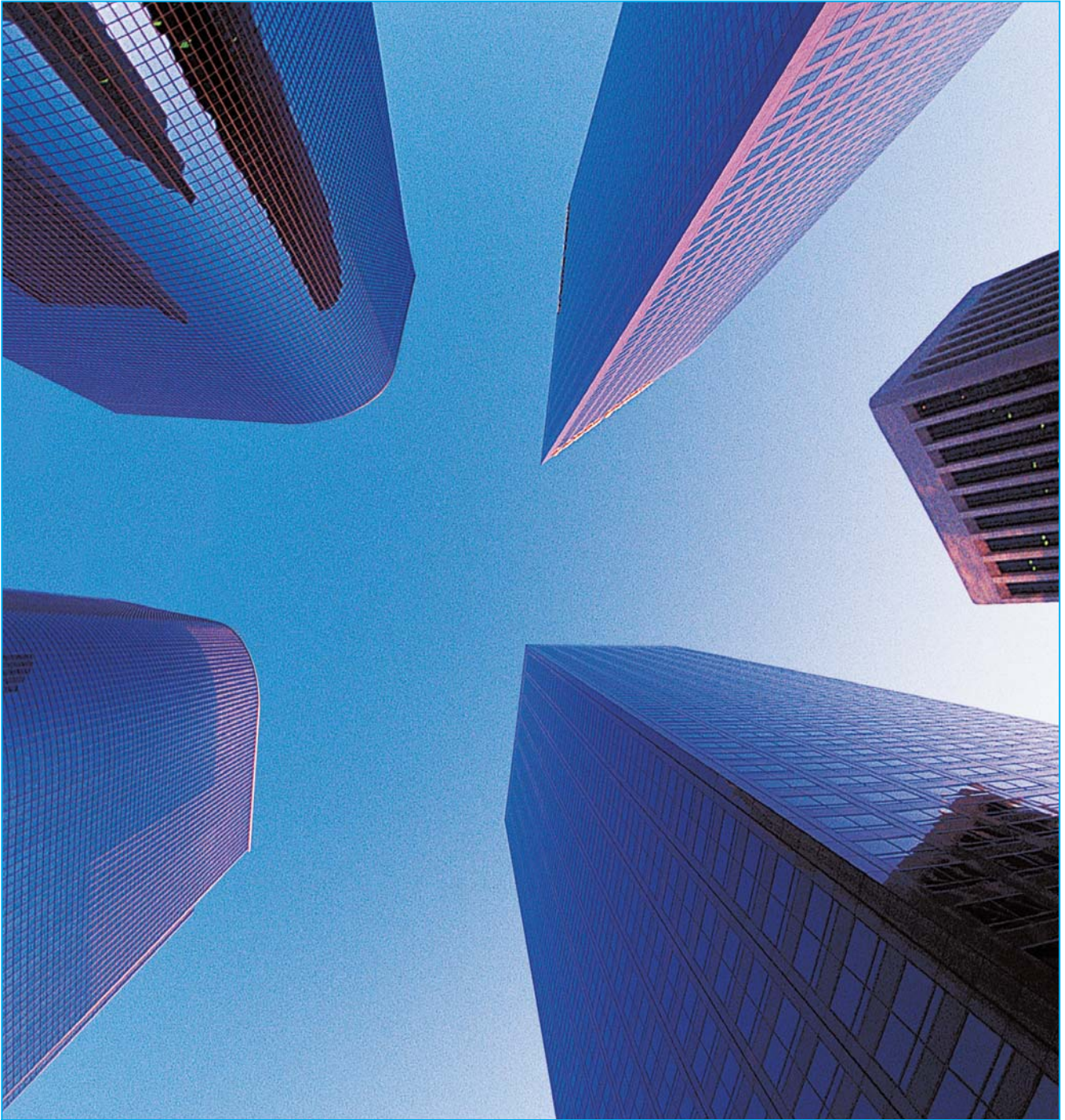
The Ripon Forum



EUROPE'S CRISIS: What It Means For America

**INSIDE: Tackling the Deficit ♦ Reforming the World Bank
The GOP and Women ♦ Lebanon Rising ♦ Putin: Russia's Savior?**

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Letters to the editor: Readers speak out on the March/April issue

Ending Our Oil Dependency

I really enjoyed reading Amory Lovins' "Ending Our Oil Dependence" piece. While it is inevitable that humans will have to move beyond oil as an energy source, suggestions on how to do so are often unrealistic. The framework of the United States is built upon the use of oil, and this reality cannot be changed overnight without serious consequences to America's economy and security. Mr. Lovins points out many ideas that seem practical and feasible. More importantly, Mr. Lovins approaches the transition away from oil through a language that businesses speak—market-based incentives and a chance for profit. Trying to induce change to cleaner energies for the sake of the environment hasn't and never will be the way to invoke change.

Ultimately, oil companies and the industries that are reliant upon oil know that the wells are running dry. Many of these companies understand that if they are to survive, they must be pioneers that will unveil the new sources of energy that will keep society chugging along. As admirable as Mr. Lovins' ambitious plans are, it will be the natural market competition of businesses affected by a dwindling oil supply that will help to deal the cards that we play much more than any sensible argument laid out on paper.

*Joe Pack
Atlanta, Georgia*

Angry White Male?

Sen. Rick Santorum is no stranger to inciting controversy over social issues. In 2002, he likened homosexuality to bestiality. Earlier this summer, he cited Boston's supposedly overly sexualized society as the reason for the molestation scandal in the Catholic Church. In his article, "Protecting the Unborn" in the March/April issue of The Ripon Forum, Mr. Santorum manages to somewhat turn down his rhetoric. But reading it, I was left with the same feeling I get whenever I hear Mr. Santorum speak:

this is an angry man.

Mr. Santorum's comments are indicative of a growing trend amongst conservatives in the Republican Party: people who seem to think that George W. Bush being reelected is a sign from the American people that they are willing to embrace some sort of bold new conservative agenda. This is not the case. Keep in mind, President Bush only received 51 percent of the vote—hardly a mandate. While the majority of Americans do consider themselves to be "pro-life," this vague term does not necessarily mean that they are opposed to Roe v. Wade. In fact, most Americans believe that Roe v. Wade is now settled law.

As the Democrats move more and more to the extreme Left, Republicans should take the opportunity to bring in the very people the Democrats are moving out: social liberals who value a vibrant economy and strong military. This may include people who are pro-choice. Republicans like Senator Santorum are not going to help with wooing these voters.

*Franklin T. Tank
Raleigh, North Carolina*

No to Green Republicans

I am responding to your "Green Opportunities for the GOP" by Samuel Thernstrom in the March/April 2005 issue. It pained me to my conservative bones when I read this article. The suggestion for the GOP to take a larger role in environmental politics is irrational.

The article points out how the environment was hardly mentioned in the 2004 presidential race. This was, and still is, because the American people realize there are currently more important issues than the environment. An American majority re-elected President Bush because they believed in his plan of action on issues such



as Social Security, Iraq, the war on terrorism and defense of traditional values. Why would a strong Republican majority turn its back on the people that elected them by not focusing on these issues?

Republicans in Congress need to work on issues that the electorate voted them in on, and not give into the left-wing, hemp wearing, tree hugging hippies.

*Richard Army
Dubbyaville, Nebraska*

The Ripon Forum

The Ripon Forum encourages letters to the editor. Letters should be submitted by e-mail to jkuhner@ripsonsoc.org or by fax to (202) 216-0036 or by mail to Jeffrey Kuhner, The Ripon Society, 1300 L Street, NW Suite 900, Washington, D.C. 20005.

Please include your full name, address, and daytime phone number. Letters will be edited for space and clarity.

Virtues of Math and Science

Education can save your kid's job—and yours

By U.S. Representative Vernon J. Ehlers

Jobs of the future will require an understanding of the basic principles of math and science. A U.S. workforce equipped with these skills is essential for our economic competitiveness and national security. These skills also generate consumers and voters who are well-educated, critical thinkers.

An understanding of scientific and mathematical principles, a working knowledge of computer hardware and software, and the problem-solving skills developed by courses in science, technology, engineering and math (collectively referred to as “STEM”) are now basic requirements for many entry-level positions or admission to college. Furthermore, these skills help ensure success on the job.

The U.S. Bureau of Labor and Statistics estimates that four of the 10 fastest-growing industries and occupations from 2002-2012 are expected to be high-tech. Even many lower-tech jobs, including clerical work, depend on a strong foundation in math and science as our society increasingly relies on computers and computer-controlled equipment.

In addition to economic concerns, a workforce equipped with math and science skills is essential to our national security. In 2001, the Hart-Rudman Commission found that the United States needs to revitalize its strengths in science and math education in order to preserve our national security. Their report states: “...the inadequacies of our systems of research and education pose a greater threat to U.S. national security over the next quarter century than any potential conventional war that we might imagine... If we do not invest heavily and wisely in rebuilding these two core strengths, America will be incapable of maintaining its global position long into the 21st century.”

Finally, a workforce equipped with math and science skills fosters critically thinking consumers and voters. Everyday products are constantly improving and contain highly advanced technological features. Today's technology will soon be surpassed by tomorrow's innovations and consumers need to be capable of understanding and utilizing these advances. Also, voters need to compre-

hend scientific issues. Almost every day, members of Congress take up science-related issues, whether they are considering health research, funding environmental initiatives or improving our manufacturing capabilities. As state referenda on environmental and technical issues increase, voters need to understand the issues.

Given how important this trained workforce is, one would expect that the United States would continue to be the world leader. Unfortunately, we are seeing disturbing trends in student performance on basic math and science tests. The recent Program for International Student Assessment (PISA), and Trends in International Math and Science Study (TIMSS), highlight the shortcomings of current K-12 science and math education in the United States when compared to other developed countries. While our fourth- and eighth-grade students recently have shown improvement, they are still below the international average, and our high-school students are consistently near the bottom. In the PISA study, 15-year-old students from 20 developed countries, including many European and Asian nations, outperformed U.S. students, even when socio-economic factors are taken into consideration.

Furthermore, the number of graduates with bachelor's degrees in the physical sciences, mathematics and engineering has been declining for two decades. The United States graduates about 50,000 undergraduate engineers per year while China produces about four times this number. Even Japan, with half the U.S. population, graduates twice as many engineers as we do.

To maintain our economic competitiveness and national security, we must expect more. New methods of teaching math and science are required, as well as better curricula with improved standards and improved training of teachers, coupled with strong parental involvement and support.

We have made progress by implementing math and science testing as part of the No Child Left Behind Act (NCLB). Congress also created the Department of Education's and National Science Foundation's Math and Science Partnerships programs, which provide necessary profes-



U.S. Representative Vernon J. Ehlers

sional development to strengthen teachers' ability to effectively teach math and science. Along with Rep. Mark Udall, I started the Science, Technology, Engineering and Math (STEM) Education Caucus (www.stemed-caucus.org) to educate congressional members and staff, and membership is booming.

As Congress considers the Higher Education Act reauthorization this year and the reauthorization of the NCLB Act in 2008, we must find ways to bolster our math and science education system. Perhaps it is time for Congress to implement more comprehensive changes. Sputnik and The National Defense Education Act of 1958 spurred U.S. leadership in science and math as a response to the Space Race and the Cold War. We need a similar boost as well. For future generations—perhaps your own children—a strong math and science education will well equip our workforce. The resulting economic improvements will also help the present generation thrive in their jobs.

I am committed to ensuring that the United States continues its leadership. I challenge you to join me in this quest to improve U.S. math and science education for the 21st century. 📧

— Rep. Vernon J. Ehlers is a Michigan Republican and member of the House Education and the Workforce Committee.

He is also the co-founder of the Science, Technology, Engineering and Math Education Caucus.

Courtesy of Rep. Ehlers' office



Dealing with the Deficit

Crushing debt load threatens nation's future

By Maya MacGuineas

With structural budget deficits stretching indefinitely into the future, the mounting national debt and few meaningful budget rules left in place, the chances of the deficit disappearing on its own are about as likely as finding a quick fix for health

care. It is no wonder fiscal conservatives are in such a state of despair. Despite numerous warnings from the Congressional Budget Office, the Government Accountability Office, the Federal Reserve and the International Monetary Fund, the past four years

have seen a solid deterioration in the nation's fiscal state of affairs. If nothing is done, it may well be financial markets that force action upon us. This is a far inferior alternative to the types of bipartisan budget deals that have led us out of budget messes in the past.

Last year's budget deficit was \$412 billion. The Congressional Budget Office projects we will borrow another \$1.6 trillion over the rest of the decade. That's before any money is set aside for further operations in Iraq and Afghanistan, reforming Social Security, fixing the Alternative Minimum Tax, or extending any of the expiring tax cuts. Even this far from rosy scenario depends on our borrowing all the surpluses from the Social Security system, and using that additional \$1.3 trillion of intra-governmental borrowing to mask the true size of the deficits.

Meanwhile, the nation's largest entitlement programs are clearly on an unsustainable track. The first Baby Boomer will retire in three short years, and quickly, we will transition from a nation where the largest generation is in the midst of its most productive years, to one where the Boomers are on the receiving end of our national entitlement programs—greatly increasing their costs. Though Social Security reform is on the national agenda, Congress has been more focused on debating whether the system faces a crisis than discussing how to actually fix it. The program is over-promised to the tune of \$11 trillion. Congress has known about the problem for years, and every year we wait to make changes, the harder the problem becomes. Given that Social Security is by far the easiest of the under-funded entitlement programs to fix, this does not bode well for a fruitful discussion on Medicare.

If changes are not made to the nation's largest entitlements, we are left with two choices: squeeze out virtually all other areas of the budget or allow the government to grow to an unprecedented peacetime size of 25 to 30 percent of GDP. Neither scenario is one we should be proud to pass along to the next generation.

Furthermore, as Gene Steuerle of the Urban Institute has pointed out, we are losing control of the budget as we pre-allocate more and more of the nation's resources. Just as we could not have predicted the major needs of today 50 years ago, it is difficult to anticipate what those needs will be 50 years from now. Yet because of our inter-generational, consumption-oriented, pay-as-you-go entitlement programs, it will be far harder to meet new needs since so much of the budget has already been promised away.

Finally, while seniors are by far the strongest voting block, it is hard to make

the case that our current resource allocation of \$8 per senior for every \$1 on children makes sense. And that ratio will be changing to further favor seniors just at the time when due to the new hyper-competitive global environment we should be investing far more in the next generation of workers.

Turning a Blind Eye

The political class has not yet woken up to the seriousness of these tremendous challenges. Perhaps we are a victim of our past successes. Politicians may hope for a replay of the 1990s, when strong economic growth and a booming stock market helped pull the U.S. budget out of what looked to be a permanent deficit spiral. But many levers were used to generate those budget surpluses: multiple rounds of tax increases, considerable spending constraint, the emergence of the peace dividend, and budget rules that would have prohibited enactment of the tax cut and prescription drug legislation that we have seen in recent years. Moreover, sitting on the precipice of such a large demographic shift, the bar for success is now much higher than it was a decade ago.

It is hopeful that the administration has acknowledged that deficits do matter and, accordingly, has promised to cut the deficit in half before the end of the decade. However, the commitment is unconvincing given the number of executive branch priorities omitted from the President's budget.

Furthermore, the goal is insufficient even if it were realistic. At the bare minimum, sound fiscal policy would involve balancing the budget over the business cycle, running deficits during a downturn and surpluses during periods of economic strength, which is a far more aggressive target than the course the President has laid out. Secondly, the goal should not include the Social Security surpluses, which not long ago, members of both political parties were committed to saving. Finally, in preparation for the upcoming demographic shift, we should have been running large budget surpluses over the entirety of the past decade. Fiscal policy would then have involved a shift between smaller and larger surpluses depending on economic conditions, with the additional savings helping to prepare us for the Baby Boom's retirement. Instead, the budget that Congress just passed, while bold in its willingness to scale back some entitlement spending, actually enlarged the deficit beyond what it would

have been if no budget had been passed!

A Financial Market Crisis?

The broader and more troubling question has become not when will Congress come up with a realistic budget deal, but instead, will it be a financial market meltdown that finally forces our hand? While the scenario may seem far-fetched—fiscally driven market crises occur in developing markets and regions, not the home of the global benchmark security—a spiraling chain of events is not out of the question. The United States is now highly dependent on lenders from abroad to finance our massive levels of borrowing. About half of outstanding Treasury bonds are owned by foreign lenders. Particularly troubling is that the composition of lenders has shifted away from private investors seeking out the highest returns, to foreign central banks attempting to prop up their currencies vis-à-vis the dollar. This leaves the United States in the odd situation of being the single strongest superpower and at the same time, the single largest debtor and thus, surprisingly dependent on other nations.

A mini wake-up call occurred when the South Korean central bank let it be known that they were considering shifting part of their reserves to currencies other than the U.S. dollar, leading to a temporary stomach-lurching decline in the dollar. It is easy to envision a more permanent scenario where concern over America's fiscal position would lead to a selling off of dollars, stocks and bonds, rising interest rates, the bursting of the housing market bubble, and a slowdown in not just our economy, but the world's economy.

While it is true that the Asian central banks have a strong interest in not letting the dollar drop to avoid taking a big loss on their existing holdings, it is little comfort that this co-dependent relationship could ultimately produce two sets of losers. Japan, India and Russia have all recently made rumblings about diversifying their reserve currencies, and when they speak, U.S. Treasury officials must now listen.

Another unsettling scenario is that private rating agencies, such as Moody's and Standard & Poor's, downgrade the United States' debt based on our high levels of borrowing and unfunded liabilities, much as they did Canada's in the mid-1990s when their fiscal policies were deemed overly reckless. A downgrade would surely cause bondholders to dump their debt, leading to

Politics: Dealing with the Deficit

an abrupt jump in interest rates and potentially setting off an unwelcome economic spiral.

No one knows if any of these scenarios will materialize. Certainly, no one knows when. Clearly, however, this is one of those times when we would rather not find out if the crisis predictions are accurate. Even if there is no financial crisis, or it is closer to a blip than a meltdown, ongoing budget deficits drain the economy of investment capital, lead to lower standards of living in the future and squeeze out other areas of the budget as interest payments mount. In short, deficits are a reflection of our spending more than we can afford and forcing our children to pay the bill.

The best scenario to stave off any potential crises and the right one in terms of generational responsibility is to take preemptive action rather than waiting until action is forced upon us. The gap between revenues and spending is large enough that a few tweaks here and there will not come close to doing the trick: a real budget deal is called for.

A Grand Fiscal Bargain

Any effective deal will have to be bipartisan to give both parties political cover on the tough choices that will inevitably be involved. Moreover, a bipartisan and balanced compromise has a far better chance of sticking, even if power in the House, Senate or White House changes hands. In order to reassure forward-looking financial markets, the deal will have to address both the short and long-term challenges.

While it is hard to picture what sort of deal could come out of this highly polarized and partisan environment, the numbers paint a pretty compelling picture of where to begin. Federal revenues have ranged

from about 17.5 percent to 21 percent of GDP over the past few decades. Today they stand at a 46-year low of 16.3 percent. Meanwhile, federal spending has been in the range of 18.4 percent to 22.9 percent over the past 20 years. On its current path, spending is expected to grow to between 25 and 30 percent. Even for those who don't worry about the inefficiencies caused by taxation at current levels, such exorbitant growth is cause for concern.

One possibility would be a grand fiscal bargain: Raise taxes in the short-run and rein in entitlement spending in the long-run so that both are more in line with historical norms. Such a balanced approach has a far better chance of success than any of the alternatives. Neither party will particularly relish the plan because both will have to give something up. But real budget deals are never easy.

First, let's take taxes. Initially, there was concern that surpluses would grow so large they would consume all the outstanding debt, prompting calls for tax cuts. Then, as the economy stalled, the case for fiscal stimulus made sense. (Though using both arguments to justify the same tax package was a bit of a stretch.)

The subsequent rounds of tax cuts, however, from a fiscal perspective were inexcusable. With the looming costs of the Baby Boom around the corner, we should have been using the government's excess funds to pre-fund the major retirement and health care programs. Moreover, once the budget surpluses vanished, the tax cuts merely exploded the deficit further. Republicans had their chance to reduce the size of government, but chose not to. Accordingly, neither the argument that the tax cuts were part of a plan to scale back government or increase economic efficiency holds. Either the President's tax cuts could

be repealed, or a new revenue stream—such as a progressive consumption tax or environmental and energy taxes—could be added. But given the current budget picture, taxes will have to go up.

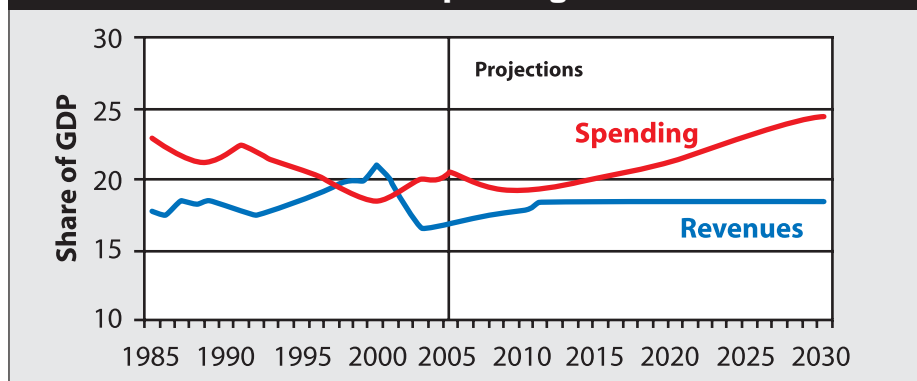
Meanwhile, Democrats must give up on the notion that entitlement programs cannot be changed, updated, or cut. We have greatly over-promised this area of the budget and have no plan for how to pay for all these promises. What did we do with Medicare, the most challenging of the problems? We expanded it by adding the prescription drug plan with virtually no regard for the tremendous long-term costs.

Entitlement programs will have to be reduced. The most sensible way to do so is to progressively scale back benefits for those who do not need them. The President's plan to reduce promised Social Security benefits for wealthier retirees, for instance, while protecting those who depend on the program, makes an awful lot of sense. Same goes for means-testing health care benefits, through reduced benefits or higher premiums for the well-off elderly. The other option of course is to employ across-the-board benefit reductions, which would do great damage to the recipients who truly depend on these programs. But surprisingly it is Democrats who tend to object to redesigning these programs in a way that would make them more progressive, fearing that it would undermine their political support. The argument that we should dole out generous middle-class benefits in order to buy political support, particularly when the cost falls squarely on the backs of workers, many of whom are less well-off, is not only excessively inefficient and costly: it is not in keeping with what progressives should stand for.

Both parties have put politics in front of principles, and this will have to change. In order to directly confront the country's major fiscal challenges, both the eras of big government conservatism and anti-progressive progressivism will have to come to an end. If we are not willing to enter into some kind of a grand fiscal bargain where everything is on the table, and both parties are willing to give up something, more than likely, financial markets will end up forcing our hand. ☞

— *Maya MacGuineas is the Director of the Fiscal Policy Program at the New America Foundation, a non-partisan think tank in Washington D.C.*

Chart 1: Federal Spending and Revenues





GOP Needs to Court the Female Vote

America's women deserve political parity

By Pat Carpenter

The late House Speaker Tip O'Neill once said, "All politics is local." That's why The WISH List (Women In the Senate and House) has made the recruitment, training and election of outstanding women leaders—at all levels of government—a top priority.

More than half of the population in America is female. That's why it is important that women have equal representation where public policy is being discussed and laws are being enacted. Women bring a different perspective and set of life experiences to the table. They see issues in a different light. It is critical that both the perspectives of women—and those of men—are aired and debated in the process of writing public policy.

Unfortunately, American women are still a long way from election parity. According to the latest statistics from the Center for American Women and Politics at Rutgers University:

- Women hold only 14% (5 Republicans, 9 Democrats) of the 100 seats in the U.S. Senate.
- Just 15% of the 435 U.S. House seats (23 Republicans, 43 Democrats) are held by women.
- Only eight of the 50 states have women governors (2 Republicans, 6 Democrats).
- Of all 315 statewide elective offices nationwide, women hold just 25.7% (43 Republicans, 35 Democrats, 3 nonpartisan).
- Women occupy just 22.5% of the 7,382 state legislative seats nationwide.
- Only 15% of the 243 U.S. cities with populations greater than 100,000 have women mayors.

These numbers are appalling. If the interests of American women are to be equally represented in government today, we must elect many more women to public office.

The Republican Party, which has always been at the forefront of the American woman's fight for equality,

“The Republican Party must take proactive steps to identify, recruit, train and elect more women to local, state and federal office.”

should take the lead once again in this important battle. The GOP must ensure that the rights and interests of America's largest demographic group are preserved and pursued.

We all recall that the Republican Party was the first political party to call for equal voting rights for women—a battle that persisted for 70 years before ratification of the Equal Suffrage Amendment to the U.S. Constitution in 1920. And the first woman elected (in 1916) to the U.S. House of Representatives was Jeannette Rankin—a Republican from Montana. These facts underscore the Republican Party's proud heritage of inclusion—a heritage that the GOP must revive in order to attract the votes of more American women.

The Republican Party must take proactive steps to identify, recruit, train and elect more women to local, state and federal office. There are a number of ways to achieve this without resorting to the restrictive mandatory quota systems that have been implemented in some countries to ensure equal representation for women.

Republican leaders must make the election of women a priority, and they should let Americans know (in speeches, writings, and the GOP platform) that Republicans are leading the way in the fight for women's equality in the political arena. In addition, Republican Party organizations—at the federal, state and local levels—need to recruit promising women to run for office—and then provide these women with financial help, strategic support and candidate training.

Emphasis must be placed on the election of female candidates at the local and state legislative levels, where women leaders gain the experience necessary to run for governor, Congress, the U.S. Senate—or even president. The more women officeholders in the pipeline at the local levels of government, the more the chances are that they will survive the harsh climb to the uppermost rungs of power on the political ladder.

The battle has not been an easy one. And it won't be easy in the days ahead. But right now America is using only a fraction of the resources we could be putting to work for us.

The political party that helps America's women acquire equal clout is the party most likely to thrive. After all, women vote.

This is why The WISH List has made the recruitment, training and election of outstanding women leaders a top priority. It will take time, determination and perseverance to bring gender equality to all levels of American government. We cannot give up. Nothing worth achieving comes easily. 🐦

- Pat Carpenter is President of The WISH List (www.thewishlist.org), a nationwide network of mainstream women and men dedicated to increasing the number of Republican women officeholders across America. WISH recruits, trains and supports pro-choice Republican women candidates running for Congress, governorships, state legislative seats and local offices.

Europe: Crisis, What Crisis?

EU must reform in wake of rejection of constitution

By John O'Sullivan



AP Photo/Susan Walsh

British Prime Minister Tony Blair stands in the center, as G-8 leaders pose together at the end of the G-8 Summit in Gleneagles, Scotland. They are, from left, U.S. President George W. Bush, Canadian Prime Minister Paul Martin, French President Jacques Chirac, Japanese Prime Minister Junichiro Koizumi, Mr. Blair, Italian Prime Minister Silvio Berlusconi, Russian President Vladimir Putin, EU President Jose Emanuel Barroso, and German Chancellor Gerhard Schroeder.

ESTORIL, Portugal—My sympathies go out quite sincerely to anyone, American or European, who seeks to understand what is going on in “Europe” (as the European Union is quaintly known in the media) following the recent “No” votes in the French and Dutch referenda on the proposed European constitution. He is likely to be more than averagely baffled if he is taking some trouble to inform himself, and he will be completely at sea if he is an official in the State Department or the National Security Council responsible for European affairs. For the more closely and scrupulously he has followed the post-referendum debates, the more wildly wrong he is likely to be about what has happened and what is now likely to happen.

Let me try to summarize the confident misinformation that fills this official's head in a brief paragraph. He will probably believe

that there is a “crisis” in the EU following the “No” votes, which have led to the abandonment or even “death” of the constitution; that this initial crisis has been aggravated by a further crisis as a result of the failure to agree on a common EU budget for FY 2007 and following years; and that this budgetary crisis was itself the result of a clash between the British preserving their budgetary “rebate” and the French defending the Common Agricultural Policy that financially feather-beds their farmers. If he has been reading the credulous British and American press, he may feel some optimism about the favorable resolution of these crises because British Prime Minister Tony Blair has proposed free-market solutions to Europe's high unemployment, low growth and galloping regulatory sclerosis. As the next rotating president of the EU, Mr. Blair will therefore seek to “modernize” Europe along the same

flexible labor market lines that his New Labor government has successfully pursued in Britain. And because a flexible, de-regulated, free-market Europe would make a more compatible partner for the United States, the United States need no longer worry that the EU is likely to develop as a rival or “counterweight” to the United States in global politics.

All that is missing from this account is a smiley-face after the last sentence. Yet not a single item in the above list is correct. Not one. Nil. Nada. Zero. Or in the language of diplomacy: Rien.

European Reality Check

For a reality check, let us go through them item-by-item.

To begin with, the Dutch and French votes have not created an EU “crisis.” The proposed EU constitution was an innova-

tion. It consolidated some things, changed others, and introduced still more. Since it has not yet passed, the existing EU treaties remain in force and govern the EU as before. If the status quo was not in crisis before the votes, as it was not, then it is not in crisis now. You don't need to panic; you don't even need to "not panic."

Nor is the constitution dead, buried, or even terminally ill. At the recent EU Council (or "summit" as the UK press calls it), the assembled heads of government decided to extend the deadline for its ratification indefinitely. Without that extension it would have perished by November 2006; it will now remain in political limbo until the EU Council decides that it can safely risk asking member-states, including France and Holland, to ratify it again. Postponing ratification is a device for saving the constitution. The same logic explains why the pro-constitution governments of Ireland, Poland and Denmark have postponed their referenda on it. They know they would lose the votes now. And they calculate it would be easier (though not necessarily easy) to win a first referendum in two years' time, say, than to ask their voters to reverse themselves in a second referendum after having rejected the constitution today.

This determination to press ahead, even if slowly, was entirely predictable. Leading EU politicians think that the only legitimate outcome of this process is ratification. So the question will go on being asked until the voters of 25 countries give the right answer.

Charlemagne, the European columnist in *The Economist*, thinks this determination is unrealistic. But is it—given a long enough time scale? After all, it has paid off before on several issues. Monetary union was first introduced in the 1970s when it collapsed disastrously; 25 years later the Euro was launched. The first European defense community was rejected in 1954; almost 50 years later it came into existence.

While we are waiting patiently for the voters to ratify their governments' decisions, some of the innovations in the draft constitution are likely to be introduced anyway under the existing treaties—and not small items, either. They include an entire EU diplomatic foreign service and a European defense procurement agency.

So if the constitution really is "dead," the theologians should be delighted: it would be the first example in nature of life after death.

In comparison with such a time-scale,

postponing a decision on the EU budget almost 18 months before it is due to come into effect is not even a difficulty, let alone a crisis. No EU budget in history has ever been agreed this far in advance. Talk of crisis is mainly to impress the punters back home and in Washington. It enables EU leaders to "stand firm" on their national positions, hurl insults, predict disaster, "save Europe" at the last minute and generally act like political leaders in a Hollywood history movie.

Fight Over CAP

The facts are less dramatic. Far from there being a complete impasse over the terms of a budgetary compromise, there is only a modest gap between the two sides. Like all British leaders since Lady Thatcher, Mr. Blair arrived at the summit promising to defend to the death the British budgetary rebate (in effect, compensation for the disproportionate sums Britain pays into the EU's Common Agricultural Policy, otherwise known as CAP). He left the summit saying that it was "an anomaly that has to go." He would surrender it in return for major reform of the CAP that spends 40 percent of the EU budget on less than 4 percent of the EU workforce. At the European Council itself, Mr. Blair offered to reduce the rebate by E5 billion; the other summiters asked for E18 billion. As *The Economist's* reporter concluded, the compromise figure is likely to be somewhere between those two points—larger if Mr. Blair can get substantial CAP reform, smaller if not.

You may confidently bet that the rebate reduction will be very modest indeed because there will be no major reform of the CAP before 2013 at the earliest, and perhaps not even then. Three years ago Mr. Blair joined everyone else in adopting a miniscule CAP reform package to last until 2013. The French have a veto on any change in the CAP until then. Every major French politician regards the unreformed CAP as a vital French national interest. And any new Christian Democrat government in Berlin (on which extravagant hopes in Washington and elsewhere are currently pinned) would not want to begin its term in office by alienating Bavarian farmers and thus its long-standing Christian Social coalition partner with massive cuts in agricultural spending.

All these considerations point to a very modest CAP reform indeed in return for a reduction of, say, E11 billion in the British rebate. In other words, a typical EU budgetary non-crisis will be settled by the custom-

ary EU "fudge." And Mr. Blair, like every British leader since 1972 except Lady Thatcher, will return claiming a "triumph" for the British approach of an open, reformed and flexible EU.

Mr. Blair has already laid the groundwork for this kind of illusionist politics in his speech to the European "parliament" setting out British intentions for his rotating EU presidency. That speech has been generally reported as a ringing call for market reforms. In fact, the prime minister advocated both sides of every important issue. He criticized the EU's high levels of unemployment but denied that there was any contradiction between this "social" Europe and market freedoms. He conceded that the referendum defeats reflected serious popular discontent with the direction of "Europe" but he wanted the existing EU structures to remain intact and even to be "deepened" by further integration. He declared that he believed in a "political Europe" not just a common market or free trade area, but he denounced as either inadequate or misguided virtually every major economic initiative taken by that "political Europe." When the speech is reduced to its essential core, his ringing call to "modernize" the EU comes down to the same (or more) Euro-institutions enjoying the same (or more) powers pursuing the same (or more interventionist) policies as now—but doing so more efficiently.

Mr. Blair could hardly argue otherwise in the light of his recent stance on things European. He entered office in 1997 pledging, like John Major, to put Britain "at the heart of Europe." In the intervening eight years he campaigned to join the Euro (now conceded to be killing German and Italian growth), abandoned Britain's opt-out from the "Social Chapter," reducing labor market flexibility in Britain, embraced an independent European defense structure separate from NATO that previous British governments had firmly opposed, and was a rabid supporter of the constitution until yesterday. His current stance is to defend the same policies with different rhetoric. It is Thatcherite rhetoric to advance anti-Thatcherite purposes, Euro-skeptic rhetoric about competition and flexibility that cloaks a fundamentally corporatist and interventionist institutional structure.

How Blairite is Blair?

That has not stopped media everywhere from proclaiming that Mr. Blair is leading a vigorous movement to make the EU more



JOHN D. MCHUGH/AFP/Getty Images

Tony Blair gives a press conference at the end of the G-8 summit in Gleneagles, United Kingdom.

like the British market model and less like the French social model. Maybe we should be grateful that this is nonsense since the British “market model” has been grossly oversold. As Mr. Blair himself said at those points in his speech when he was wooing the Left parties in the Euro-parliament, social regulations and benefits have both increased rapidly under his government. One estimate is that 70 percent of these new regulations are generated domestically. Many of the European regulations are the result of Mr. Blair’s signing onto the European Social Chapter. Recent job growth in Britain—about which he boasted—has occurred almost entirely in the public sector and is therefore a drain on enterprise rather than an example of it.

And as several British commentators have noticed, public spending is accordingly rising sharply as a percentage of GDP. The OECD forecasts that Britain’s public spending will rise to 45.2 percent of GDP in 2006

from 40.2 percent in Labor’s first year of office. At the same time—as skeptical British commentators such as Helen Szamuely, Richard North, Neil Collins, and Ambrose Evans-Pritchard have pointed out—European economies have actually reduced their state spending: Spain and Italy by 9 percent, Sweden by 16 percent, Denmark, Belgium, Holland and Austria by 6 percent. Even despised Germany has reduced the state sector to 46.1 percent of GDP, less than one percent higher than the British share, and still going down while the UK share is going up. Mr. Blair was lecturing people who, by that central measure at least, were showing more concern for enterprise, competition and the private sector than he was.

It is, in fact, quite difficult to see exactly where Mr. Blair and most of his European critics seriously differ outside the limited issue of the EU budget. He wants modernization of the present European institutions; they would not object to that in principle.

More efficiency? Ditto. He praises market reforms which makes them nervous. But when he lists those reforms, they turn out to be the average EU bureaucrat’s list of pro-business interventions.

From Mr. Blair’s speech again:

“The Kok report in 2004 shows the way: Investment in knowledge, in skills, in active labor market policies, in science parks and innovation, in higher education, in urban regeneration, in help for small businesses.”

No European head of government would be worried by such policies; he would merely call them “civilized” corrections to market “anarchy.” And though such terms would be self-praising economic stupidity, they would be a more accurate description of the policies than Mr. Blair’s enthusiastic hymn to flexibility, openness, competition and whatnot.

But this raises a question. If Mr. Blair and most EU leaders are essentially agreed on a more streamlined version of the corporate economy with more rational priorities (i.e., less spending on agricultural supports and more on scientific research), why have such policies not been adopted? And when they have been adopted, as with the “Lisbon agenda,” why have they had such limited and disappointing results? And how come the EU has stubbornly resisted reform of the CAP and continues to spend 40 percent of its budget on 4 percent of economic activity when anyone can see this is foolish?

The answer is that political priorities are not necessarily economically rational. They reflect the interests of powerful groups—rent-seekers such as French farmers and Spanish fishermen—rather than textbook economic theory. Such groups will not surrender valuable privileges simply because Mr. Blair argues they do not maximize returns on spending or represent optimal economic outcomes for the EU. States representing the interests of those groups will insist on being “paid” for conceding some of the privileges by obtaining some other benefit—the placing of an EU agency in their country, for instance. In a non-market political system of distribution—and the EU is a cartel of governments—log-rolling becomes the standard method of directing investment. This systematically misallocates resources increasingly over time. It requires heroic measures to keep the losses to moder-

European Union

(Austria, Belgium, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Slovakia, Slovenia, Spain, Sweden, United Kingdom)

Population: 457,030,418 (2005 est.)

Population growth rate: 0.16% (2005 est.)

GDP: \$11.65 trillion (2004 est.)

GDP – net growth rate: 2.4% (2004 est.)

GDP – per capita: \$26,900 (2004 est.)

Inflation rate: 2.1% (2004 est.)

Unemployment rate: 8.9% (March 2005)

ate proportions, let alone abolish them in the course of setting more rational priorities. Hence, this is the reason for the persistence of CAP spending.

If Mr. Blair wants Europe to be an efficient corporate economy, let alone a vibrant open market one, then he will need to reform the entire institutional and legal structure of the EU and re-write the existing European treaties. He will have to replace regulatory harmonization with the principle of “mutual recognition” of national standards. And he will have to transform the present cartel of governments into a market of governments in which European nations compete with each other by offering different mixes of tax and regulation to attract investment and talent.

Given Mr. Blair’s record to date, any attempt to make such changes is highly unlikely; given his chameleon political character, however, it cannot be entirely ruled out. He may even be trapped into it by his flights of libertarian fantasy.

Political Connections

To explore what such policy might look like, let me resort to political science and draw a theoretical diagram. As Noel Coward said when musical comedy star Gertrude Lawrence appeared in a serious play: “Legitimate at last—Mother will be pleased.”

Let me suggest that when we distill the various disputes over EU policy into pure theory, we will be left with three large debates. Each of those debates is, so to speak, a spectrum of opinion going from Left to Right:

Spectrum A on political economy goes from the Social Model on the Left to the Market model on the Right.

Spectrum B on international relations

goes from the anti-American “counterweight” model of the EU on the Left to the Atlanticist model on the Right.

Spectrum C on governmental structure goes from supra-nationalism on the Left to intergovernmentalism on the Right.

It is fair to say, I believe, that there are family resemblances linking the positions people take on these different models. Those who favor the social model in political economy will tend to support both the “counterweight” model of

Europe in foreign policy and supra-national model of European integration. Those favoring the market model will lean towards the same end of the other two spectrums. We can reasonably assign these various ideas to their traditions. Those ideas that cluster at the Left-hand side of the spectrums fall into the general category of “Constructivist Rationalism” which is a general philosophical approach to politics found more commonly in continental Europe than in the English-speaking world. Contrariwise, the positions on the Right-hand side of the spectrums I would label “Adaptive Evolutionism” which is my term for the main “Anglo-Saxon” tradition in political thought, though there are distinguished continental Europeans, Alexis de Tocqueville for instance, who are ornaments of it.

Such inter-relationships are tendencies, however, rather than absolutely firm relationships. Some especially logical souls will find themselves at the same extreme end of all three spectrums. Until recently at any rate, France’s President Jacques Chirac would have embraced the social model, the counterweight model and the supra-national model—but the apparent decline of French influence in the EU may be giving him second thoughts about supra-nationalism. The British Tories would tend to be at the opposite end of all three spectrums to Mr. Chirac—I certainly would find myself there. But others would pick and choose. I think it reasonable to describe the current head of the EU Commission, Manuel Barroso, as a supra-nationalist who is nonetheless nearer to the market model than the social one and who as an Atlanticist dislikes the counterweight concept of EU foreign policy. The East Europeans are currently market modelers who favor intergovernmentalism and Atlanticism, but all three preferences may be

subtly modified if they obtain larger subsidies from Brussels. Mr. Blair thinks of himself as a market modeler, intergovernmentalist and Atlanticist, but only his claim to the third will survive examination, and even that may evaporate as Britain sinks deeper into the morass of a common European defense and foreign policy. And so on.

At first glance it seems more pragmatic and reasonable to mix-and-match different positions from the three spectrums. But there is a reason for these different attitudes being linked aside from political dogma.

Consider, first, the relationship between the spectrums on political economy and governmental structure in the light of current controversies. Suppose too that Mr. Blair genuinely wants the EU to develop a more flexible labor market that would reduce labor costs in order to cut unemployment. He would then have to face the fact that many French voters rejected the Euro-Constitution precisely because they believed—wrongly, in my view and in that of the French government—that the constitution would weaken their treasured social model on “Anglo-Saxon” lines. No French politician—not even Nicholas Sarkozy—is likely to win an election by advocating what the French quaintly call ultra-liberal “modernization.”

Here is where governmental structure comes in. In an intergovernmental Europe (or what is sometimes called a “free trade area”), that difference of opinion need not matter overmuch. Both French and British governments would pursue their distinctive economic policies in an environment of “jurisdictional competition.” And there would be endless battles of statistics to seek to prove which tax-and-regulation model had delivered the goods. In a supra-national Europe, however, such a live-and-let-live arrangement would be impossible. The requirement for common policies and the “harmonization” of different national regulations would compel both countries to adopt the same set of rules. No doubt those rules would be a compromise of sorts between markets and social intervention. Neither country would be satisfied; the compromise would probably lack the virtues of both approaches; and we would never settle the superiority of either system through competition. If there really is to be market competition in Europe, the EU needs to lean heavily towards the intergovernmental end of the spectrum.

The social model in the economic spectrum also clashes with the Atlanticist end of

Feature: Europe: Crisis, What Crisis?

the diplomatic one. Nor are the reasons obscure. A social model a la francaise increases domestic industrial costs and reduces competitiveness. If those costs can be exported to other EU members through harmonization, costs rise throughout the cartel. With higher costs, continent-wide, the EU now has either to export its regulations internationally or erect various tariff and non-tariff barriers to trade. In fact, it does both. The United States is currently protesting the EU's attempts to impose new and more onerous chemical regulations through the "cultural exception" in WTO rules, and the Chinese are angry at the EU for cutting textile import quotas. The more ambitious the social model, the more protectionism it requires, and the more likely it is to provoke trade disputes, and over time the more it will alienate its alliance partner.

Now, the same is true—though less obviously—of the relationship between Spectrum B and Spectrum C. Supra-nationalism may not actually mandate a diplomatic stance of rivalry towards the United States, but it makes one more likely. For their own

nation-building purposes, EU supra-nationalists tend to promote anti-Americanism as the glue of an otherwise disaggregated European identity. Still more fundamental, supra-nationalism makes rivalry possible. An intergovernmental Europe simply could not be a rival of the United States even if it wished to be one. It would be unable to maintain a consistent common stand—see Iraq passim. It would have no armed forces. It could never unite around opposition to U.S. policies since there would always be some nations on the side of the United States. Atlanticism would then be the only sensible and effective common foreign policy open to it. Advocates of supra-nationalism argue that the EU could shape such a common policy without wanting to become a rival to the United States. But this neglects a vital point: supra-nationalism tends to manufacture rivalry by its very workings even when no one necessarily intends them. Mr. Blair inadvertently revealed this in a passage of his speech that was intended to prove that the common foreign and defense policy would make the EU a good partner to the

United States internationally:

"We are leading the debate on climate change and developing pan-European policies to tackle it. Thanks to Xavier Solana, Europe has started to make its presence felt in the Middle East peace process. But my point is very simple. A strong Europe would be an active player in foreign policy, a good partner of course to the United States but also capable of demonstrating its own capacity to shape and move the world forward."

Mr. Blair's own examples make the opposite case. The EU's policies on climate change were to use the Kyoto accords to raise U.S. energy costs disproportionately, to demonize the United States when it resisted this tactic and in general to make a rational debate on global warming impossible by, er, raising the temperature. Its main contribution to the Middle East peace process has been to distinguish itself from U.S. policy by consistently striking a more pro-Palestinian and anti-Israeli posture without being able to get its clients to make concessions of their own or to respond sensibly to Israeli concessions. Here EU policy is driven by the sad



Toyota's U.S. Manufacturing Facilities*

Year	Number of Facilities
1972	1
1987	2
1993	4
1999	8
2005	16

We're breaking new ground with more than just our vehicles.

Toyota Motor North America, Inc.
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fact that it would never have been noticed if it had not run counter to American policy. And, finally, if Mr. Blair had wanted to add a third to these two boomerangs, he could have cited the EU's support for the International Criminal Court. Not only has it tried to force the United States to abide by a treaty it has not ratified but the EU has also sought to frustrate American efforts to protect its soldiers from ICC prosecution by making agreements with third states. This potentially bitter dispute arises entirely from ideological motives: the EU sees the ICC as a model of supra-national governance like itself, and a rebuke to the outmoded sovereignty of nation-states such as the United States.

What the model suggests, therefore, is that supra-nationalism in the EU context obstructs not only economic rationality but also continuing good transatlantic relations. Europe's current difficulties, though they fall short of being a "crisis," nonetheless present the United States and the Bush administration with a wonderful opportunity to assist the re-shaping of Europe along "Adaptive

Evolutionary" lines that would benefit its traditional allies, New Europe and pro-American political forces throughout the continent and thereby advance its own economic and strategic interests. It is a moment that may never come again.

Yet it is at this very moment that senior U.S. administration figures are quoted as saying that President George W. Bush and his foreign policy team have determined to give full support to the traditional policy of endorsing EU integration. President Bush's speeches in Europe and Secretary of State Condoleezza Rice's endorsement of the EU constitution were intended to signal that advocates of "disaggregation" (i.e., supporting some, generally economic integration, but resisting other, generally political integration) had lost the administration debate. Washington would in future place more stress on dealing with the EU than on bilateral relations with individual European states. In short, Washington would return to its traditional policy of obtaining good alliance relations by backing "integration"—in practice a synonym for supra-national-

ism—in Europe.

Let's go back to Mr. Blair, the man of the moment, however. About a year before he became prime minister, he shared a railway compartment with a former Tory minister, Norman Lamont, with whom he was on friendly terms. The Tory asked him to explain how he would approach the EU once he was in power. Mr. Blair argued that he would make clear that Britain was fully committed to European unity, gain the trust of other EU leaders, dispel the aroma of obstructionism clinging to British policy, and from a position of greater acceptance seek to persuade his fellow leaders to adopt a more outward-looking, liberal and Atlanticist strategy. Mr. Lamont smiled.

"I've seen this movie before," he said, "and I know how it comes out."

Well, I've seen the American version before too, and it doesn't come out any better. ☞

— *John O'Sullivan is a nationally syndicated columnist and former editor-in-chief of The National Interest*





The Rise of the Euro

Currency is emerging as rival to the dollar

By Adam S. Posen

The European Union's currency, the euro, is now in use by 12 nations with a total population of 300 million people in an economic zone two-thirds the size of the U.S. economy. Since its introduction on January 1, 1999, it has been readily accepted at home and in global capital markets. Also, several nations in Eastern Europe and around the Mediterranean are eager to join the eurozone or peg their national currencies to the euro. In contrast to the predictions of some American pessimists about its prospects, the euro has

delivered low inflation and low interest rates to the Continent.

However, that being said, the euro has been a partial success at best so far. The euro's share of global reserves and of invoicing in international trade remains far smaller than its share of global GDP (22%) or the dollar's overwhelming share on both counts (more than 60%). European financial markets are still fragmented along national lines once one gets past the money markets. And eurozone member countries' economic performance has not improved

since the euro's launch, despite the decline in average interest rates. This has contributed to the European public's recent resistance to the proposed EU constitution.

Challenging the Dollar

Nonetheless, the euro does present a challenge to the dollar's dominance in three areas. Over time, this challenge will only grow more formidable, particularly if Europe undertakes economic reforms internally. Even in the absence of Europe

“The euro does present a challenge to the dollar’s dominance in key areas. Over time, this challenge will only grow more formidable, particularly if Europe undertakes economic reforms internally.”

liberalizing and becoming more attractive as a place in which to invest, it is incumbent upon American policymakers to make themselves aware of these trends and their potential impact on the U.S. economy and foreign policy.

First and foremost, the existence of the euro provides investors with an alternative currency having wide enough acceptance and deep enough markets to shift into should there be a decline of confidence in the dollar. In recent decades, since the end of fixed exchange rates, there have been periods of marked dollar decline, such as the early 1970s and the mid-1980s; another one appears imminent due to our balance of payments deficits. In each case before now, the available alternative currencies—the yen, pound, and deutsche mark—all had limitations in their attractiveness, not least in their size of underlying economies and in their liquidity. No such limitations apply to the euro.

As a result, the euro stands to gain market share in usage (as a reserve currency, in invoicing of trade, and as a vehicle for financial transactions) in a lasting fashion when investors opt out of the dollar. This will increase the cost of capital to the United States on a sustained basis since we will have to compete harder to retain investment in our currencies. This also will erode some of the competitive advantages of our financial industry by encouraging denomination of transactions in euros, and will add to uncertainty for our industrial companies as more products are sold with euro price tags. This will not happen wholesale or overnight. Such erosion, though, is exactly the process of slow decline that undercut the British pound’s advantages as a reserve currency over the first half of the 20th century once the dollar existed as an alternative to it.

International Underground Economy

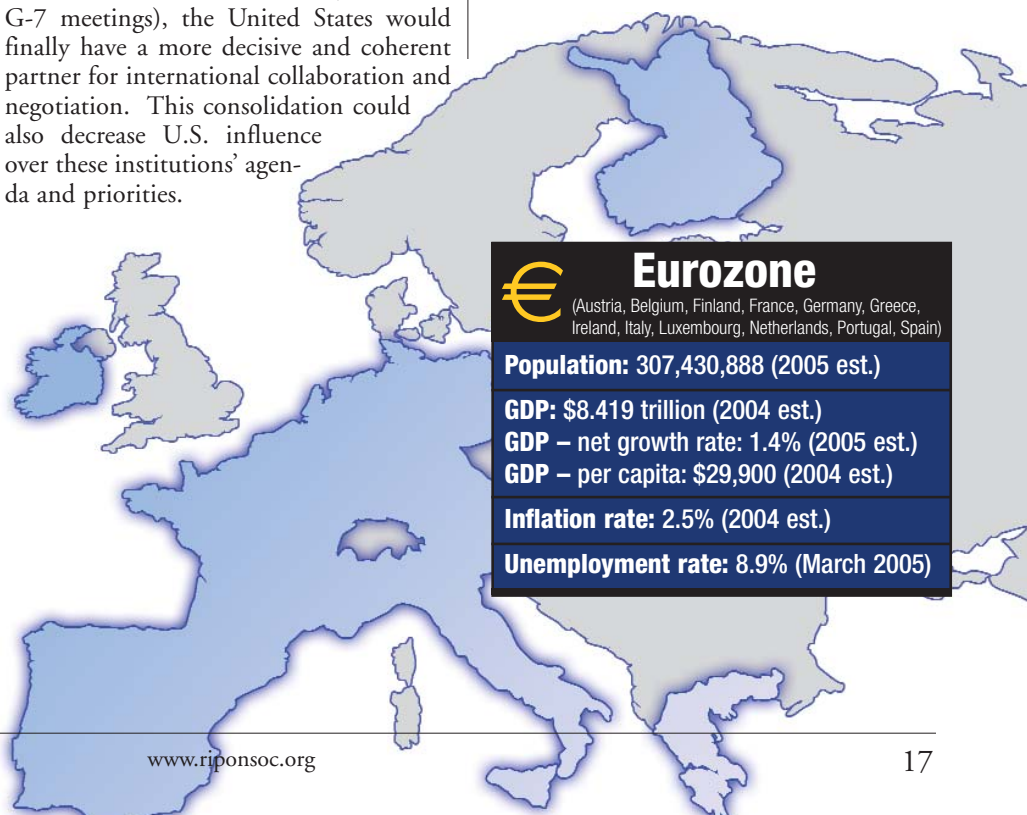
The second challenge presented to the dollar by the euro comes from the two currencies’ relative usage in the international

underground economy. Both illegal activities and transactions avoiding taxes tend to utilize cash for obvious reasons—and this cash when used abroad creates seigniorage revenues for the issuing government. By being closer to much of the underground economy in Eurasia and issuing large denomination (euro 500) notes to facilitate their transport (versus bundles of \$100 bills), the euro is rapidly increasing its market share. This may not be a business the United States wants to be in, but the euro’s expanding role in it will both cost the U.S. Treasury money and complicate the ability of the United States to track and respond to the underground economy.

The third euro challenge to the dollar is institutional. Right now, the combined share of eurozone votes in the IMF and World Bank exceeds that of the United States (23% to 17%), but is fragmented across “constituencies” which include combinations of euro, non-euro, and even non-European members. Should the eurozone member countries consolidate their representation in these institutions (and in the G-7 meetings), the United States would finally have a more decisive and coherent partner for international collaboration and negotiation. This consolidation could also decrease U.S. influence over these institutions’ agenda and priorities.

The long-term upwards trajectory of the euro’s role in global finance thus will largely come at the expense of the dollar. In some areas, such as usage in the underground economy, the costs to the United States of the euro rivaling the dollar are small. In other areas, such as representation of the euro in international forums, there are some advantages as well as costs for the United States. Most pressing and importantly, the existence of the euro means that American fiscal indiscipline or ill-advised financial regulatory measures in U.S. markets will have larger and more lasting negative impact than when no realistic rival currency existed. ☞

— Adam Posen is Senior Fellow at the Institute for International Economics, which just published his new book, “The Euro at Five: Ready for a Global Role?” Dr. Posen has been a visiting scholar at and consultant for central banks worldwide, including the Federal Reserve Board and the European Central Bank.



Future of U.S.-EU Relations

An interview with Ambassador Rockwell Schnabel

By Jeffrey T. Kuhner

Rockwell Schnabel, the U.S. Representative to the European Union, was confirmed by the Senate on September 26, 2001. Ambassador Schnabel came to Brussels from Los Angeles, California, where he was chairman and co-founder of Trident Capital, a venture capital firm aimed at supporting new economy companies. A longtime businessman, he started in the securities business as a financial analyst before joining the LA-based firm of Bateman, Eichler Hill Richards Inc. (now Wachovia Bank) and rising through the ranks to become its president.

He accepted his first government post in 1986, when former President Ronald Reagan named him U.S. ambassador to Finland. One of his achievements there was the negotiation of an export control agreement between the U.S. and Finland.

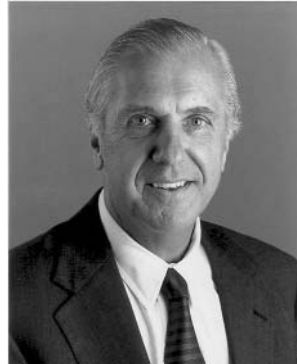
After leaving Helsinki in 1989, Ambassador Schnabel went to Washington, D.C., where he served at the Department of Commerce as Deputy Secretary and then as Acting Secretary of Commerce in the administration of George Bush Sr. As Deputy Secretary, he worked on the early talks on the North American Free Trade Agreement (NAFTA). He also spearheaded a Commerce Department effort to commercialize diverse technologies produced by U.S. government laboratories.

The Ambassador attended Trinity College and holds an Honorary Doctorate of Law from Pepperdine University.

We wish to thank his staff for their cooperation and generosity in making the interview possible.

RF: Why do you think the referendums on the European Constitution were voted down in France and Holland?

Schnabel: I think it was fear of globalization and a number of other things. But I think the essence was fear of globalization. Then of course, you get into the issue of enlargement, the concern about people from the new member states taking jobs



Courtesy of Ambassador Schnabel's office

Ambassador Rockwell Schnabel

away and a variety of things—the misunderstanding of the Constitution to begin with. A vote which was a referendum in France on President Jacques Chirac; in Holland it was the murder of Mr. Theo Van Gogh. But essentially, it was globalization, which in my way of thinking was directly related to economic issues.

RF: When you say globalization and economic issues, do you mean the sphere of greater liberalization and free markets?

Schnabel: It is fear of people coming in and taking jobs away due to the enlargement process. It is the fear of liberalization, the fear of people coming in and out, competing with the Europeans, and taking away their social network and their social system. But if you cut through it all, it has to do with economics. The good part about the failure of the referendum votes was the fact that people basically didn't really understand what the Constitution was all about and that it was a vote against bureaucracy. It was a vote against excessive regulation and against anything to do with interference with people's well-being—especially, economic things such as jobs. The flipside of that in my judgment is that the focus from the recent European summit is going to be on the economy.

For starters, there will be a new focus on the whole area of regulation, with basically doing away with barriers. There will

be a new attempt to get a fully integrated capital market system within Europe, which would substantially help the economy. So I think the bottom line, regarding the focus on economic issues: No. 1 is the regulatory process which is vitally important; No. 2 is on integrating financial markets; and then No. 3, the restructuring of the economy—particularly, freeing up labor markets. I think between those various things those reforms could dramatically increase Europe's GDP. The bottom line issue for Europe is economic growth. If you have no growth, how do you take care of the welfare system and the social system? You simply have a very difficult time to do that and ultimately, you can't.

RF: What is America's policy toward the EU?

Schnabel: It is probably the most positive it has been in a long time. There were a number of things that helped to affect transatlantic relations, starting with the Kyoto accords, the steel tariffs, and ultimately, the debate over Iraq where there was a lot of division within the EU on the subject. But all along, we have said that the United States is in favor of a strong, democratic, prosperous Europe and in favor of enlargement.

President Bush delivered the same message when he came to Brussels in February. He made it very clear that the United States is very supportive of the EU. The reason is very simple: the EU today is roughly the same size as our economy. Together with Europe we constitute something close to 60 percent of the world's GDP. Together with Europe we can accomplish a lot of things, including such issues as fighting terrorism and fighting global poverty. On the economic side working together is vitally important because we are each others' largest trading and investing partners. So it is very important to the United States to have a strong, prosperous Europe.

RF: When you say a strong Europe, a lot of commentators say Europe is at a cross roads. It can either go down the path of closer and tighter integration—a United States of Europe—or a more decentralized, free trade zone, like we have in North America regarding NAFTA. What is the administration's policy? Does it support a closer, more integrated Europe or would it prefer a politically looser Europe based on a common currency and trade?

Schnabel: We recognize clearly that Europe is not the United States of Europe. Power exists in the network of states. The power ultimately is in the hands of individual states in a number of different areas. Trade happens to be the one thing that is totally handled in Brussels, and a lot more of the competencies in the future are going to go to Brussels in a lot of different areas. Exceptions to that, for the immediate future, will be the areas of taxation and education. We work very closely in the areas of trade, the environment, science, financial issues and homeland security in fighting terrorism.

A number of the smaller European countries will have a much greater say in world affairs through the EU than otherwise they would have had before joining. There are a lot of smaller member states that have a vote at the table, which they didn't have in world affairs before. So you are going to see, in my judgment, a greater integration of Europe over time, including in the political area and also in the area of security. That integration will become deeper over time.

Europe has to learn from what recently happened in France and Holland. Europeans can try to stick to the old ways, the social welfare network ways. The fact of

the matter is in reality the EU has to look to more liberalization of markets in order to compete worldwide. Europe will be competing with India and China, where they don't have those social networks. Basically, Europe can't compete with them unless it reforms. Ultimately, Europe must liberalize or perish in my judgment; this liberalization, however, does not have to be at the expense of the social systems. The Europeans just must reform them. This has been done in countries such as Denmark, Holland and Sweden.

What's happening now in Eastern Europe is having a competitive influence on the rest of Europe, and is actually very positive. A good example of that is Slovakia, which is next door to Austria. Slovakia has a flat tax rate, which I believe is around 19 percent. Austria's rates were almost twice as high. But Austria was forced to lower its corporate taxes in order to be competitive. That's going to happen in other countries as well in order to be competitive with the rest of the world. So those 10 new Eastern European members are really a positive influence on the rest of Europe.

RF: A lot of people are now saying regarding the fallout from the referendums in France and Holland that the EU has suffered a body blow. Do you believe the EU can be saved and what form will a more acceptable EU have to take?

Schnabel: Whether you call it a body blow or not, I'm not sure. I prefer to call it a bump in the road. The fact is that the EU has gone through a number of similar types of things in the past. Over the last 50 years there have been a number of cases where Europe went through a very difficult time. It was moving along at a rapid pace and hit

a speed bump, which slowed things down; there is no question about that. But it also gives the Europeans time for reflection in finding out what is really needed in order to move forward, if this thing is going to continue. The 25 members are in place. They are working together. No one is going to unravel the EU and/or the currency, and it is moving forward. I think what you are going to see is a slowing down of the enlargement process, and then you are going to have a Europe that reflects upon what has happened and what needs to be done in the future.

I believe that Europe will have a comprehensive economic review, which will be at the top of its agenda. In particular, this review will be pushed along by the European Commission under the leadership of Mr. Barroso. The commission is more right of center; it's more for the transatlantic relationship; and it is essentially more for liberalization. I also believe Mr. Blair, who has the presidency of the EU for the next 6 months, will play a major role in the process. France clearly at the moment is not part of that thinking. Mr. Chirac continues to try to come up with ideas that haven't worked before. The fact of the matter is, in my judgment, Europe will have to liberalize over time in order to compete. Maybe Europe will use this crisis that you refer to as the very thing that is needed in order to get to the economic restructuring that is necessary to put Europe on a more competitive basis with the rest of the world. This would then be the positive result of the referenda because often times you can't get these kinds of changes without a crisis. ☞

— Jeffrey T. Kuhner is communications director at The Ripon Society

“Together with Europe we constitute something close to 60 percent of the world's GDP. Together with Europe we can accomplish a lot of things, including such issues as fighting terrorism and fighting global poverty. So it is very important to the United States to have a strong, prosperous Europe.”



Overdraft of Power

Banking powers should not include real estate brokerage

By U.S. Representative Ken Calvert

During the floor debate of the Gramm-Leach-Bliley Act (GLBA) in 1999, Rep. Jim Leach, Iowa Republican, warned that “the movement to go beyond the integration of financial services and eliminate the traditional barriers between commerce and banking is simply a bridge we should not cross.”

Shortly after the passage of GLBA, the banking and real estate industries engaged in a serious debate about the congressional intent of the law, specifically, as it related to allowing banks to enter into the real estate brokerage and management industry.

I believe Congress has a responsibility to clarify any misinterpretations that seem to exist from the passage of GLBA. In an attempt to do so, I have introduced the Community Choice in Real Estate Act, H.R. 111, which prohibits national banks from engaging in real estate brokerage or real estate management activities. This legislation, which I first introduced in 2001, continues to receive broad, bipartisan support in Congress.

Earlier this year, my good friend and colleague Rep. Michael Oxley, Ohio Republican and chairman of the House Financial Services Committee, introduced competing legislation that would allow national banks to engage in real estate brokerage and management activities. Mr. Oxley and I agree on most issues; however, we have a different perspective on this issue. My bill has more than 240 co-sponsors, while the chairman’s bill has one. However, as chairman, he sets the agenda and the only committee hearing he has held on this subject in the last three years focused on his legislation.

The question before Congress could not be clearer: Should we define real estate brokerage and management activities as financial in nature and, therefore, allow national banks to engage in these activities?

GLBA was landmark legislation that allowed banking, securities, and insurance companies to operate in affiliation with each other under the umbrella organizational form of financial holding companies. GLBA also permitted these companies to engage in a variety of activities not previously allowed to banks.



Courtesy of Rep. Calvert’s office

U.S. Representative Ken Calvert

Under GLBA, the Federal Reserve and the Treasury Department possess the authority to issue regulations expanding these new activities. When considering whether or not to define an activity as financial, and permit national banks to partake in that activity, they must find a change in the marketplace and/or technology that undermines the ability of national banks to effectively compete with other financial companies.

Within months of passage of GLBA, the national banks were applying to redefine real estate as a financial activity, even though nothing had changed in the marketplace or technology. Shortly thereafter, the Federal Reserve and Treasury Department proposed a rule defining real estate brokerage as an activity that is financial in nature and therefore permissible for national banks.

Immediately following the release of the proposed rule, the debate was reignited between the banking and real estate brokerage industries about what constitutes a financial activity and under what scenario would consumers truly benefit. Congress quickly became ground zero for this debate. With significant bipartisan opposition to the rule, Congress included language in the FY2003 Treasury Appropriations bill that prohibited the expenditure of funds to finalize the rule.

That action did not end the debate. Congress still faces this unresolved issue and must again address the problem this year, with either a lasting solution or continue to

put it off for another year. The latter choice has been the preferred route for the past three years as Congress has continued to prohibit the implementation of the rule through the appropriations process.

As a member of Congress that voted in favor of GLBA, I believe it is important to put this question into context. The goal of GLBA was to modernize and modify the activities of national banks to ensure their competitiveness in a changing global marketplace. The silence of GLBA on the topic of banks and real estate brokerage should not lead one to believe that it was not discussed.

Legal and economic realities prevented the inclusion of real estate brokerage activities to the list of new activities included in GLBA, since such an inclusion would have seriously jeopardized the passage of the bill. Conversely, an outright prohibition of the activity would have been received with considerable consternation by members looking to expand banking activities.

Appealing for expanded powers under GLBA so quickly after its passage made it clear that the banking industry wished to gain from the Federal Reserve and Treasury Department what they were unable to pass through Congress.

I believe the issued rule incorrectly proposes that real estate brokerage and management services are financial in nature. By failing to clearly articulate any compelling reason to change the traditional characterization of real estate brokerage as a commercial activity, the proposed rule would seriously blur the line between financial and commercial activities and would set a dangerous precedent.

If you are still unable to decide for yourself if real estate brokerage is a commercial or financial activity, I recommend you apply what I call the “Saturday night test.” If you can conduct a business transaction on a Saturday night, then it is a commercial activity. If you can’t, it is probably a financial transaction. I think most people would agree that you are far more likely to do business with a realtor on a Saturday night, than you are with a bank. ☞

— Rep. Ken Calvert is a California Republican



The First Freedom Bush's judicial nominees deserve a vote

By U.S. Representative Henry J. Hyde

Political discourse in America, both civil and combative, reflexively takes the form of disputes over rights, as contending interpretations and orders of precedence do battle for the public's favor. This medium is being pressed into service once again as the Senate approaches a High Noon showdown occasioned by the Democrats' filibustering of President George W. Bush's judicial nominees. Advocates on both sides have scoured the armory of rights to select their weapons, and the rhetorically bloody tournament has already begun.

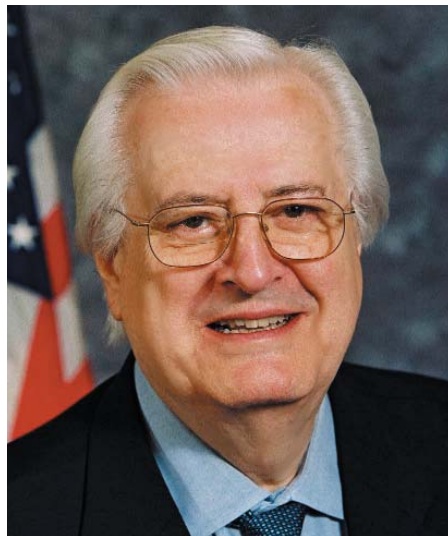
The issues at stake in the increasingly sharp debates and grim struggle over political power are many. But overlooked is the fact that this dispute represents a clash of two fundamental rights: the right to speak and the right to vote.

To most Americans, these rights are complementary, even inseparable. But just as the closest of friends may sometimes clash, this is true of fundamental rights as well.

The right to free speech is universally acknowledged as being among the most basic of political and personal rights. Liberty, democracy, and even modern society would be inconceivable without it. For that reason, the degree of its freedom of exercise is correctly regarded as the best measure of liberty's health in any political system. We are wise to greet efforts to impose limits on it, however noble the avowed purpose, with cold skepticism.

Although free speech is of surpassing importance in the deliberations of political philosophers, its true value is grounded in its practical application to the mundane world. The exchange of information that modern societies require to operate, the ability of public debate and scrutiny to weigh competing claims and facts and weed out those which are unsubstantiated or marred by logical or factual error, can only be guaranteed by the freedom to speak freely. Intelligent choices, especially in voting, could not occur in its absence. A society and government deaf to the world and to dissenting voices could not hope to prosper.

The right to vote, then, would appear



Courtesy of Rep. Hyde's office

U.S. Representative Henry J. Hyde

to require, and perhaps be dependent on, the right to free speech and the accompanying right to examine and debate issues publicly and at length. Yet regardless of the validity of this assumption, the parallel fact is that the right to vote is the more profound of the two, perhaps more fundamental than any but the right to life itself. This is because voting represents deciding, choosing, taking action, the prerequisite by which all other rights are distilled from theory into reality. It must be stressed that to decide means to engage with the real world, the world where life is lived.

In the Senate, the minority Democrats' assertion that a vote on judicial nominees should not be allowed to take place without their consent, regardless of that body's constitutional responsibilities or the needs of the country, is in effect a subordination of the right to vote to the right to speak. What is at stake is not the right of a minority to free speech—in this case, the right to filibuster—but the responsibility to take action after the right to speak has been fully, exhaustively exercised. The obvious effect of the Democrats' course would be paralysis, for which no amount of empty rhetoric can substitute.

The legitimacy of our political order is based on its guarantee of our rights, a propo-

sition first and most elegantly enunciated by Thomas Jefferson. But the relationship is not one-way. Although our political system ensures our exercise of those rights, the integrity and resiliency of our political order in turn depends upon our ability to actually do so—a virtuous circle that has only strengthened over two centuries.

Unlimited, non-germane speech for the purpose of eviscerating the right to vote is at best a perversion of the right to free speech, if not a more serious menace to the responsibility to ultimately act. The consequences of this irresponsibility are more dangerous than a passing political conflict may suggest, however heated that contest may become. For employing one right to prevent the exercise of another undermines them both and thus the edifice on which all rest.

The outcome of the drama in the Senate will have an enduring impact in many areas, from the purely political to the ideal worlds of philosophical abstraction. But this contest also represents a test of our understanding of those rights as guides to action. Be it whispered or delivered full-throated, political speech is a prerequisite to liberty. But, however eloquent or impassioned, political speech cannot be allowed to substitute for the inescapable responsibility that we have to judge, to decide, to act, and ultimately, to vote. ☞

— Rep. Henry J. Hyde is an Illinois Republican and member of the House Judiciary Committee

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Re-examining NEPA

After 35 years it is time to give measure a fresh look

By U.S. Representative Cathy McMorris

We all share the goal of clean water, clean air and making sure we do our part to protect our environment. We want our environmental laws to best protect and enhance wildlife, watersheds, wetlands and communities—not just perpetuate a federal bureaucracy. We need to ensure our protections are working effectively and allocating resources properly. For these reasons, we sometimes must take a hard look at both a law's successes and its shortcomings.

Everyone can agree that when the National Environmental Policy Act (NEPA) was passed, it served an important and laudable goal: to ensure that federal agencies would consider environmental concerns when making decisions. Yet after 35 years, Congress needs to take a closer look at the NEPA and determine whether the law is fulfilling its original intent in the best way possible. This law has a major impact on our country on an everyday basis. We must review its effects to ensure the best outcomes, for both the environment and our economy.

What started as an overly vague single paragraph statute have become 25 pages of regulations, 1,500 court cases and hundreds of pending lawsuits that are blocking important projects and economic growth in our country. We can and must do better. Since NEPA was enacted in 1970, Congress has never thoroughly reviewed the legislation to see if it is working or if it needs to be improved.

I have the honor of being appointed by the chairman of the House Resources Committee, Rep. Richard Pombo of California, to lead the Task Force on Improving the National Environmental Policy Act. The task force is a bipartisan group of Resources Committee members that have been charged with reviewing and making recommendations on improving NEPA.

One of the trademarks of NEPA is to take into account public comment. With that in mind, the task force believes the best way to get input about how the NEPA process is working is to get outside Washington, D.C., and listen to those directly affected by the process.

NEPA contributes to delays, additional



Courtesy of Rep. McMorris' office

U.S. Representative Cathy McMorris

costs and lawsuits that have stalled dredging on the Columbia and Snake Rivers. Our river systems play a vital role in the region's economy, transporting our goods and supporting our tourism. We cannot afford to ignore these problems.

A gross abuse of the NEPA process halted efforts to ease traffic congestion in Las Vegas, Nevada. Environmental groups, which chose to remain uninvolved in the public comment process during the decade of NEPA analysis, filed a last-minute lawsuit to block the project, four years after the completion of all environmental studies. The lawsuit was finally settled last month. But delay of this project hurt local businesses, traffic congestion, air pollution and highway safety.

In Arizona, power outages have become a way of life for the 38,000 people living in the southern town of Nogales. Environmental review for a desperately needed power line has taken nearly five years. Power went out during the local high school's graduation ceremony last month, as graduates and proud parents were left in the dark with no ceremony and no commencement parties.

Wildfires raged in the eastern part of the state in 2002, growing in size comparable to the state of Rhode Island and nearly engulfing the three neighboring towns. Homes were burned to the ground. Sadly, this massive tragedy could have been prevented. But the forest management plan that would have

prevented such a massive blaze was tied up in NEPA litigation.

The task force has received many public comments on fires like this. In California, frivolous environmental lawsuits are preventing timely action on desperately needed thinning projects around communities. For every acre thinned, three acres have been destroyed by fires.

The stories of project delays and inaction are numerous. Too often we hear horror stories about endless reams of paper needed to complete environmental impact statements because agencies now operate in fear of litigation. NEPA provides little assurance for the federal agencies, so avoiding litigation becomes the standard to meet.

The task force must look at this litigation and decide whether it advances or hinders NEPA's intent. It should not be a choice of either protecting the environment or allowing timely projects to be completed. We can do both while maintaining the public's right to participate and be informed of federal government actions.

We have held two successful field hearings in Spokane, Washington and Lakeside, Arizona that have provided opportunities for us to engage in dialogue with communities on how to improve NEPA. We have heard testimony saying NEPA should not be changed and that federal agencies need to better utilize the tools NEPA provides. Others believe that changes in the law are necessary to produce certainty and finality. Still others told the task force that so-called state mini-NEPAs provide just as much environmental analysis as NEPA, but in less time and money and with fewer lawsuits.

From any perspective, most agree the NEPA process must be examined. I look forward to attending the four other field hearings this summer to enable the task force to take a hard look at this law from all sides and perspectives.

The final product of this task force will be a report that lays out facts and makes appropriate recommendations. Whether or not our findings lead to further legislation, the task force will have succeeded in ensuring NEPA's original intentions. ☺

— Rep. Cathy McMorris is a Washington Republican and member of the House Resources Committee

Straight Talk on Children and Abortion

Procedure for minors must have parental consent

By U.S. Representative Ileana Ros-Lehtinen

In a country that espouses the importance of protecting the inherent rights of every person, abortion denies the rights of our most innocent and vulnerable members: Our children.

As legislators, we have the great responsibility to strive to uphold the truths upon which our great nation was founded, especially that every individual is entitled to life, liberty, and the pursuit of happiness.

Abortion is perhaps one of the most life-altering and life-threatening of procedures. It leaves lasting medical, emotional, and psychological consequences and, as noted by the Supreme Court, “particularly so when the patient is immature.”

Although *Roe v. Wade* legalized abortion in 1973, it did not legalize the right for persons other than a parent or a guardian to decide what is best for a child. Nor did it legalize the right for strangers to place our children in a dangerous or potentially fatal situation.

There are many rules and regulations in our society that ensure the safety of our nation’s youth through parental support and guidance. In most schools, an underage child is prohibited from attending a school field trip without first obtaining a signed permission slip from a parent or legal guardian.

An underage child is also unable to receive mild medication at school, such as aspirin for a headache, unless the parent signs a release form permitting the school nurse to administer such medication.

Every one of these principles emphasizes that parents should be involved in decisions that can seriously affect their children. The decision of whether or not to obtain an abortion, a life altering, potentially fatal and serious medical procedure, should be no exception to these rules. As a mother of two teenage daughters, I want to know what is going on with my children, especially something as significant as an abortion.



Courtesy of Rep. Ros-Lehtinen's office

U.S. Representative Ileana Ros-Lehtinen

My legislation, the Child Interstate Abortion Notification Act (CIANA), incorporates all of the provisions previously contained in the Child Custody Protection Act, a bill that the House has passed on three previous occasions. My bill makes it a federal offense to transport an underage child across state lines in circumvention of state and local parental notification laws, for the purpose of having an abortion.

It protects minors from exploitation from the abortion industry, promotes strong family ties, and helps foster respect for state laws. In addition, the bill requires that, in a state without a parental notification requirement, abortion providers must notify a parent.

About 80 percent of the public favors parental notification laws, and over 30 states have enacted such laws. Yet these laws are often evaded by interstate transportation of minors, often openly encouraged in advertising by abortion providers.

Parental consent or parental notification laws may vary from state to state, but they are all made with the same purpose in mind: to protect frightened and confused adolescent girls from harm. It is amazing

that such a bill is necessary—considering that it is a crime to transport a minor across state lines without parental permission for any other purpose but abortion.

A minor who is forbidden to drink alcohol, to stay out past a certain hour, or to get her ears pierced, is certainly not prepared to make a life-altering, hazardous and potentially fatal decision, such as abortion, without the consultation or consent of at least one parent.

My legislation closes a loophole that allows adults not only to help minors break state laws by obtaining an abortion without parental consent, but also contributes to ending the life of an innocent child.

As an ardent advocate of human rights for all, especially those suffering political and religious persecution, it is my hope that we will one day live in a world where all may live and work together in a spirit of peace, mutual respect, and solidarity and where the sanctity of human life is preserved on all levels.

I am truly pleased and honored that my colleagues in the House have given this important bill this great vote of confidence. It passed the House on April 27, 2005 by 270 to 157. The bill will now go to the Senate. I am extremely hopeful that we shall see positive results there as well.

We have a great responsibility as a nation to maintain a true reverence for protecting vulnerable human life, and to continue to build up a culture of life. I will continue to work together with my colleagues to ensure that the precious gift of life and the dignity of womanhood are promoted and protected on every level.

May we continue to work together to ensure that our precious children are protected and that the rights of every parent are upheld. 🙏

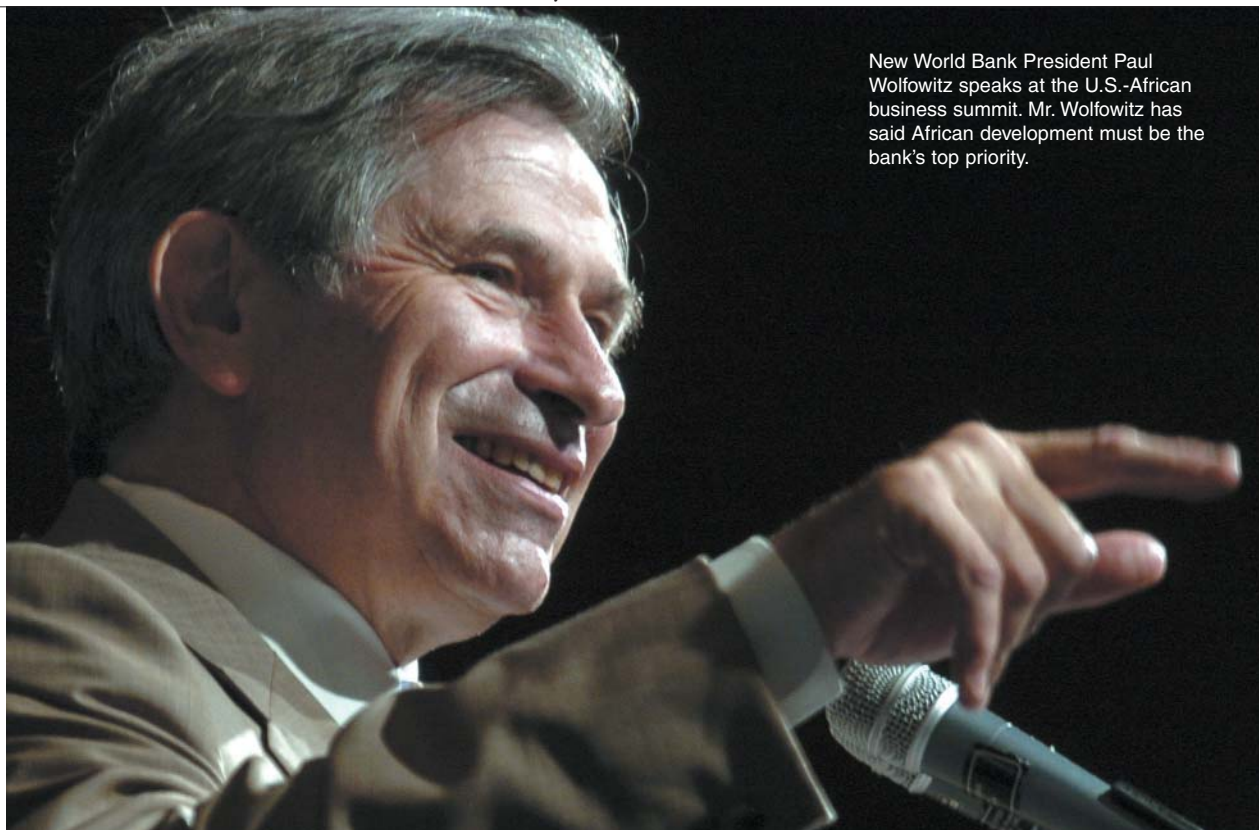
— Rep. Ileana Ros-Lehtinen
is a Florida Republican



Reforming the World Bank

Paul Wolfowitz must push concrete policies

By Ana Isabel Eiras



New World Bank President Paul Wolfowitz speaks at the U.S.-African business summit. Mr. Wolfowitz has said African development must be the bank's top priority.

AP Photo/Geoff Burton

Paul Wolfowitz, having assumed the presidency of the World Bank, now faces the challenging task of turning the Bank into a more effective organization. Despite five decades of good intentions, the Bretton Woods institution has failed to reach its goal of a world free of poverty.

The World Bank was conceived at the end of World War II out of fear that private markets might not provide the resources necessary to reconstruct Europe. The United States and the United Kingdom pushed to establish an international framework to prevent a recurrence of economic recession and to promote reconstruction in war-torn Europe. A central component of this framework was the World Bank. The Bank followed its mandate closely and contributed to the effort, but in the end, it was private markets that played the major role in the reconstruction of Europe and Japan.

Despite this first-hand evidence of the private sector's effectiveness, the World

Bank then found a new purpose: to facilitate the development of poor nations and newly independent former colonies with aid. But after five decades, most aid recipients remain just as poor as—if not poorer than—they were when lending began.

First Challenge: Why to Lend

A major part of the problem is that the Bank's mission—to eliminate poverty—is based on the false assumption that economic growth and development can be achieved by giving aid. This premise flies in the face of five decades of development experience and the bulk of economic studies, which indicate that economic freedom and the rule of law are far more important than assistance as determinants of growth. Furthermore, giving aid to countries with poor policies helps to support corrupt governments and perpetuates bad policies that retard development.

Between 1980 and 2003, for example,

the Bank disbursed \$261.36 billion of economic assistance. This aid failed to consistently catalyze strong growth in per capita income in low-income countries. According to the Bank, of the 105 recipients of International Development Association (IDA) credits between 1980 and 2002 for which per capita gross domestic product (GDP) data are available, more than a third had negative average compound annual growth in real per capita GDP and 16 percent grew between zero percent and 1 percent.

The lessons are clear. It is not lack of aid that is preventing these countries from addressing their problems; it is anti-market economic policies, corruption, and the absence of the rule of law—all of which undermine economic growth. The World Bank, therefore, needs to focus assistance on countries with relatively sounder policies and demonstrable commitments to economic freedom and the rule of law.

Second Challenge: Whom to Lend

A good strategy for the World Bank should be to help every nation attain a credit rating good enough to borrow on international capital markets at reasonable interest rates. The reason is that first, the resources available through international capital markets, foreign direct investment, and increased trade are far larger than any transfer from multilateral and bilateral assistance; and, second, if governments have to depend on private capital, they have a huge incentive to implement sound policies and create a stable environment with a strong rule of law.

But the Bank doesn't seem to have an "exit strategy" for its debtors and continues subsidizing lending even if aid recipients have access to private markets. In this way, the Bank removes these market incentives to pursue good policies. For example, in 2004, the World Bank disbursed 56 percent of its funds through IBRD loans, which are targeted to relatively wealthy countries. At least a third of IBRD recipients have an investment grade credit rating (BBB or better) according to Standard & Poor's. Only 44 percent of the World Bank's funds in 2004 were disbursed through IDA credits, which are available only to countries with a per capita income less than \$865. Only 40 percent of all World Bank (IBRD plus IDA) funds disbursed in 2004 went to low-income countries without access to capital markets. Clearly, the World Bank is not focusing its resources on the poorest of the poor.

By providing subsidized loans to countries that have access to capital markets and that are not the poorest, the World Bank not only undermines incentives to make free-market reforms and sound fiscal decisions necessary to reduce credit risk, but also diverts resources away from poor nations to countries that could borrow elsewhere. The Bank should end this practice and focus its efforts on low-income countries that have too low an investment grade to borrow in capital markets.

Third Challenge: When to Lend

The Bank should give aid only to countries with relatively good policies already in place. This idea of establishing preconditions that reward good policies already in place rather than providing money in hope of encouraging reform is supported by many economic studies.

Of course, this approach works only if the World Bank actually stops lending to countries with policies that impede economic growth and development. The challenge for the Bank is to draw a hard line, no matter how poor the country. It must stop lending when there is no progress in terms of reform. Not only will this provide greater assurance that the assistance will be more effective, but it will provide incentives for other nations to adopt policies that will increase their opportunities for economic growth and development.

Fourth Challenge: What to Lend

The failure of development assistance to facilitate economic growth has left many poor nations with a large debt burden. However, the world's poorest countries that lack access to capital markets do face problems that could be assuaged through assistance. In such situations, it makes little sense for the World Bank to provide loans that are not likely to be repaid and that are intended to alleviate the immediate consequences of poverty—such as immunizing children—rather than to spur growth. Such activities should be funded by performance-based grants rather than loans.

World Bank officials resist the change from loans to performance-based grants, believing that grants would undermine project effectiveness because they would not have to be repaid. This is unlikely since, as proposed by the International Financial Institutions Advisory Committee, the recipient of the grant would have to match a portion of the grant and the money would only be disbursed after an outside auditor verifies that the proposed project has been completed. Future grants would depend on the recipient's adherence to the agreed terms of the grant, creating strong incentives to implement the project as planned and permit independent evaluation of the project.

Officials at the World Bank also fear that grants, because they are not repaid, will undermine the Bank's resource base and create a greater reliance on frequent contributions from member states. But IDA contributors could provide resources for an IDA endowment to be invested in low-risk instruments similar to a pension fund. Originally, this amount could be similar to that of a typical IDA replenishment, which donors fund every three years. The most recent IDA replenishment was for \$34 billion. For example, at an 8 percent rate of return, an investment of this size would

yield \$2.7 billion annually. Sentiment for support of an IDA investment fund should exceed that for the current system because the original investment would not be disbursed as grants; only the earnings from the investment would be distributed, thereby eliminating the need for future donor contributions.

As long as the World Bank performs well, it should retain donor support. If the IDA fails to perform as envisioned, the donors could reclaim their portions of the investment. Market discipline is good for the World Bank as well as for recipients.

Fifth Challenge: How to Give

Providing assistance to governments of countries that have a weak rule of law and that lack transparency and accountability invites corrupt use of assistance by government officials. Once a loan is disbursed, it is extremely hard to monitor. In addition, the World Bank frequently fails to enforce loan conditions and often continues to finance projects regardless of whether country officials comply with loan terms.

A better strategy would be for the World Bank to contract out directly to private-sector businesses, charities, universities, and other appropriate entities to fulfill measurable objectives. A hospital could be paid per vaccine when a vaccination project is completed. A charitable organization could be paid after feeding children at a local village for the expense incurred. By circumventing the governments and paying directly to private sector providers, the bank could exert greater control over the project's execution, monitor results more easily, and reduce the opportunities for corruption.

With all of its good intentions, the World Bank has failed to achieve its goal of ending poverty. Mr. Wolfowitz has an opportunity to change this disappointing record and turn the World Bank into a more effective organization.

This effort should start with setting a more appropriate mission for the World Bank: encouraging poor nations to bolster the rule of law and increase economic freedom. It is these policies that will remove obstacles for economic growth and pave the way to the Bank's ultimate dream: a world without poverty. ☞

—Ana Isabel Eiras is Senior Policy Analyst for International Economics in the Center for International Trade and Economics at The Heritage Foundation.



Challenges Confronting Lebanon

The country's emerging democracy takes shape

By Michael Young

On June 2, a month after the withdrawal of Syrian soldiers from Lebanon, a prominent Lebanese journalist hostile to the Syrian regime was killed by a bomb placed under his car in an east Beirut neighborhood. Samir Kassir had developed close ties to the Syrian opposition and was active in calling for democratic change in Syria. Colleagues had little doubt that the regime of Syrian President Bashar Assad was behind the killing, carried out by the Lebanese intelligence network that Syria helped set up during its decades-long presence in Lebanon.

Two weeks later, Lebanon held the third round of its parliamentary elections in the central (and predominantly Christian) Mount Lebanon district, and in the Bekaa Valley. In Mount Lebanon, Gen. Michel Aoun, the former head of a military government that fought Syria in 1988-90, won a sweeping victory, thanks largely to Christian frustration with the political maneuvering of the general's rivals, which had resulted in the marginalization of Christians. The same day, in the northern Bekaa district, Hezbollah won an easy victory, echoing its triumph a week earlier (in alliance with another Shiite party) in south Lebanon.

Challenges Ahead

These successive events provided convenient headings in an impressionistic illustration of the challenges Lebanon faces in the coming months, to which we must add a fourth: the need for urgent economic reform.

Kassir's death showed that, despite the Syrian military withdrawal, Syrian intelligence agents still operate freely in Lebanon—a view endorsed by the Bush administration. At the same time, the killing appeared to send parallel messages: that Damascus would not tolerate Lebanon's becoming a source of instability for the Syrian regime; and that the international community, particularly France (Kassir was a dual French-Lebanese national) and the United States must not push Syria too far, since retaliatory violence remains an option.

Lebanon's first challenge, then, will be to ensure that it can rid itself of the remnants of the Syrian order, particularly what the opposition has called the "Syrian-Lebanese security apparatus." The process will require purging the upper echelons of the various intelligence and security agencies and the army. This is easier said than done. The supreme overseer of the network, Lebanese President Emile Lahoud, is not likely to soon be removed from office; his rivals are divided, while he has no intention of surrendering the last card he holds.

At a broader level, Lebanon will also have to avoid being transformed into a playing field for regional or international rivalries—particularly between the United States and France on the one hand and Syria on the other. The trick will be for it to do this while preserving an open society and free expression, and not shy



A Lebanese woman casts her ballot at a polling station. Voters in Lebanon took part in the fourth and last stage of Lebanon's parliamentary elections on June 19, 2005.



Illustration by John M. Boone

LEBANON

Population:

3,826,018 (July 2005 est.)

Population Growth:

1.26% (2005 est.)

Ethnic Groups:

Arab 95%, Armenian 4%, Other 1%

Religion:

Muslim 59.7%, Christian 39%, Other 1.3%
(Total of 18 officially recognized religious groups)

GDP: \$18.83 billion (2004 est.)

GDP – per capita: \$5,000 (2004 est.)

GDP – real growth rate: 4% (2004 est.)

Public Debt:

177.9% of GDP (\$33.5 billion) (2004 est.)

away from this to avoid confrontation with more powerful autocratic Arab states.

Improving Christian-Muslim Relations

Michel Aoun's victory focused attention on another reality of post-Syria Lebanon: the need for a new relationship between the religious communities. The general's victory, while it took place at the expense of the opposition, was seen by many Christians as payback for the community's marginalization in the run-up to the elections, when leading opposition politicians, including the Druze leader Walid Jumblatt and the Sunni leader Saadeddine Hariri, son of the late Rafik Hariri, dismissed Christian displeasure with a discriminatory election law.

The Christian "revolt" only underlined how complicated will be a future re-balancing of communal relations to satisfy all sides. Christians, though they are believed to be between 35-40 percent of the population, have half the seats in Parliament, according to a political system designed, among other things, to reassure minorities. In the future, this may prove problematic, as some of the larger Muslim communities could begin demanding parliamentary representation commensurate to their size in the population.

The Taif agreement, which put an end to Lebanon's civil war, offers a broad mechanism, namely the creation of a Senate where Christians and Muslims would be represented equally, sitting atop a non-sectarian parliament; administrative decentralization, so all communities would have more of a say in their own affairs; and an equitable election law to dismantle the Syrian-imposed gerrymandering that so thwarted true representation in postwar elections. The question is, however, whether the communities are prepared to engage in a debate on these issues in the fluid political environment Syria left behind.

Disarming Hezbollah

The third issue the Lebanese will have to address is the disarming of Hezbollah, which the United Nations has demanded in its Resolution 1559. This is an extraordinarily complex issue, complicated further by Hezbollah's success in the recent parliamentary elections. Solidly anchored in the Shiite community and increasingly in state institutions, including parliament and local councils, Hezbollah publicly rejects disarmament, and has vowed to fight it. However, while most Lebanese don't want to see the party brought to heel by force—nor believe this possible—they also aren't prepared to defy

the international community merely so the group can keep its weapons.

Hezbollah's disarmament will most probably require some sort of an international agreement, which includes Iran, in tandem with negotiations inside Lebanon to offer the party more of a stake in the political system. This is easier said than done. But Hezbollah is not irrational: it will drive a hard bargain and try to retain what it can of its weapons; but it is unlikely to take steps fundamentally threatening Shiite influence in the system (nor does it have a mandate to do so). In that context, the Lebanese consensus to avoid violence will be vital.

These predictions will come to naught if the new Lebanese government that emerges from the elections doesn't move quickly to reform the economy, which is struggling with a \$36 billion public debt and with a GDP of around \$20 billion. This is the stuff of economic collapses, and unless the debt is rescheduled through international aid, Lebanon could face a financial meltdown making all else look trivial. ☞

— Michael Young is opinion page editor of the *Daily Star* newspaper in Lebanon, and a contributing editor at *Reason* magazine in the United States.



Wrong on Putin

West is misguided in its criticisms of Russian leader

By Hereward Senior



AP Photo/Alexander Zamilionchenko

President Vladimir Putin looks on during his meeting with top German business executives at the 18th century Konstantin Palace outside St. Petersburg, Russia. During the meeting Putin hailed the economic ties between the two countries and voiced hope they would grow.

Russian President Vladimir Putin cannot hope to remain in power unless he can deal effectively with terrorism. For such a task he requires more powers than are normally provided by a democratic system. This is part of a larger problem which the West has had trouble understanding: the Russian difficulty of catching up with Western Europe.

Tsarism was meeting the challenge after its fashion until the revolution set Russian society back about three generations. Between February and October 1917, various Russian liberals and social democrats demonstrated their inability to govern. Vladimir Lenin's coup d'etat removed a bankrupt would-be democracy and started a civil war. It is necessary to understand that the Communists achieved an internal conquest which demanded defeat not only of the White armies, but the peasants and

Lilly

Answers That Matter.



minorities as well. After 1920, at the time of the Kronstadt mutiny, the Bolsheviks also turned on the working class of Petrograd, which originally had helped them to seize power.

Russian intellectuals convinced the West that they could govern better than the Tsar. The truth was that they could not govern at all. The obvious alternative to Tsarism was a military dictatorship less liberal, less stable and less likely to evolve into a democracy. Lenin secured his claim to power by promising peace, land and bread. Even so, he gained only a local and temporary majority in Petrograd and Moscow. What he actually delivered was unconditional surrender to Germany, the seizure of peasant land, and famine.

After seizing power, the Bolsheviks discovered that they could not hold it without creating a privileged class. By creating such a class they survived for three generations, but only by grace of a totalitarian system which demanded a personality cult after Lenin's death. This was difficult, as Lenin tolerated no equals. What he failed to detect was Josef Stalin's talent for office intrigues until it was too late. As Stalin had talent for little else, most of his decisions were disasters which he

covered up by putting the blame on potential rivals, hence the continuous series of purges. He in part demonstrated the ability to create a personality cult without a popular personality. In any case, the victims of Stalin were mostly old revolutionaries whose talents for conspiracy were little use to the new Soviet ruling class.

Nevertheless, there was still Leon Trotsky, in exile. He commanded no substantial following but his place in history made him a potential rival. Any minority staging a coup d'état might have gained credibility by bringing back Trotsky. Therefore, he was murdered in Mexico in 1940 by an agent of Stalin.

Stalin's rule has been, with some justice, compared to that of Ivan the Terrible and Peter the Great. However, there was this difference: the two absolutisms were used in the service of a possible objective—the creation of a powerful Russian state, and most of their efforts were successful. Stalin was committed to the impossible objective of creating a Utopia, and most of his efforts were failures.

The need to maintain the belief that the Soviets were engaged in creating an ideal society was the Achilles' heel of the Soviet

Union. It demanded continuous tension with the West and prevented the emergence of a working market economy. Concessions could be made to reality—for example, the retention of Tsarist-style military uniforms and ranks, and gestures toward other Russian traditions such as films about Peter the Great and Ivan the Terrible. The difference was that the bureaucratic ruling class which the Communists created did not understand the market economy. They thought in terms of production statistics instead of meeting actual needs. That is also Mr. Putin's big problem: the limitations of the surviving elite which Communism created.

Stalin's successors tried to keep the system going, but it needed another Stalin; they could not produce one because of fear of one another. Democracy will eventually emerge in Russia because the country has the resources to create wealth and security. Meanwhile, Mr. Putin must do his best to re-educate the Russian ruling class. It is in the interest of world stability that he succeeds. ♡

—Hereward Senior is a professor of history at McGill University.

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Bolton and the Balkan Tribunal

U.N. court is a failure, wasting U.S. taxpayer dollars

By Jeffrey T. Kuhner

The International Criminal Tribunal for the former Yugoslavia was initially created to punish those who perpetrated war crimes in the Balkan wars of the 1990s. It was never intended to become a politicized, anti-democratic tribunal aimed at intimidating opposition journalists in the region. Yet this is exactly what has happened.

Carla Del Ponte, the ICTY's chief prosecutor, recently indicted four journalists in Croatia—Ivica Marijagic, Markica Rebic, Domagoj Margetic and Stjepan Seselj—for "contempt of the tribunal." These journalists' alleged "crime" was that they published the identity and statements of a protected witness in the 1998 case of a Bosnian Croat general. The ICTY stipulates the maximum punishment for such an offense is a fine of 100,000 euros and seven years in prison.

The tribunal prosecutor's office is seeking to justify these outrageous indictments by claiming the witness' statements were given in a "nonpublic," secret proceeding. Hence, by publishing those statements these journalists supposedly violated the witness' protection guarantees of the tribunal.

However, it is the tribunal's responsibility, not that of the Croatian or international media, to ensure secret witness testimony is not leaked. More importantly, freedom of the press and the public's right to information trumps any claims the tribunal may have about witness protection. It is the role of journalists in a free society to hold public officials accountable for their actions and to reveal sensitive, even privileged, information in order to inform the public.

These indictments are a direct assault on Croatia's democracy and its independent media. This is why Mrs. Del Ponte's actions have aroused the attention of Republicans on Capitol Hill, as well as leading U.S. press watchdog groups.

"We are concerned about the tribunal's activities in regards to the indictments of these journalists and we are watching it closely," said Alex Lupis, Europe program coordinator for the Committee to Protect

Journalists. Based in New York, the CPJ is America's largest organization devoted to monitoring and protecting global press freedom.

"We think the tribunal should focus on indicting and prosecuting war criminals rather than going after journalists," he said. "There is a legitimate need on behalf of the tribunal to protect secret witness testimony but this is not the best way to go about it."

Mr. Lupis stressed the CPJ opposes the ICTY having "broad jurisdiction over journalists." He urged the tribunal not to "overstep its authority. ... Journalists should be allowed to do their work without criminal penalties," Mr. Lupis said.

Leading Republicans maintain these indictments may trigger a movement in Congress to cut off funding for the ICTY. "This is something we will be looking into," said an official on the House International Relations Committee, who spoke on the condition of anonymity. The official went on to describe the indictments as "outrageous," especially since the ICTY, as an offshoot of the United Nations, is partly financed by U.S. taxpayers. Surely, Americans are not pleased their hard-earned money is being used to help put journalists in jail.

This is not the first time Mrs. Del Ponte has abused her prosecutorial powers. Numerous Croatian journalists have complained her office has often sought to intimidate them in order to prevent any negative press coverage of the tribunal.

They claim officials close to her have threatened to use their influence with governmental authorities and prominent editors to have reporters fired, demoted or muzzled.

Lord Acton, the great 19th-century British classical liberal, famously said: "Power corrupts, and absolute power tends to corrupt absolutely." This is clearly the



case with Mrs. Del Ponte. She has become corrupted by power: She is now engaging in anti-democratic, thuggish behavior. She is seeking to silence all opposition to the ICTY within the Croatian media. Someone needs to remind her she is not a former Hapsburg governor of a backward Balkan province, whose mandate is to crush internal rebellions. Her mandate is to pursue genuine war criminals; it is not to intimidate and silence journalists.

Republicans would be wise to finally rein in Mrs. Del Ponte. Her conduct warrants not only closer congressional scrutiny, but an official investigation. Moreover, John Bolton, President Bush's choice to be U.S. ambassador to the United Nations, has made no secret of his dislike for the ICTY. He advocates winding down the tribunal and transferring most cases to local courts.

Once confirmed, Mr. Bolton faces numerous challenges in trying to reform the U.N. Removing Mrs. Del Ponte and having these indictments dropped should be near the top of his list. ☞

— Jeffrey T. Kuhner is communications director at The Ripon Society. The views expressed represent solely those of Mr. Kuhner.

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