



QUARTERLY SUPPLEMENT

“I don't really see the hurdles, I sense them like a memory.”

– Edwin Moses, athlete

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❑ **Crackdown and Growth: Beijing's Twin Efforts to Quiet Peasants and Stabilize the Economy**

While China's economy has grown rapidly, especially over the past few years, the benefits of this growth have mostly accrued to a minority of China's huge population. China's poorer and inland populations are growing resentful of the increasing economic stratification and have taken to the streets in protest. Political leaders in Beijing are employing two approaches to restore stability: a crackdown on citizens and corrupt officials, and using more economic growth as a means to improve the economic situation of the poor. However, leaders in Beijing must now contend with new technologies that allow the angry peasantry to communicate more effectively and freely. They also must balance the needs of the peasantry with China's growing class of businessmen, who would like to see Beijing loosen its controls on the economy and allow more privatization. **(IF 2605)**

❑ **European Moment (The): Popularity and Reform Advance The European Model**

European leaders and their countries have recently become the toast of the world, with heads of state from the rest of the world vying for time with their European counterparts to set new treaties, sign new accords and advance new trade arrangements. As the nations of the world realign themselves in accordance with their emerging needs, Europe has become more and more important. The European Union (EU), the largest free-trade region in the world, has attracted interest from several countries both on the Continent (hoping to join it) and elsewhere (hoping to expand trade with it). The Continent's popularity has created both opportunities and disadvantages.

The European Model—a cultural refinement to the Washington Consensus of open markets, privatization and control of public spending—has helped create the Continent's appeal and success. Now, it is undertaking several reforms to its preference for managed economies, universal safety nets and corporate responsibility. Those reforms will enhance the Continent's leverage even more. The Continent still must deal with a demographic

dislocation and several problems arising from the EU's popularity (elevated currency, a long line of countries wanting to join, and immigration tensions), but Europe's positive conditions portend solid economic times ahead. **(IF 2606)**

❑ **Future of Healthcare (The)**

The Genome Payoff—The Human Genome Project identified the string of letters that comprise the code of the human DNA. Now, a group of researchers with the endorsement of two federal agencies within the National Institutes of Health plans to form the Human Cancer Genome Project. The proposed project would determine the sequence of the DNA in at least 12,500 tumor samples, representing 250 samples from each of 50 major types of cancer. Scientists will compare the sequences of DNA letters in the tumor cells with one another and to cells with normal DNA as well, looking for mutations that cause or sustain cancer. Researchers promise to make the databank of DNA mutations will become freely available to all scientists and, theoretically, the databank will provide a base for developing ways to diagnose, treat and prevent cancer. Elsewhere, a former head of the International Human Genome Project is spearheading a new project by an international consortium of genetic scientists to make and archive mouse mutants that mirror human disease, gene by gene. A catalogue of new mice per gene could then be available to researchers. Meanwhile, scientists at a biopharmaceutical company, Medarex, discovered that, by inactivating two key genes and then adding two human genes, immune systems of mice can produce human antibodies. To get specific human antibodies, the mice are injected with cells or material from a tumor, infectious agent or other disease target. Fifty pharmaceutical and biotech companies have become Medarex collaborators or have licensed its genetically engineered mice for use in drug research. Currently, roughly 20 experimental drugs that use Medarex antibodies and that treat diseases ranging from lupus to cancers are in various stages of clinical trials.

Stem Cell Research—At a basic level, human stem-cell research involves scientists coaxing undifferentiated human stem cells to express themselves in such a way as to replace specific damaged or diseased cells. The ethical controversy of using the stem cells from human

blastocytes has resulted in some governments in the U.S. and Europe limiting embryonic stem cell research. In 2001, President Bush signed an executive order banning creation of new research stem cells, forcing scientists to use those stem cell lines already available. Yet, despite these roadblocks, worldwide stem cell research is progressing.

Across Asia, the governments of South Korea, Singapore, Taiwan and China are ramping up stem-cell funding, setting up new institutes, programs and grants and providing incentives for private companies. The South Korean government is spending \$50 million over 5 years to set up the Bio-MAX Institute in Seoul, charged with fostering interdisciplinary research in the life sciences, with a major focus on stem cells. In February 2003, two scientists from Seoul National University isolated embryonic stem cells from cloned human cells, a world first and seen as a key step toward therapeutic, or research cloning. Singapore's Agency for Science, Technology and Research spends about \$7.3 million per year to support stem cell research, using both embryonic and adult lines, while the National University of Singapore reports that about 12 groups are working on stem cells. In November, 2002, a lead scientist at that university, along with Australian and Israeli colleagues reported the first propagation of human embryonic stem cells without using mice. The group turned over its cell lines and intellectual property to ES Cell International for commercialization. In 2001, the Taiwan-government-affiliated Industrial Technology Research Institute started working with human stem cells. The Institute's 18-person group is targeting insulin-producing cells. In December 2003, China issued regulations for the use of embryos, and while those regulations place a strict ban on human cloning for reproductive purposes, they require only informed choice and consent for research cloning. China hosts stem cell initiatives by the central government, cities, provinces, private companies and venture capital funds. The work involves all types of stem cells and includes scientists trained in the U.S. and Europe.

Meanwhile, some U.S. citizens are starting to push stem-cell research at home. Californians passed Proposition 71 in November, which will provide an average of \$295 million per year over the next decade to fund stem-cell research. The first installment will fund

lab construction and equipment. Not to be outdone, legislators in Wisconsin, New Jersey, Maryland and Illinois have all proposed initiatives to encourage stem-cell research investment at the public and private levels. And, over the last four years, studies in Germany, France, Japan and most recently, South America, have successfully treated heart-failure patients with adult stem cells. Those studies have shown the treatment can improve cardiac blood flow, strengthen pumping, reduce the chest pain of angina and relieve heart-failure symptoms such as breathlessness. Now, U.S. government-approved trials, involving adult stem-cell treatment for heart therapy, are underway or planned in Texas, Arizona, Pennsylvania and New York.

Drugstores Threatened – The rising costs of U.S. healthcare, and pharmaceuticals in particular, have affected the budgets of consumers, companies and governments. As one effort to reign-in the rising costs of drugs, many public and private employers are beginning to require their employees to purchase prescriptions by mail. Approximately 50 percent of large companies require employees to obtain medications for chronic conditions through the mail. As a result of these kinds of cost-saving actions, mail-order drug sales for the 12 months ending in September 2004, increased 16 percent. The companies, government agencies and pharmacy benefit managers that administer these programs can also control costs through rebates, volume discounts and approved-drug lists that dictate brands of drugs that doctors can prescribe. Maintenance-type drugs that these companies want ordered through the mail account for about half of Walgreen's total prescriptions. The mail-order mandate also means less foot traffic in stores where pharmacies operate, which affects sales of cosmetics, candy and other goods. In retaliation, both Walgreen and CVS have stopped serving some large health plans that have mandatory drug mail-order provisions. In another cost saving move, the governors of Illinois, Wisconsin, Missouri and Kansas have established for residents of their states Internet purchasing sites that list pharmacies in Ireland, Britain and Canada where citizens can get discounts of 25 to 50 percent. While these state sites are up and running, a bipartisan coalition of U.S. senators is sponsoring a national bill to authorize consumer importation of drugs from Canada, the European Union, Japan and Australia.

□ Global Realignment Affects Energy

We have observed what appears to be a structural realignment among countries as they attempt to shore up old relationships while creating new ones – without the United States. World leaders have become more assertive and more public in their expressions of disappointment with U.S. foreign policy. As a result of their changing attitudes about American influence, they are realigning political, economic and military relationships to balance global power. This realignment includes the energy market, as the drive for a constant supply of energy has created new partnerships and altered cooperation efforts.

China, now the world's largest recipient of foreign investment, has been able to develop favorable energy relationships with countries as diverse as Iran, Russia, Australia, Venezuela and Brazil, as well as numerous countries in Africa. Three arrangements illustrate the depth of these new partnerships: 1) China's gas agreement with Iran, which calls for Iran to export to China 10 million tons of liquefied natural gas (LNG) per year for a 25-year period, is valued at \$100 billion and could grow to more than \$200 billion in value; 2) In late 2004, China lent Russia \$6 billion to enable Rosneft, owned by the Russia government, to buy Yukos's biggest oil-producing unit. That loan was backed by Rosneft's promise of oil deliveries over the next few years to China; 3) The third example may be the most telling. Venezuela, the world's fifth-largest oil exporter, enlisted Iran's help to steer oil exports away from the United States and to China and other Asian markets.

While China is having a major impact on new oil agreements, other countries are developing new relationships, based on their energy needs. Iran, Pakistan and India are considering a joint effort to develop a gas pipeline, while Japan and Russia have announced a pipeline deal, this one worth \$11.5 billion which will bring oil from East Siberia to the Pacific coast.

These new global partnerships, combined with a slowdown in oil production in Norway and a changing energy strategy by Saudi Arabia, are forcing the United States to develop new opportunities and relationships of its own. In 2004, U.S. officials explored the possibility of Saudi Arabia stockpiling oil closer to the U.S. market,

but the idea floundered for lack of sufficient surplus production capacity. The United States also proposed a northeast Asia-focused forum for cooperation on energy with China, Japan, South Korea and Russia, but China refused to participate. Meanwhile, the U.S. has focused its sights on African oil. In July 2002, the Bush administration claimed African oil as a "strategic national interest," meaning that it deserves protection by the U.S. military. The U.S. has troops in Botswana, Ethiopia, Ghana, Kenya and Senegal, and has designated \$7 million for assistance to Mali, Mauritania, Niger and Chad. In addition, the European Command of the U.S. Army has deployed troops and arms headed for Angola, Chad, Gabon, Congo-Brazzaville, Sao Tome and Principe, and Equatorial Guinea. Further, U.S. "access agreements" are in place with Senegal, Uganda, Ghana, Cameroon, Zambia, Namibia, Benin and the Ivory Coast (see "Good Atmospherics": Changing Realities Revalue the Developing World," **IF 2514**, 6/22/04).

These new energy relationships represent a shift in the global power alignment and may carry economic implications as emerging alliances seek openly to advance the possibility of a multipolar world. The scramble for energy represents just the tip of the iceberg of the larger movement toward global realignment.

□ Global Realignment and The Dollar, Part I: Changes in Attitude and Affinities Among the Countries of the World

World leaders have lately become more assertive and more public in their expressions of disappointment with U.S. foreign policy. The change of attitude that these expressions represent is starting to affect their actions as well. European and Asian countries are seeking to realign themselves in such a way as to shift the balance of power in a world they see as unbalanced and dangerous because of a de facto unipolar system in which the U.S. predominates. While public statements might seem benign and new political alliances may seem harmless, the changes in attitudes that these new alignments represent are starting to alter economic alignments as well, and that is the subject of Part II of this *Briefing*. (**IF 2601**)

□ **Global Realignment and The Dollar, Part II: The Fork in the Road, or It's Not Just The Economy, Stupid**

In Part I of this *Briefing*, we outlined the beginnings of a global rearrangement of power that many world leaders intend as a rebalancing of what they see as an out-of-kilter system of political and economic power. Their actions in the political sphere are spreading into the economic sphere. They are changing their attitude about continuing to rely on the dollar as the world's reserve currency – but the changes in attitude and behavior are really not just about the dollar. The U.S. economy, seen as sufficiently stable as to warrant granting the American dollar its status as the world's reserve currency, is threatened in ways never before seen in the post-World War II era. Because of this change in perspective about the American economy, countries are shifting trade alliances and financial policies to lessen their dependence on the U.S. and its currency.

China is moving to consolidate a regional “yuan” zone across Asia, Europe is working on better connections with China and the Middle East, and Russia is working with both China and Europe to enhance its military and economic status. A global realignment has started, the first of this magnitude since World War II, and it is not just about the dollar, the military or the economy. It encompasses all of them. (IF 2602)

□ **“How's Free? Does Free Work For You?” Industry Battles for Market Control Miss the Consumer's “Liberation” of Distribution**

The communications industry continues to obsess over the latest technology, competitors' moves and market-share battles. These obsessions have distracted them from consumer practices, at least one of which – personal distribution networks – should get their full attention.

Consumers are using new software and the Internet to develop their own ways of delivering content to whoever may be interested, and each of their efforts eats away at either audience or financing of mainstream media. Consumers have developed free-ad networks,

free-call systems, podcasting, freenets, peercasting and even a “Darknet.”

These developments have resulted in several industry effects and actions: Security as Quaint, Death by a Thousand Cuts, (Price) Tending to Zero, and Zero Plus Something (at least gets their attention). Overall, distribution channels are proliferating, and as in any industry with a proliferation of suppliers, price pressures are mounting. The fact that these latest “competitors” (e.g., personal distribution networks) are not on the industry's radar screen does not mean that they could be any less impactful down the road. (IF 2604)

□ **“I've Never Seen the Internet”: Societal Assimilation of Internet Technology**

Society adoption of the Internet may be moving slower than Internet technology advances. By looking at an analogy of technology integration – the automobile's movement from novelty to economy-controlling entity – we can get a better handle on how American society brings technology into its routines and processes.

In the automobile's integration, American society passed through four stages: **acknowledgment**, a period in which the new technology made familiar activities easier and faster; **acceptance**, a period in which society came to recognize the positive attributes of the new technology and began to find new uses for the automobile; **adoption**, a period in which society started altering and rearranging routines and practices to make room for the automobile; and **assimilation**, the final period in which the automobile started creating its own reality and dictating behavior among individuals.

We have found that the integration of Internet technology is following a similar process. Based on that assessment, American society is roughly halfway through the integration process, meaning that many significant changes and surprises await society in the years ahead. A cultural digital divide – as distinct from the economic digital divide – is slowing the process. (Special Briefing)

□ **“One-Off” Changes Create Opportunitites and Dangers**

Oil Shipping – New security concerns, environmental risks and potential political disputes are altering the

dynamics of oil and gas shipping routes and, in the process, have created opportunities for shipbuilders and shipping companies. Turkey recently set up a new tracking system for all vessels traveling through Bosphorus Strait and has instituted shipping controls that limit traffic to daylight hours. This has slowed vessel transit as well as increased costs for oil and gas shipments from Russia and Central Asia. On December 29, the U.S. National Geospatial Intelligence Agency warned that the recent Southeast Asian tsunami may have altered the seabed configuration, changed shorelines and depth limitations and damaged ports of call in the Malacca Strait (between Malaysia and Indonesia's Sumatra Island). Approximately 80 percent of Japan's oil imports travel through the strait, and an April 2004 report by the U.S. Energy Information Administration estimated that 11 million barrels per day passed through Malacca Strait in 2003. Meanwhile, in January, Venezuelan president, Hugo Chavez, signed accords with China's vice-president, to allow the China National Petroleum Corporation to develop oil and gas reserves in Venezuela. Mr. Chavez is in talks with both Iran and Panama to find faster ways to transport oil exports to Asia, including across the Pacific Ocean via the Panama Canal. Overall, new situations are altering the pattern of oil shipments worldwide.

Convention Dreams: If You Build It, Will They Come? – Between 1990 and 2004, space for trade shows, exhibits and conventions in the U.S. grew 51 percent. Since 2000, 19 cities have built new convention centers, while 34 others have expanded existing floor space. In addition, 22 cities are planning new centers, and 22 more are considering expansions. Conventional wisdom holds that more space means larger events, which means more visitors spending more money in the local economy, thereby creating more jobs and more tax revenues. Unfortunately, attendance at the 200 largest trade shows has been falling since a peak, in 1996, of 5.1 million attendees. The Internet offers both buyers and sellers a new research tool, and, by extension, greater control over expenditure decisions. Fears surrounding a possible new terrorist event have added to some attendees decision-making. Meanwhile, as co-called megastores have proliferated, merchants have demanded that manufacturers travel to store headquarters. As a result, convention centers find themselves in an

increasingly competitive environment and have resorted to deep discounts, incentives and even giveaways to lure tradeshow groups. This dynamic of expanding capacity and contracting attendance highlights less-than-ideal business conditions for local municipalities, as well as an array of convention-support businesses.

“Tuning” of Cars – One trade show that has grown in attendance is the Specialty Equipment Market Association (SEMA) annual gathering in Las Vegas, now the second-largest trade show in the country. The business of customizing cars has exploded recently, with sales in aftermarket auto parts doubling in the past decade to an estimated \$29 billion in 2004. We have written extensively about the turmoil created by World War III and the resultant Crisis of Identity for many individuals. Customizing vehicles, which may include anything from fancy chrome hubcaps, neon lighting and restyled grilles, to \$10,000 entertainment systems, allows owners to create a car to reflect their own personas. Major auto manufacturers such as Ford, General Motors and Toyota have begun offering aftermarket parts for their cars and making an expanded array of factory-approved accessories available through dealers. Most recently, “tuning” has moved to the exclusive brands. At the most recent SEMA show, Porsche, Jaguar and Bentleys were on display with various “tricked-out” features. In this emerging marketplace, the need to assert an individual identity via automobile is driving highly profitable sales for both independent parts vendors and traditional suppliers.

Nuclear Power, Again – For more than 20 years, an undeclared moratorium has governed nuclear power plant construction, as coal and natural gas generated cheaper electricity and concerns heightened after safety breaches at Three Mile Island, Chernobyl and several sites in Japan. The growing obsolescence of current nuclear plants, unease about uninterrupted oil exports from the Middle East and concerns surrounding soaring natural gas prices have generated interest in new nuclear power construction. In addition, the fact that nuclear power does not emit greenhouse gases and that the Energy Policy Act of 1992 simplified the system for licensing nuclear power plants in the U.S. adds impetus to revival interest in new nuclear-power generation.

The world's aging nuclear power plants currently generate approximately 20 percent of U.S. electricity,

one-third of France's energy, ten percent of Japan's and 2 percent of China's. The French government figures it has about a decade before its reactors need replacing, but some governments and industry players see a more immediate need to develop nuclear facilities. As part of China's plans to solve its surging energy demands, for example, the government recently announced construction plans for the world's first operational pebble-bed reactor. Further, the central government's Energy Research Institute has plans for new reactors to be commissioned at a rate of nearly two per year between now and 2020. Also, Japan's Fukui state government recently approved plans to use aid from Tokyo and restart its prototype fast-breeder nuclear reactor, which had been sitting dormant since an accident in 1995. India and China are also working on fast-breeder technology. And in the U.S., one remote Alaskan village voted to accept an offer by Toshiba for a free "micro-reactor" that the company is hoping to market to other isolated small towns, factories and mines. This test-product reactor generates about 1 percent as much power as a typical plant and runs on uranium enriched to 20 percent allowing it to run for 30 years without refueling. Meanwhile, in March, Duke Power met with the Nuclear Regulatory Commission to seek permission to build a nuclear power plant in the Piedmont region of the Carolinas. Attempts to resurrect the nuclear industry range from the small scale project in Alaska to the Chinese plan which rivals the scale and pace at the peak of U.S. construction in the 1970s, yet all will use uranium to varying degrees.

Click Fraud – Last year, money spent on Internet advertising rose from \$7.2 billion to \$9 billion, with the fastest-growing category – search-engine advertising – growing an estimated 55 percent. Search-engine ads are so popular because advertisers only pay search sites and Web-site publishers when someone clicks on an ad link. However, that advantage has new problems. "Click fraud," which results when someone – or perhaps a competitor – relentlessly clicks on an ad link without any interest in the product for sale, has started to send costs upward. Software programs are available that automate this process, raising ad costs exponentially. This malicious process can wreak havoc on an advertiser's budget as well as potentially invalidate the current search-engine advertising model. New businesses

are now emerging to measure real clicks and ignore fake ones.

Classified Advertising – Individuals are developing alternative networks for distributing content, including classified ads. The Internet site Craigslist enables users to publish classified ads for free. Avid followers post everything from apartment listings to job searches, and others search the sites for the availability of those items. The network of local listings has spread across the U.S. and has now reached Europe, South America and Pakistan. Recently, eBay, which owns a 25 percent stake in Craigslist, launched Kijiji.com, a group of classified Web sites that offer local job and goods postings in 50 international cities. A local assessment determined that the Craigslist, which started in San Francisco 10 years ago, is costing newspapers in the Bay Area alone between \$50 and \$65 million annually in lost revenue from employment ads (see "How's Free? Does Free Work for You?" Industry Battles for Market Control Miss the Consumer's "Liberation" of Distribution," **IF 2604**, 2/16/05). While some individuals will use these Internet sites to distribute ad content, others may choose a recent iteration of a more traditional model and still limit expenses. Roughly 40 free daily newspapers have hit various markets in the U.S. in the past 5 years, and these dailies are attracting a steady flow of advertising dollars.

❑ Risk? What Risk? The Quest for Higher Returns Sends Risk Profiles Higher

While consumers are showing signs that they would like to reduce their exposure to debt, institutional and other professional investors are showing signs that they are looking for riskier ventures in an escalating effort to collect higher returns. The professional quest for higher returns has enlivened the junk-bond and initial-public-offering markets, as well as the leveraged, speculative and subprime loan markets. Venture capitalists and private-equity firms have loaded their coffers with cash lately, and are looking for ways to spend those funds. Based on recent actions, when these firms do spend, they will try to force much faster returns on their money than have been typical in the past.

These actions have installed a bias toward risk-free thinking among investors, and that attitude has

spread to the art, mutual-fund and pension-fund investment markets. Those whose actions are affected by such a risk-free bias should attend some of the meetings that Argentina is holding with its debt holders,

look closer at some events in the U.S. housing market and consider the realities faced by consumers, whose spending represents more than 60 percent of the American economy. (IF 2603)



Did You Know?

- ❑ In 2003, nearly 10 million people played paintball in the U.S. at about 2,500 paintball sites. In the 5 years ending in 2003, sales of paintball equipment at wholesale more than doubled to \$400 million. (*New York Times*, 11/15/04)
- ❑ Since 1995, when the first laughing club – a group of people who gather just to laugh as an exercise and therapy – was formed in Bombay, about 2,500 laughing clubs have been formed worldwide. (*Psychology Today*, 2/05)
- ❑ Cartoon Network's *Adult Swim* is the top-rated program slot on late-night TV in the 18 to 34-year-old male category, beating both Leno and Letterman by 26 percent in the Nielsen ratings. (*Business Week*, 2/14/05)
- ❑ In 2003, total healthcare spending in the U.S. reached \$1.7 trillion, a record dollar amount, and accounted for 15.3 percent of the nation's gross domestic product, also a record. The year over year growth rate, at 7.7 percent, was the first drop in overall healthcare spending growth in 7 years – down from 9.3 percent in 2002 and 8.9 percent in 2001. (*Modern Healthcare*, 1/17/05)
- ❑ More than 18 million Americans have type-2, or so-called adult-onset, diabetes, while another 41 million are pre-diabetic, with blood sugar levels higher than normal. Diabetes consumes one of every seven dollars of total healthcare spending. (*USA Today*, 3/21/05)
- ❑ There are more than 54,000 call-center jobs in Africa, out of a total of 6 million such jobs worldwide. The African workers make about \$4,500 a year, including performance bonuses. (*New York Times*, 2/3/05)
- ❑ Over the past 6 years, subscriptions to mobile-phone services in Africa have increased 1000 percent, the fastest-growing mobile market in the world. Total mobile-phone penetration just reached 6 percent on that continent. (*European Business*, 1/05)
- ❑ The December 26 tsunami deposited more than 40 million tons of titanium ore – 10 feet high in some spots – along 300 miles of India's shoreline. The mineral is used to make cars, computers, sports equipment and aerospace projects. (*Discover*, 4/05)
- ❑ A man in Nebraska recently auctioned ad space on his forehead on eBay. The winning bidder paid him \$37,375 to wear a temporary tattoo for a snoring remedy. (*Christian Science Monitor*, 2/7/05)
- ❑ In 2004, intermodal transportation via the railroads increased 10.4 percent, topping 10 million containers and trailers for the first time. (*U.S. News & World Report*, 3/28/05)
- ❑ The U.S. Army and Army Reserve missed their recruiting goals in March by 32 percent and 46 percent respectively. That followed shortfalls of 27 percent and 25 percent in February. (*Dallas Morning News*, 4/1/05)
- ❑ Following the elimination of educational deferments in Russia, military recruitment officers recently raided college dormitories in Moscow, sometimes dragging students from their beds, in a surprise effort to find fresh military conscripts. Some students were taken directly to medical clinics for physical exams. (*Chronicle of Higher Education*, 2/11/05)