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357th Meeting
91st Year

C. Michael Armstrong
Chief Executive Officer
AT&T

and

Alexander Trotman
Chairman and Chief Executive Officer
Ford Motor Company

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Introduction

President Raymond K. Price

Welcome to 357th meeting in the 91st year of the Economic Club of New York. It has been some time since we have had an evening of two great captains of American industry as our guest speakers. If we had had this dinner twelve months ago, we would have said that the world was a very tranquil place. The American economy was growing nicely – it still is. The Asian Miracle was still very much in place – not quite so anymore. And the world, everywhere one looked, was looking particularly good, growth rates relatively strong everywhere.

Since then, the United States has appeared to be an island of prosperity in an increasingly troubled sea. And we must ask ourselves, are there some things about the American economy that make it work better – not perfectly – but work better than any other economy in any other country? I would suggest to you that one of the single most important reasons is that we have a huge structural advantage. We Americans have an ability to continue to restructure ourselves in order to make our country and our economy work better. That is particularly evident when you look at two of the fabled American companies, AT&T and the Ford Motor Company.

AT&T has had the courage to look into the future and its board of directors decided that to lead AT&T into the future, it needed a new man with new ideas, a brilliantly successful leader of companies to come and be its chief executive officer. So it is with particular pleasure that I introduce to you our first speaker this evening, Mr. C. Michael Armstrong, the chairman and chief executive officer of AT&T. (Applause)

C. Michael Armstrong

Chief Executive Officer, AT&T

Thank you Ray, and thanks to the New York Economic Club. It is indeed a privilege; it's an honor to be here. It's really nice to come home back East to New York. We've spent some six years out in California. And I know that Ray's counsel was get to the point, make your point, and sit down, but I would have to tell one story about moving from West to East if I may. Because for my wife and I, it was terrific to come home, but as we were packing up a few months ago to come home we were bringing our granddaughter with us. And she was saying her prayers as I walked by the hall packing the yellow boxes. She said, God bless mommy and daddy, and God bless grandma and grandpa and the aunts and the uncles and the dogs and the cats and the whole family. And she paused and looked up and she said, well, goodbye God, we're moving to New York tomorrow. (Laughter)

My theme today is both a celebration of the success of U.S. trade policy and an examination as well of its limits. To call America's trade policy of the past half century an unequivocal success is some understatement. In the 50 years of GATT's existence worldwide, the average tariff has been cut from over 40% to just 6%. As those border barriers came down and trade went up, the

U.S. and the world experienced a prolonged period of growth and prosperity unmatched in human history.

In the developing world, hundreds of millions of people moved from subsistence living to a much higher quality of life. In the industrial world, the pace of prosperity quickened to the point that one decade's novelties – from air travel to email, from TVs to PCs – became the next decade's necessities.

And the U.S. has benefitted just tremendously from global trade. In 1997, exports and imports combined accounted for a full 30% of U.S. GDP – just one statistical snapshot of how our country is not a trading nation. In fact, if we focus on the power of U.S. exports as an economic engine, since 1993 American exports have accounted for one-third of all growth in our GDP. If trade performance is strong, our trade potential is even greater.

We all hear we're evolving into a service economy, again that's good news for America. We've been running a surplus in service exports, everything from accounting, financial systems, to travel and tourism, not just this year or last year, but every year since 1970. And as for the effect here at home of all those American exports, whether they're moving through the Port of New York or the click of a mouse through a PC port, we know trade-related jobs pay as much as 15% higher wages than the average American wage.

Well, if all that is right, then what could possibly be wrong with our trade policy? The short answer, I would submit, is U.S. trade policy is becoming a victim of its own success. We're at a point in the development of our international economy where reducing remaining border barriers and tariffs have triggered the law of diminishing returns. Please make no mistake, the business of bringing down trade barriers remains critical for the United States government and a key component of our U.S. policy. But as we drive tariffs down to zero, the going gets harder and the gains get smaller.

The time has come for trade policy to give way to competition policy. And what do I mean by this? Think of it as the difference between knocking down walls and opening doors. The aim of trade policy was bringing down tariffs. Competition policy understands that removing border barriers is not enough. Stopping there can still leave in place an internal regulatory environment that makes a market that is nominally open, effectively closed.

How do we move from a trade policy to a competition policy? First, we start by asking not just whether a market is open, but also is that market competitive. Is there evidence of the free flow of investment, of the unfettered new players and the new markets that shows that competition exists, not just in name, but in fact. Second, competition policy requires a government that sees its regulatory role more as a referee than as a dictator. In the eternal tug of war between public and private sectors that means a government that sees its mission as clearing a space for the market to do its work. And third, competition policy requires willing partners. Competition policy is more carrot than stick. Our trade partners must believe that it is in their economic interest to force their companies and institutions to face competition. And from what we've seen, economic benefits are directly proportional to the degree a country creates an open and competitive market. Just look at the benefits the U.S. derives from deregulating everything from airlines to energy to railroads, financial services, even to long-distance.

Well, all of that is well and good, but may I pose a question tonight? If we were to come back a year from today, would we still be talking about the same issues or would we have seen some actions? And may I suggest three indicators, three competitive challenges that if resolved I believe will tell us and the rest of the world that we're on the track in moving beyond trade policy to competition policy.

The first indicator is how far we get in making Federal regulatory policy more market-driven. And this starts with the recognition that rule making is law making, period. If government must make rules, then let's provide the means to measure their impact – a metric that tells us how effective government regulation is in achieving the aim it set out to accomplish. And that's precisely what the proposed Thompson-Levin Bill would do by making mandatory regulatory risk assessments, regulatory impact statements that tell us clearly what the costs and consequences of new regulation will be.

And we'll need a feedback mechanism to let us assess and then to adapt regulation to the changing market conditions and realities. After all, when products fail in the market system, we improve them, or we pull them off the market. It should be the same when regulations fail. We should improve them, or we ought to get them off the books. The Washington watchers tell me that passing Thompson-Levin will be difficult in this Congress, and we should all hope that there's life left in it yet because regulatory reform is critical to this country's competitiveness.

If the first indicator of our progress towards a competition policy is the pace with which we reform our regulatory paradigm, our second indicator shows just what I mean about competition policy going beyond the removal of border barriers. Take the current telecom dispute with Mexico as a case in point. Now in this post-NAFTA era, Mexico is very much an open market for U.S. companies. But in the telecom industry, we see how open markets alone aren't enough to guarantee competition.

The competitive barrier in this instance isn't a tariff, it's the arbitrary accounting rate Mexico assesses to connect every call into Mexico. With no relevance to the cost of putting a call through, it's not just anti-competitive; it's a windfall profit to the dominant market position of Telmex, Mexico's monopoly carrier. And who pays? Every consumer who picks up a telephone to make a long-distance call, whether they live in Manhattan or Mexico City. And how much do they pay in addition to what they should? Philip Peters, a fellow with the Washington-based Alexis de Tocqueville Think Tank, calls accounting rates an un-legislated foreign aid program which has U.S. long-distance carriers paying $5 billion a year with the single largest payment of

$800 million going to Mexico.

Like everything else in our fast-forward economy, our accounting rate dispute isn't just happening in a vacuum. With Telmex planning to enter the U.S. market through a joint venture with Sprint, we face the possibility of seeing Mexico's monopoly position exported into the American consumers, and for those of us who backed NAFTA, that's not exactly the kind of export we had in mind.

If Mexico offers an example of the way non-tariff barriers can stand in the path of true competition, my third and last example illustrates a key corollary of the competitive policy I believe we need. And that corollary is simply this. Our progress in persuading other nations to eliminate internal competitive barriers in their own countries depends on our commitment to eliminating our own competitive barriers right here at home.

Take my own industry as a case in point. We still face the ongoing challenge of opening up one of America's last monopoly situations – a local exchange telephone market. As some will recall, back in 1983, AT&T had about 90% of the local and the long-distance market. To spur competition in long-distance, AT&T agreed to resell its service to other companies at wholesale rates that today are about 50 to 60% below retail levels. Every telephone switch in this country was re-programmed to handle any carrier's long-distance call on an equal basis. As a result, today there are over 500 long-distance companies in America and the average cost of a long-distance call has come down more than 55%. That's half the story.

To no one's surprise the Bell Operating Companies who continue to enjoy 99% of the local service business have wanted to get into the long-distance business from the day that the breakup took place. The judge overseeing the consent decree kept slapping down their applications to get into the long-distance so they went to Congress, and eventually with the support of the entire industry, government and all the regulatory agencies, the grand compromise was passed, the Telecommunications Act of 1996, and it became law. It's a good law. It says that the Bell Companies can get into long-distance but not before they open their local markets to competition.

It establishes two very important principles to promote local competition. First, since the only wire into people's homes gives the Bells an unfair advantage, the Act required them to resell that wire at an economically viable cost-based rate. Second, the Act foresaw that the payments long-distance company makes to local carriers to connect their calls would be competed down to cost as these local markets were opened up. And failing that, it empowered the FCC to do that on a unilateral basis. This is not a small item. The local phone companies charge about three cents a minute to complete each end of a long-distance call, about six cents a minute. Their actual cost is about a half a cent, and that really adds up. Long-distance rates include about $17 billion in connection fees that are over these costs. Taking these costs out could save consumers about 20% on long-distance.

So what's happened? Nothing. The Telecom Act never went to the marketplace. It went straight from legislation to regulation to litigation. The Bells took it to court. No local phone competition has developed, and they still – two years later – have 99% market share. Of course, with the Telecom Act in legal limbo, with no facilities available resale at a reasonable price, and with these excess connection charges intact, now these Bell Companies would like to get into long-distance. This is not a model that will work for this country, nor a model for the world to copy.

So what might work? Well, if the Telecom Act can get out of the courts and into the market and take effect, it will work. If the Bells are split into separate wholesale and retail operations, it will work. If industry consolidation was truly used for enforceable market opening, it will work. If Congress or Federal regulators would enable the telecommunications industry to operate solely on a cost basis, removing subsidies and taxes, it will work.

But in the market volume that exists right now as legislators, regulators, and litigators ponder these events, I submit three things should take place. First, protected Bell monopolies should not be extended into competitive long-distance markets. Second, the FCC should use its power to bring excess access charges down to real cost on a scheduled basis for consumer benefit. And third, industry consolidation should not only be measured by classical market power, market opening, and competitive markets but on what makes sense for a globally competitive American telecommunications industry. If our market system is based on competition, then it must also enable competitive enterprises, not just beyond our borders, but within them as well.

And that, ladies and gentlemen, brings me full circle in my remarks tonight. The beneficiaries of competition policy won't just be the companies fighting to win a larger slice of market share; it will be the consumers here in the U.S. and in every other country that commits to competition who will enjoy the widest possible choice and the lowest possible costs. But achieving this will take more than a mere continuation of the policies of the past which is why I believe we must move beyond trade policy to competition policy. Our next great wave of global prosperity depends on it. Thank you. (Applause)

Chairman William J. McDonough: Thank you very much indeed. Henry Ford, the founder of the Ford Motor Company, was one of the true revolutionaries in American business history. He did not, of course, create the automobile, but what he did create was the ability to take the automobile to the mass market through his method of manufacturing automobiles. The creativity of the Ford Motor Company has made it one of, if not the, great model, in the automotive industry for any competitor to follow.

Its present chairman and chief executive officer is another example of one of those benefits that the American economy has compared with others. American industry not only picks the best person in the company to be the chief executive officer, but it certainly doesn't get confused on thinking that only a native American can be the chief executive officer. If Alex Trotman had stayed in his native Scotland, considering that the entire management of the British political system is now in the hand of Scots, the only question is whether he would have been the Prime Minister or the Chancellor of the Exchequer.

Fortunately, for the Ford Motor Company and for consumers around the world, he decided to be an automobile executive and has become the chairman of Ford Motor Company. And it is our great pleasure to ask you to join us at the podium, Alex, and to tell us your thoughts for the future. (Applause)

Alexander Trotman
Chairman and Chief Executive Officer, Ford Motor Company

Good evening ladies and gentlemen. Thank you, Bill, for that very gracious introduction. I'm honored to speak to such a distinguished audience. I'm glad to be in New York again and relieved to find that it survived Godzilla and we're still here. (Laughter)

Of course, New Yorkers are very tough, as you know, and also very smart, demonstrated again by the doorman at the hotel. When I got in this afternoon, he said, hello, Mr. Trotman, what brings you to town this evening? I said, well, I'm talking at the Economic Club. He said, well, what are you going to talk about? I said, well, globalization of markets and companies, the need to create an economy of scale, the use of common components and systems worldwide. I'm going to talk about reducing layers of management and bureaucracy, and the elimination of all non-value added products and activities. That's essentially what I'm going to talk about. So he said, oh, it sounds like you're simply going to say you have to take out all of the BS. (Laughter) So, of course, he's a New Yorker so he didn't abbreviate. But that is what I'm going to talk about tonight, in a nutshell, what I told the porter.

I'd like to give you a global manufacturer's view of what is going on in the world as we see it, what we think governments and companies should do to be successful in a tough environment. And, of course, my perspective is automotive, as you would expect it would be, but we believe that much of what we see happening is universal. It doesn't apply only to the auto sector. It applies to pretty well every business sector.

I think everybody would accept that the world is changing very rapidly. What I find as I go around the world, though, that it's amazing how few people understand just how rapidly it is changing and just how much we are all going to have to change in our companies and in our governments to succeed in the next century.

I was in China all of last week. We have six joint ventures there in China, making automotive components, and we're in vehicle assembly too in Jiangxi Province. But when I was in Shanghai, I was asked several times, as I've been asked pretty well everywhere else in the world I've been recently, were you surprised by the Daimler takeover of Chrysler? And my answer every time has been, no, I wasn't really. I didn't predict that those two companies would get together at this particular point in time. For sure, I didn't do that. But for years I've been pontificating about the upcoming consolidation of the auto industry and the certainty in my view that we're going to see shake-outs, mergers, and some outright failures in the auto business.

We have huge overcapacity in the auto business today, absolutely huge. We sold roughly 50 million new cars and trucks last year worldwide in the auto business. There were 19 million vehicles at capacity, more than that, about 40% over the top. Now the numbers are hard to grasp but think of 80 modern assembly plants closing. That's the size of the capacity excess in the auto business today. And by 2002 we are projecting that excess will increase to 22 million vehicles. And yet we still have new people investing in the auto business. Samsung has just begun building cars even though South Korea's auto capacity today is already twice the domestic requirement for automobiles in Korea. So it's a tough environment and I think consolidation is the word. And if you'll excuse another reference to Hollywood, I think Daimler-Chrysler is just the tip of the iceberg. There's more to come.

I saw a recent study that said that of the 40 or so auto companies that are in business today around the world, that that number will shrink to about 20 in the next century. I think that's baloney. I think that will be down to six. Two Americans, we just managed to go to two Americans just a couple of weeks ago, so that's easy. I think two in Europe and two in Japan. So we'll be down to six. And they'll all be tremendously strong global competitors, real tough guys.

Of course, we're going to be one of them. And I'm just talking about the auto manufacturers, people like Ford.

In 1988, there were 30,000 suppliers making components for the auto industry worldwide, ten years ago. By the end of this year, 8,000 – from 30,000 to 8,000. Last year alone there were 700 mergers and acquisitions in the global auto industry with a value of about $28 billion and it's going to keep going.

It isn't just the auto industry as you well know. We're in the middle of the biggest merger and acquisition boom of all time. Last year alone, in the United States there were 11,000 deals valued at about a trillion dollars. Chemicals, pharmaceuticals, telecommunications, aerospace, computers, banking, auto retailing – if you're not looking over your shoulder out there, you should be. It's happening to pretty well everybody.

So there's a long list of people consolidating. It's a shrinking, borderless world. As Mike said, although it's not shrinking as much as it appears to be shrinking because there are still many hidden constraints to trade. But the WTO, the European Union, NAFTA, Mercosur, they're all helping to create a single, emerging single marketplace.

And we're creating customers who are more sophisticated and demanding. Because of that opening marketplace and because of the tremendous improvement in communications around the world, customers are becoming more sophisticated, more demanding, less willing to pay than any group of customers ever, and less loyal to a specific brand, whether it's an automotive brand or corn flakes or whatever. It's the greatest buyer's market in history today. That's why among other things you don't see any pricing in many sectors around the world.

The mergers and acquisitions that we're looking at today aren't the pillage and opportunistic plunder jobs that were often the case ten or fifteen years ago. Now we're seeing strategic, more or less, strategic alliances that are driven by the need to survive and prosper in the next century and to anticipate the big global battle that's in front of all of us.

We can't be too modest about it. None of this is new to us. We've been looking at this in Ford, this whole set of changes, for many years. And we began serious preparations for the next century four or five years ago. And we decided it was right to replace our regional organization and make ourselves a truly global company and we started formally to do that in January 1995. And we think it's the largest re-engineering job that's ever been done in any large organization. We call our plan Ford-2000. It's very simple really. We just took the European region, North-American, Asian, and Latin American which had been more or less autonomous regions of the company for years, we took them, smushed them all together and said, guess what, guys, we're now a single automotive company – Ford Automotive Operations.

We have to work together. We have to use all of our enormous talent and capability around the world very synergistically on behalf of our customers. Take out duplication, all the dumb stuff. Share the best practices no matter where it's from – Germany, Australia, United States – it doesn't matter. Economy of scale and design and manufacturer in purchasing, in treasury even. Whatever we do, do it on a global scale and get the juice out.

The focus has been on re-engineering the four basic core processes of our business, the auto business – product development, manufacturing, vehicle ordering and distribution, and after sales service – so that we can deliver maximum value and maximum quality everywhere in the world. In product development, we now have an integrated, global product plan with no duplication. We've improved quality and reduced cost. We've reduced the number of basic platforms or basic vehicle designs that we had a few years ago by 50%. We've taken out half the platforms, increased the parts utilization, the commonality by 50%, and we're offering 50% more models to the customer so the customer is seeing a 50% increase in the product offering and we've reduced our lost motion, so to speak, by 50%.

Some examples: the new Lincoln LS which we announced at the New York show recently shares a platform with a superb, new Jaguar that's coming in a few months, a midsized Jaguar. The new Mercury Cougar is based on a high volume European automobile Ford called the Mondeo. And that's going to be sold in North America and Europe, the Cougar. The Ka and Puma in Europe which are derived from a little car we have in Europe called the Fiesta, a high volume car. The Ford Expedition and Lincoln Navigator are derived from the F-Series pickup truck, America's best-selling vehicle for 19 years. And the Ford Focus which we unveiled in Europe in March is going to arrive in the U.S. next year and that is going to be the basic platform for a large number of derivatives.

Three of those platforms, the F-Series truck, the Fiesta, and the Focus platforms each will have sales of over a million vehicles a year. So with three platforms, over 3 million, approximately half of Ford's worldwide volume from three basic designs. A tremendous economy of scale in the design, in the manufacture, and in the purchasing of an enormous $70-odd billion worth of content that we have to purchase to make those vehicles every year. So much for product development.

In manufacturing, we're implementing a lean, a uniform production system worldwide replacing an immense number of do-it-yourself systems that developed over the last 90 years. And we're taking time and cost out of our vehicle distribution system. We're working with our dealers to have a standard practice around the world with 15,000 dealers. We are building some super-stores in Salt Lake City, Tulsa, and San Diego to name three places – we're starting there – as well as in several places in the United Kingdom.

We have a tremendous intranet inside Ford connecting 120,000 work stations around our company. It gives employees and major suppliers access to thousands of Ford websites. Our product development system is updated every hour on the intranet. It lets engineers, designers, and suppliers across the Pacific and Atlantic work from the same data around the clock. It keeps the process moving, reduces development time substantially, and it boosts quality and efficiency. We've taken our lead time to develop a new vehicle using some of this technique from 36 months to about 24. In a few years I think we'll be at about 12 months. And we're also going to shorten order to delivery time and over time we'll take that down to about two weeks from the order to the delivery. That will save billions of dollars in inventory around the world.

So we've made a start on becoming a single global company over the last three or four years, but we're a long way from realizing the full benefits. Results so far have been encouraging. Last year we lowered our total cost $3 billion at constant volume. We've never lowered our cost by ten cents before from one year to another in Ford and we went down $3 billion. We earned more profit than any auto company has ever earned in a year - $6.9 billion after tax. And our shareholders saw a return of 57%.

We kept it going in the first quarter of this year with a profit of $1.7 billion, a record for any quarter, any first quarter. And that was the eighth consecutive quarter of year over year improvement, and I think we're in our ninth right now. It was our fifth quarter of declining costs globally. In the first quarter, we more than went halfway toward achieving the billion dollar commitment to reduce cost in 1997. I think we're going to blow that objective away for the year. Our total return to our shareholders so far this year, since January 1, is 80%.

We just got good news today. The J.D. Power annual quality results were published this afternoon. And Ford, the first company that's ever done this, swept the North American manufacturing field with the first, second, and third best quality plants in North America. St. Thomas and Ontario that builds our full-sized Ford Mercury, Chicago, who was second, builds the Taurus and Sable, and Michigan Truck building the Navigator and Expedition was third. So that was great news.

The only bad news in all of this as far as I'm concerned is that the other guys are starting to take notice and other companies are organizing around the Ford-2000 approach. The Daimler-Chrysler rhetoric that we've heard the last couple of years sounds like the script from the Ford-2000 startup three or four years ago, and so does the General Motors annual report this year.

Governments, like business, have to change too though. It's not just us. And Mike touched on some of the things I was going to say so I won't belabor the point. But there has to be an environment that attracts capital, that creates globally competitive tiger businesses. Those two things are inseparable. I think with the wrong government policies, the capital doesn't come.

We have to support and continue to support flexible workforce practices, truly free market conditions, and sound tax, monetary, and fiscal policies. The Japan model of closing markets to imports and building excess capacity for exports around the world has been adopted by many other Asian countries, as you know, and their policy has failed. Japan needs to set a new example for the region by dealing with its economic problems. I'm not going to complain about the yen but I have to say I don't like it very much at 139 to the dollar.

But the weakened Asian currencies are going to change the competitive dynamic, in my opinion, quite dramatically for a number of business sectors. We'll see that over the next few quarters. Particularly we'll see it in North America and Western Europe. The trade deficit has already hit a record level in the last few weeks, and I think it's going to keep going to new records. I really hope the Japanese government does finally do something to get their domestic economy moving. They've been talking about it for long enough, but it's still dead in the water. And until that domestic economy gets rolling, I think Asia is going to stay in the dumps.

Mike Armstrong also talked about the collaboration of business and government when it comes to regulation, and I think it's a very important variable in the dynamic of competitiveness. The partnership for a new generation of vehicles that we have running in the United States, I think, is a good example of collaboration. This is where auto makers in the Federal labs and other Federal institutions are working to put very affordable, highly fuel efficient family-sized cars on the road as soon as they're practical. I think that's a good example.

The Trans-Atlantic business dialogue I think is another good example where Brussels and Washington and a number of large companies in Europe and North America combined their efforts to try to harmonize regulations for 15 different business sectors across the Atlantic. And to my immense surprise, we actually made some progress in doing that. I chaired the American side of that group a couple of years ago. Without standardization and regulations, it's not really going to be possible to have truly global products and bring the full benefits of large-scale production to the consumers around the world.

And by the way, on that subject, or a related subject anyway, I don't think that the Kyoto Agreement is a good example of regulation that's going to work. We simply think it's a bad agreement. Without the developing nations being involved – 130 or so nations are excluded from that agreement – we don't think there's going to be any overall environmental benefit. And the task of meeting a legally binding 30% energy cut in ten years in the United States is likely to direct resources away from the breakthrough technology that we're going to need in the next century and that will make a real difference over the long term.

So we're aiming, in our company, for breakthrough improvements in the environment and on safety. We want to move, and we plan to move, beyond compliance with regulations to take a leadership position in the industry. It's not only the right thing to do, we think it's a competitive necessity. We have more top safety ratings, by the way, in the United States from NHTSA, the National Highway Traffic Administration. We have more top safety marks than any other company. We have six vehicles with a top rating of five stars on both passenger and driver sides in our vehicles. We're the leader in dual air bag protection. We're the first to commit to de-power the air bags of our entire fleet. And all of our 1998 vehicles will have these new second generation air bags installed. We even signed up with Sesame Street. Big Bird was at my annual meeting with me as one of my props. And Sesame Street and Big Bird have been very effective communicators for us in getting across proper seatbelt usage to families and to young children.

We're developing cleaner factories and vehicles. We're lowering emissions beyond standards in many cases and improving fuel economy, recycling, and reaching out to communities all around the world. We're trying to convert New York taxicabs to natural gas. We announced with Governor Pataki at the New York Auto Show, I announced with the governor, a program to encourage installation of natural gas in the cab fleet. We have a heavy incentive to make that happen. About 30% of the pollution in Lower Manhattan at the surface is caused by the 12,600 cabs, and we could take 2,600 tons of pollution out of the air if we convert all of those to natural gas. We're the leader in alternate fuel vehicles in the world. We sold 95% of all the AFVs sold in America last year. We were way out in front. We launched an electric pickup truck, the Ranger, and we have $5,000 incentive across the nation on that vehicle to try to get that moving. We have 44 dealers in 12 states who are going to sell and service those vehicles.

And the 1999 model year, just a few months away, all of our sport utility vehicles which have attracted a lot of commentary in the newspapers in these parts in recent months, all of our sport utility vehicles and the Windstar minivan will be sold nationally as low emission vehicles. That's one in every five of the vehicles that we sell in North America. And those sport utilities will be the greenest, gasoline-powered sport utilities on the market. They'll be as clean as most of the very modern cars now on the road.

Along with other major automakers, we produce cars with 70% lower emissions in the Northeastern United States– we will do, by 1999 – and nationally by 2001. And so far the state of New York has chosen to copy California's emission regulations, but we're still hoping and trying very hard to get this state to sign up with the other Northeastern states to adopt a highly effective low emission vehicle program.

And, of course, we're working very hard on fuel cells which we have for 20 years or so. We've made tremendous progress. Twenty years ago our fuel cell car was only 100 times more expensive than an internal combustion vehicle. In the intervening 20 years we've brought that down to only ten times the cost of an internal combustion vehicle. We have huge investment behind the development of fuel cell vehicles with Daimler-Benz and Ballard. And we have a major effort going with Mobil Oil to improve fuel economy and cut vehicle emissions with new fuels. I could go on but I won't. There's a long list of things that I'd like to talk about, but time doesn't permit.

So none of that is much of a surprise to any of you, I hope. It certainly isn't rocket science. We just simply accept in our company that the world is going to change one heck of a lot. And we better change a heck of a lot too if we're going to survive and be a very successful company and look after our shareholders in the next century. It's very simple, we benchmark the best companies, and we set out to beat them in everything that we do. Better value, better technology, better quality, better service for our customers. Just take out all of the BS as the guy at the front door of the hotel told me.

Communication technology is going to be a big part of it as we leverage all of our asset around the world. We have to keep addressing social issues as we move, and I suspect we'll have to do that more energetically in the next 100 years than we did in the last 100.

So we're off to, we think, a fairly gratifying start over the last three or four years as we get prepared, but there's a lot more work still to do. It's going to be an enormous dogfight, but in our opinion, the companies that are prepared and the governments that are prepared which is, I think they go in parallel, for those who are prepared to take on what's coming in the next century, the rewards are going to be even bigger than they were in the 1900s. The rewards out there in the next century are going to be absolutely staggering. (Recording issue) (Applause)

CHAIRMAN WILLIAM J. MCDONOUGH: Thank you Alex. I'm sure that all of you noticed a very interesting theme in both of the presentations, and that is that the customer is king. Both gentlemen were talking about having to manufacture a product or create a service for the customer. I was so overwhelmed by the confidence in their companies and in themselves of our two speakers that I was very happy that on a trip to Chicago over the weekend I rented a Ford Taurus and I made a telephone call going and coming on the airplane via AT&T. (Laughter)

QUESTION AND ANSWER PERIOD

We will now have as is custom at the Economic Club a question and answer period. I get to sit down, gentlemen. You two get to stand up here. And we have two questioners, Mr. Thomas E. Dewey, Jr., a partner in the firm of McFarland and Dewey, and Barbara Hackman Franklin, the Former Secretary of Commerce. We will begin, gentlemen, if you will stand up and prepare yourselves, ladies going first, and Barbara, you will ask the first question to the gentleman of your choice.

BARBARA HACKMAN FRANKLIN: I think this question will go to Mr. Armstrong. I want to focus on the telecommunication businesses, and I've always viewed that business as one of our competitive edges here in the U.S. which we would like to keep, so the question before that, it seems today that the communication companies are increasingly getting into each other's businesses. That would be local phone companies, as you indicated, long-distance, there's cable, there's wireless, internet, and then you overlay the whole global thing on top of that. If you could think into the future here a few years, how is this phenomenon going to play out? Who will the winners and losers be? And what will the companies that survive in that general area, what will they look like in the early part of the next century?

C. MICHAEL ARMSTRONG: Mrs. Secretary, first of all, AT&T will be the winner.

BARBARA HACKMAN FRANKLIN: Well, I knew that. I lost my head...(Laughter)

C. MICHAEL ARMSTRONG: Second, you're absolutely right. Part of the excitement of what's going on, you know for 75 years we had this black instrument that Alexander Graham Bell bestowed us with and we dutifully could either wind it up or ring it up, and we got to communicate with each other, but so much is changing so fast. In our business, you brought up technology, and not only do we have the technology of electronics at work, but we have the technology of photonics at work – white waves as well as transistors. And, of course, Moore's law, every 18 months the price performance of electronics is going to double. But something that people don't understand is that in the world of white waves, photonics, we are running at a technology pace two to three times that of Moore's law. And so when you think about the fire that's laid in this country and that will be laid around the world, you're thinking about infinite capacity and virtual bandwidth on demand. And so there are many alternative technologies that this can be applied to. You've named several. Cable, which is fiber, and coax, electric wires, can carry communications. Radio frequency can carry increasing amounts of bandwidth in the air, whether it goes cellular or whether it goes satellite. And so as we look forward to the future, technology is going to redefine how we work, how we play, how we live, how we communicate to each other. And it's just not communicating; it's also the content of life. I think some people might be interested to know that the internet, which is just an exploding application on communications, 75% of internet traffic is made up of three applications – messaging, email, and chat. Now if that's not what AT&T is supposed to do for a living, I'm not sure what we are supposed to do for a living. And I don't think that everybody wants to do their email and their chat and the messaging with a $3 million line operating system and a $3,000 device and be tethered to their desktop, the counter top, or their car. We rather think that with this technology, that we can, with the thumb and a wireless device, make the phone the most ubiquitous Internet device in the world. So that the simplicity of gaining information and of living our life and enjoying our life will be as simple as answering our phone, and we think it's going to be a fun future.

THOMAS E. DEWEY, JR.: This one should have been for Mr. Trotman, it really should be, but it's not going to be. It's kind of a follow-on question. First of all, Mike, I hope that you've told your granddaughter that in moving to New York – what might be the best place in the world – the God she gets here is less of an oxymoron than the one she left in California. (Laughter) In following up on what Barbara had to say, I mean a somewhat broader, global question. I think practically everybody here, except people who have special interests in the ARD VOX, would agree that eventually the regulatory hurdles will fall and that we will have competition, and in many cases, cutthroat competition, in all the markets that there are in telephony, including the German and the French and the places that you referred to. But if you believe all of that, and we also realize that there is something called the internet out there, who is going to make any money in the telecom business in the next century and how?

C. MICHAEL ARMSTRONG: First of all, the telecom business is a very profitable business. AT&T is a very profitable company. We have about an $8 billion free cash flow and we make a very nice margin. But the largest cost of goods in our bill of material to provide telephony service in America are access charges and taxes. We pay somewhere around $12 billion in access charges and taxes that are imbedded. I mentioned in my talk that's $.02.8 cents for an origination of a call and a $.02 for completion of a call. And people get excited about telephony over the internet. We're the first company to have a telephony offering. It's called Connect and Save, $.07 to $.09 a minute. And the question that comes up often to me, how in the world can AT&T make any money at $.07 to $.09 a minute? We're all used to $.10 a minute or $.14 a minute or $.15 a minute. And the simple answer is that when you take the access charges and the taxes out of the cost of goods sold, you can make money because the real cost, the fundamental unit cost of a minute on an AT&T network is a half a cent. When you pile on top of that, customer care, service and support, value add, a reason to have a backup and reliable network, and other things that make up the respect that AT&T owns in the marketplace, but there's a cost structure out there that's going to do nothing but go down. And there's a market elasticity that's going to do nothing but go up. And out of that, I believe that those who lead will get a fair return, and yes, prices will decline. I remember in the computer industry, that I spent 31 years in; we always used to have this debate. When the mini-computers would come in, or the next level of technology for the mainframes, when we got into parallel processing, and everybody had something on the desktop, we thought where is all that computing power going to be used? How can anybody fathom? We're going to be in a declining market, our revenues are going to dip, and the elasticity of the market was there to consume it and more and it's still a great growth industry. And the communications industry is going to be a great growth industry, and those who lead it in technology, and in paying attention to the customers, are going to make a good return.

BARBARA HACKMAN FRANKLIN: This one is for Mr. Trotman, your turn. In keeping with your comment that we would have six automobile companies globally...

ALEXANDER TROTMAN: I'm not going to name them. (Laughter)

BARBARA HACKMAN FRANKLIN: ...I wasn't going to ask that...in the next century. This is kind of a vision thing question and also the idea that the customer is king here. Would you speculate a little bit, let's say over the next ten years or so, what automobiles are going to be like in terms of style, what customers want, in terms of materials that are used that might be different than we are using today, in terms of safety effects, in terms of power plant, the alternate fuel kinds of things that you were talking about, and anything else? And I'm assuming that you are going to lead whatever it is. But you would speculate about what the future looks like?

ALEXANDER TROTMAN: Did you ten years or twenty?

BARBARA HACKMAN FRANKLIN: I said ten, but if you want to go ten or twenty, go ahead.

ALEXANDER TROTMAN: Well, I think ten is easier. Twenty is a little tougher. In ten years, the majority of vehicles will be internal combustion engine vehicles, brand new vehicles. There will be a number of different types of vehicles on the street, but a small percentage of total sales will be electric, hybrid electric. There may be a fairly significant number of natural gas vehicles and some methanol and ethanol-driven vehicles as well, but internal combustion engines with much clear fuels with lower sulphur and fewer impurities than we have today. And those are going to come out and be available. We'll be able to take the emissions from the tailpipe down to very close to zero with the latest technology, electronics, and engine combustion systems and very, very clean fuel. We're going to get the tailpipes down to practically zero. And from an economic standpoint, energy per pound or per dollar or whatever, is going to be very, very tough to beat that formula. But there will be a number of other types of vehicles, I think, in the fleet, but not a truly substantial piece. There will be a much wider use of aluminum, more graphite fiber. The vehicles per cubic foot will be lighter weight, substantially lighter weight, with lower friction losses and an enormous increase, I think, in the amount of lightweight material per vehicle. More aerodynamic. As to their shapes, I think customers are becoming, in the last ten years what they've told us is that they really value, you know, for decades, our credo was low, longer, and wider. And as we look back, and as I look back on it, we didn't care an awful lot about crunching the customer down and, you know, having lower head room, and easy entry and exit and so forth. Longer, lower, and wider doesn't fit these days. As you see, the boon in the truck business is now approaching, what we call "trucks in America," approaching 50% of the total market which I said it would ten years ago. It's 48, 49%, and it's going to go past 50. And that's because people really like the utility with a big U, the seating utility, the space, the convertibility of things like an Explorer, our next vision, where you can fold the seat and take everything – the dogs, the kids, and the picnic gear and surfboards and goodness knows what. The tremendous freedom that that gives people, it's becoming more and more widespread as a desire. The next step, we think, one of the next steps will be crossover vehicles that are neither cars nor trucks. And you see a few of those starting to emerge over the last year. So you won't know what to call them. It'll just be Ford...I want one of those Fords, and I'm not sure what it is, but I want one, I gotta have it. So we are working on a few of those, you're going to have them. But I would merely be a little bit cute by describing them as crossover vehicles right now. But the vehicles you'll see ten years from now, and I fancy if you pushed me to twenty, you will recognize them as descendants of the vehicles that are on the street today. I really don't think in any high volume they'll be fundamentally different. They've got four wheels, a body, four or five seats, or up to ten seats, lighter, but more efficient and cleaner and safer. Tremendous now, a lot of people have really discovered safety. Thirty years ago, it didn't matter what we said, we couldn't get people to take an interest in vehicle safety. Now they're very interested. And we exceed all the safety standards. We put a huge margin into beating every regulation in safety in our company. And we're going to have airbags; you won't be able to hit yourself without encountering an air bag first in a car. We're rushing to put side air bags in all of our vehicles now so that you're protected all the way up the side and all up the front of your body. So side collisions and frontal collisions are protected. Improved braking, we can still make our brakes even more effective than they are today, although they're terrific now. But there will be small, incremental improvements in the dynamics of vehicles. And an awful lot of, with a terrific surge in electronic capability that we have now, you'll be able to, you'll be able to in the regular everyday vehicle, you'll be able to adjust the pedals back and forward or up and down. The seats, of course, do that today. Everything will be voice-command. You'll say Radio Channel 4, Volume 7, and it all happens. And then you'll be able to dial in the steering effort that you want and the right firmness or softness that you want and the handling capability that you want. You just dial it in. You design your own car as you're driving. And if you change your mind and you want to go for a soft ride because you want to relax and just listen to FM radio, you just dial it all in for plush and quiet and away you go. So that's what it'll look like in ten years.

THOMAS E. DEWEY, JR.: Also for Mr. Trotman, I think the first major deconstruction in the automobile industry was the sale nine years ago of Rouge Steel by Ford which, of course, was the final giving up on Henry Ford's original dream of having everything under one roof. There were many, many reasons for that, including the fact that both levels of UAW wages are higher than any of the steelworker's wages and you had assembly plant, UAW wages being paid for people who were in the steel business which made it pretty uncomparative. Since then, there have been other divestitures of parts operations by the Big Three with the same relative objectives of different UAW or no UAW wages plus the ability to do business with other buyers and achieve better utilization levels. I wondered what your plans are for doing any of that from now on?

ALEXANDER TROTMAN: Well, first, maybe, you didn't ask me the question, but I want to say we have great respect for the UAW, tremendous working relationship with the United Auto Workers Union, and we think it's one of our companies competitive advantages. We haven't had a strike for donkeys' years. We cooperate very fully on all matters of policy with the union. We wouldn't make a move of any of the type you're suggesting we might make without the full buy-in of the UAW – just as an opening statement. We are examining everything we do, and if we can't do something at world-class levels, we're not going to do it. We'll get out of it over time. We don't have any imminent spinoffs in mind, but we have taken our parts business over the last six months and separated it from the auto business in an operation called Visteon. It's the second biggest car parts manufacturer in the world, some $17 billion a year in revenue, 90,000 people in 19 countries. So it's a huge operation. We've taken that away from the automotive piece of Ford and we're publishing the financial data for that operation separately. So if it makes sense for us at some point to spinoff part of that operation, then we'll do it, but we don't have any specific plan to date to do that. It might make sense down the road. But going back to the question before, ten years from now, I really don't think that our integration level in Ford will be noticeably different from the integration level that you see today. We may go into some businesses or back into some businesses that we haven't been in before, or that we exited in the last 90 years – some of those businesses we may go back in. We're very pragmatic – where do we find the value for the shareholders? If we can't find it in something we're doing, it's going to go over the side. We exited the heavy truck business last year. We had been in the heavy truck business since Adam was a boy. And we dumped it last year, we sold it. And we dropped six vehicle lines including the Thunderbird, because we just couldn't extract the value for the shareholder out of those vehicles. So we're very pragmatic. We'll do whatever it takes to get the value. But we have nothing specific in mind right now with respect to the specific question.

CHAIRMAN WILLIAM J. MCDONOUGH: Could we have one last question from each questioner.

BARBARA HACKMAN FRANKLIN: One for Mr. Armstrong. This is one of my favorite former Commerce Secretary questions. Re-engineering seems to be a fact of life in almost every industry today. It's been going on for years and it would appear that it will continue. The effort to cut costs, take head count down throughout layers of management, and so on, thereby increasing, I believe, the concern – and perhaps anxiety – in workforces all around corporate America, and eroding the ties of loyalty that at least I grew up with in my early days, company loyalty to the enterprise. Given that this is a fact, my question would be are you concerned about this? Again, you are taking out another 15,000 to 18,000 people as I understand that you're doing. Are you concerned about this? And if so, what does one do as the leader, the CEO, of a large company to counteract the erosion of loyalty?

C. MICHAEL ARMSTRONG: You're absolutely right that when you downsize and restructure an organization, that it's very important that you not only earn the respect and trust of the people who are leaving, but the people, 85%, 88%, who are going to stay behind and build the future share a trust and respect of the organization and its leadership. That's why we were fortunate at

AT&T with a view of what we had to do to get ourselves competitive, it really was going to source from both our operations and a force reduction, that we spent a lot of time figuring out how to do the force reduction on a voluntary basis. And we were, again, lucky to have an over-funded pension plan which we could use in order to offer a pension bonus for a one-time offer so that people could look at the rest of their life, the rest of their career, and determine with their service and their age what they wanted to do. And it was their decision, not the company's decision. In fact, we estimated that some 10,000 people would take this pension offer on a voluntary basis and, in fact, we announced this morning and we tabbed it up that 14,000 took it so we were able to get the force reduction of 18,000 in a one-year period instead of a two-year period and do it in a way that people felt good about themselves, that they had given their careers, much of their life, to the AT&T Company, and we in turn respected that and gave them something back – rather than tapped them on the shoulder and said, you're out of here. And the reaction from the people who are staying has been an increase in their morale and an increase in their trust and confidence. And of course, we've got to share a vision of not just saving ourselves into the future that gives them the confidence that what we're doing, to be a leader in the telecommunications industry, is going to unfold for them to have a bright career. So it's not only taking care of what needs to be downsized, but also presenting to the people that are going to stay the kind of vision, the kind of future. I mean we all work for a lot of things, but when it's all said and done, we work for hope. And we have hope that what we're going to be tomorrow and what we can contribute tomorrow, our satisfaction tomorrow is going to be better than it was yesterday. All our workforce, they really go to the mat with you. And I feel very good that we were able to do our force reduction in this kind of environment so that the trust and respect of the company is intact and the morale of the people that are here to go forward is also intact.

THOMAS E. DEWEY, JR.: Okay, for Mr. Trotman, you mentioned in your remarks, as you did in the annual report, something that is generally realized to be true by every observer of the automobile business which is vast global overcapacity in the business. And I wondered what your view is of the, a lot of which is in Europe and I think everybody realizes is maybe more serious now than it was a year or so ago when Asia was expected to take up all those automobiles and light trucks that we have too much capacity to make, which they perhaps might take longer to do. I wondered what your view is as to the effect that the euro as the first, as a first step, and also closer political union, which a lot of people think is coming in Europe, is going to have on the previous pretty chauvinistic reactions to the various European countries on eliminating some of the substantial overcapacity there?

ALEXANDER TROTMAN: Well, that’s a big question. I’ll be brief I guess. I was with a group of eminent Europeans a couple of weeks ago and somehow the subject came up, this subject. It was the unanimous view of the group that Maastricht would fail today, that the Maastricht vote taken today would fail. The anxiety level is up to here now that we’re getting closer to the dentist’s chair in Europe. I think, I have anxiety too, because I’m not sure it’s going to work. I think there will be enormous social tension when there’s one blanket over Europe and the French aren’t able to do things to move their economy up and down or address some huge unemployment issues in the Bordeaux Region or whatever. And that Dr. Purdy(?) can't do what he wants to do. And Italy, when things get bad there – I think things will get bad there – there will be some regional upsets there. And whether they can handle them with a common currency and the new rules, I doubt. I think there's going to be some tremendous stress and strain. But I think the only way to get to the automotive overcapacity, which is about 6 million vehicles in Europe of overcapacity, to get to that, the only way I think that that's feasible to address is with a total buy-in of the German, French, and Italian governments. I don't think it can be done by private industry alone. I can't visualize for example a merger of two or three of the, if Franco-Italia Motors were created tomorrow, for example, to rationalize the capacity I think would be unfeasible unless with the total buy-in of the governments, at least two of those governments. And would that happen? I don't know. I mean it's a big question. I really can't give you a good answer because I just don't feel I know the answer. But I think there will be some tremendous stresses and strains to deal with over the next few years in Europe as a result of the new Brussels policies. One of the eminent commentators in the United States put it recently, I think to me anyway it rang something of a bell, that the Europeans should have had a Civil War first, like the Americans, and then had the dollar. To do the dollar first, to do the EU first and have the Civil War later seems to be doing it backwards. (Laughter and Applause)

CHAIRMAN WILLIAM J. MCDONOUGH: Well, ladies and gentlemen, certainly a central banker should never be in the stock-picking business. But if one were to decide that you place your bets on two people who are enormously competent and have great confidence in the futures of their companies, you might just buy AT&T and Ford. Thank you, gentlemen, for being with us. It's been a wonderful evening. Ladies and gentlemen, we are adjourned.