

U.S. TAXES: WHY THEY'LL GO UP
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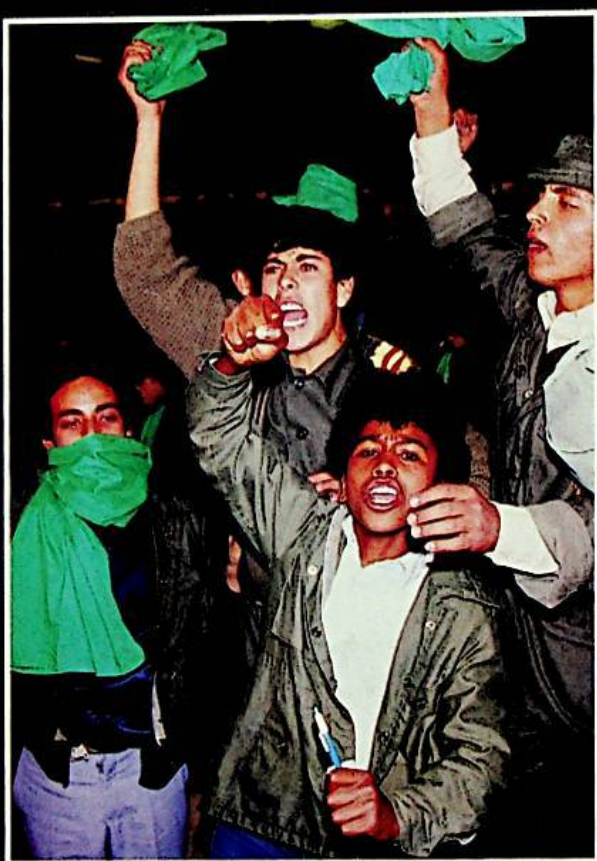
THE HOT MARKET FOR COMPUTER WORKSTATIONS PAGE 56

INTERNATIONAL
BusinessWeek

A MCGRAW-HILL PUBLICATION

FEBRUARY 3, 1986

INSIDE LIBYA



Fervent revolutionaries make Qaddafi seem invincible. But a collapsing economy could provoke a coup that would trigger his downfall

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QADDAFI'S IMAGE EMBLAZONED ON POSTERS IN TRIPOLI CAN'T OBSCURE THE THREAT TO HIS POWER POSED BY LACK OF MONEY

Cover Story

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Qaddafi's grip on Libya is weakening—and not just because of U. S. sanctions. His economy is threatened with collapse. The decline began with falling oil prices, but mismanagement on a massive scale has compounded the country's plight. Now, as foreign companies leave, key development projects may grind to a halt—a crippling political blow to Libya's strongman

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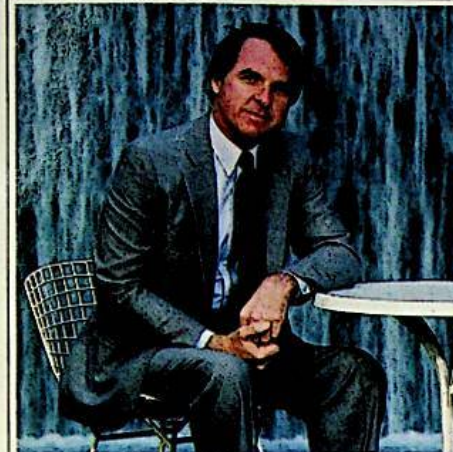
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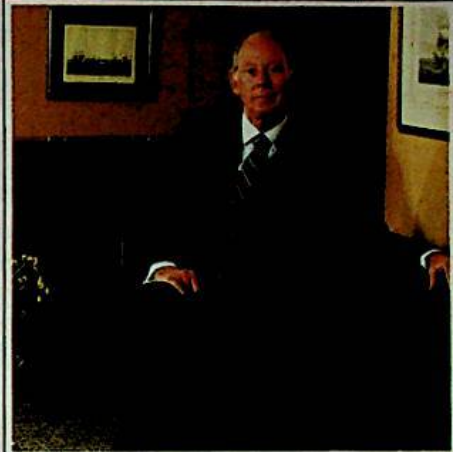
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Business Week (ISSN 0007-7135) published weekly, except for one issue in January, by McGraw-Hill Inc. Subscriber rates available on request. Executive, Editorial, Circulation, and Advertising Offices: 1221 Avenue of the Americas, New York, N. Y. 10020. Second-class postage paid at New York, N. Y., and at additional mailing offices. Title Reg. in U. S. Patent Office. Postmaster: Send Form 3579 to BUSINESS WEEK, P. O. Box 430, Hightstown, N. J. 08520. Argentina: Clasificada por el Correo Argentino como de "interés general" bajo tarifa postal reducida. Concesion No. 873.

INSIDE LIBYA: QADAFI LOOKS SHAKY

AN ECONOMY IN CRISIS—NOT REAGAN'S SANCTIONS—MAY BRING HIM DOWN

The ultramodern Hall of the People in Tripoli is packed with thousands of Libyan teenagers, none much older than 17, some closer to 12. Draped in bright green revolutionary scarves, they are feverishly waiting to hear the only hero they have ever known: Colonel Muammer Qaddafi. The hypnotic chants of "Death to the U.S." and "Our Revolution Is Forever" begin to mount. Some girls cry with hysteria, one faints. Finally, Qaddafi arrives. Pandemonium breaks out.

It is carefully choreographed theater intended to convince Libyans that Qaddafi is invincible, that he will rule forever. But in truth, Qaddafi's hold on Libya weakens with every passing day. And if the colonel's 16-year dictatorship runs into trouble, the major cause will be the rapidly deteriorating economy—and the political opposition it has kindled—rather than the embargo imposed by U.S. President Ronald Reagan.

'IT CANNOT LAST.' Lack of money is tearing Qaddafi's political revolution apart at the seams. Oil has plunged to less than \$20 a bbl. amid an international price war, and that is cutting deeply into Qaddafi's money machine. Libya's oil income already has plummeted more than 50% over the past three years. The austerity program the Libyan leader has imposed will have to get even tougher. Discontent will no longer be soothed with petrodollars.

From Tripoli to distant military camps in the desert, shadowy power struggles are breaking out between the traditional armed forces and police on one side, and the growing number of young, fanatical members of Revolutionary Committees on the other. These teenagers, a revolutionary generation akin to Mao Zedong's Red Guards, have become Qaddafi's last sure base of support. A middle-aged Libyan teacher is dangerously candid: "It is crazy, and it cannot last."

Libyans still loyal to Qaddafi say the country's problems are temporary. "We'll always find markets for our oil," claims Major Abdul Salaam Jalloud, Qa-

daffi's No. 2 man. But economic mismanagement on a massive scale has compounded Libya's plight. Qaddafi plunged his country into too many fanciful development projects. Now that oil revenues are falling, Libya has become so slow in paying its bills that thousands of foreigners who once flocked in to build hospitals, schools, universities, and factories are leaving. Showcase projects, such as

a \$1 billion aluminum smelter, already are on hold, and some may soon be halted, dealing Qaddafi a political blow from which he may never recover.

To divert attention from the failing economy, Qaddafi is stepping up his support of terrorism. By boldly announcing that he would send "suicide squads" into American streets and that he planned to

make Ronald Reagan the "world's last

Nazi," he poses as David fighting Goliath, at the same time hoping his people do not blame him for the lack of basic foodstuffs and consumer goods. And by challenging the U.S. Sixth Fleet, he poses as a champion of all Arab nations against "imperialist aggression," a role he has long cherished.

Ironically, the colonel's timing could hardly have been more disastrous for his country. Although Qaddafi may have won the rhetorical battle for the time being, the U.S. embargo has focused attention on his collapsing economy. Companies from South Korea, Japan, Turkey, Italy, West Germany, Austria, France, and Spain have begun to ask themselves if they can make money in Libya. In the tough world of international commerce, that could inflict greater damage on Libya than moral outrage over terrorism.

Even before the embargo, the recent experience of European companies in Libya was nightmarish. With the drop in

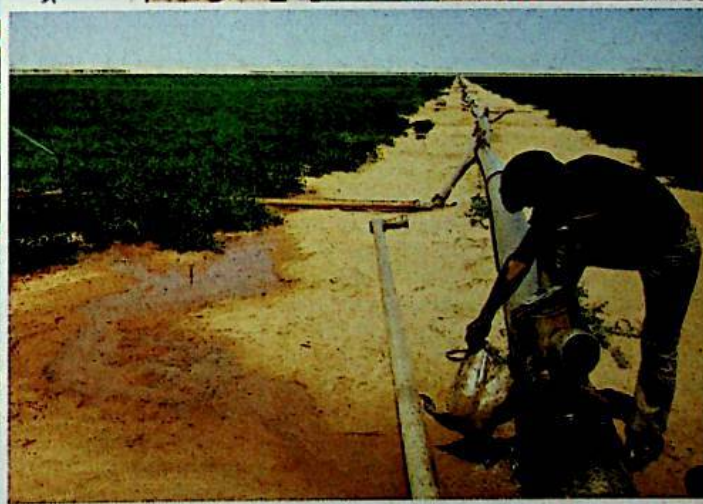
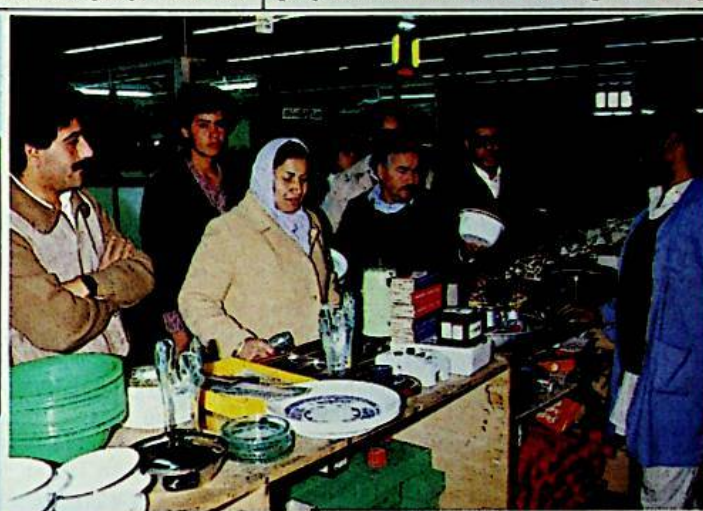
energy prices, all oil-producing nations have had to cut back, but Libya's austerity program has been among the most brutal. Overnight, government importing agencies simply stopped paying their bills, as Libya's central bank held up foreign currency transfers for most non-essential imports. Italian companies, for example, are owed more than \$700 million. In Rome, a construction company spokesman says there is "not much to do in Libya now."

German companies such as Hoechst, the chemical giant, and Mannesmann, a steel pipe and industrial plant supplier, also have had sizable drop-offs in business with Libya. In Bonn, there is concern about German exposure in Libya. The government has guaranteed \$4.4 billion worth of exports to Libya by German companies, many of which are now suffering excruciating delays in getting paid. "It's as if from one day to the next there was no more money," says a manager of one German company, who has

been waiting at Tripoli's official hotel, the El-Kebir, often rubbing shoulders with Palestinian commandos. He is seeking payment for a completed \$46 million contract but says ruefully: "I doubt we'll ever see the money."

RESCUE EFFORT. The Europeans aren't the only ones having trouble. A week after Reagan imposed U.S. sanctions, South Korean businessman Choi Won-Suk, the chairman of Dong Ah Construction Industrial Co., arrived in Libya in a panicked attempt to save one of the company's most important deals. Korea is one of the countries most deeply involved in Libya—and one of the most exposed.

Indeed, five Korean construction companies, including Dong Ah, have projects worth about \$11 billion that employ 21,000 Korean workers. Dong Ah is lead contractor on Qaddafi's grandiose \$25 billion "Great Man-Made River Project," currently the largest single construction project in the world. It is designed to tap



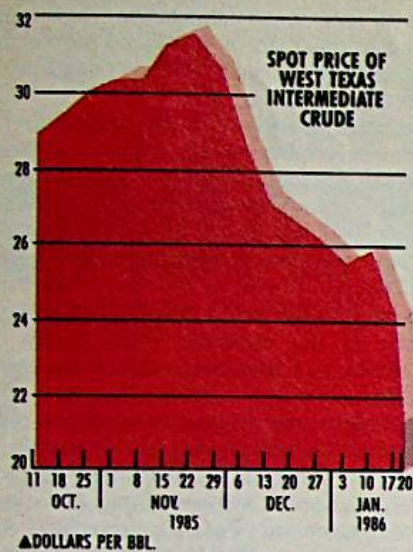
LIBYA TODAY (CLOCKWISE FROM LEFT): MARCHERS SHOW SUPPORT FOR QADAFI'S REVOLUTION; IN A TRIPOLI "SUPERMARKET," CONSUMERS FIND A DEARTH OF MODERN CONSUMER PRODUCTS; FOREIGN IRRIGATION PROJECTS HAVE TRANSFORMED DESERTS INTO PASTURES—BUT ARE ENDANGERED BY THE MONEY CRUNCH

ARAB / SIPA / SPECIAL FEATURES

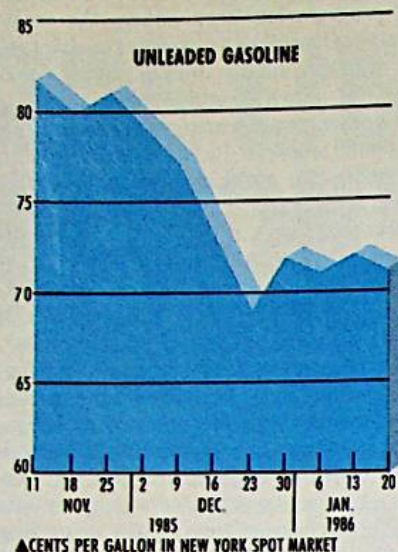
TOP: TURNLEY; WOODFIN CAMP; BELOW: ABBAS / SIPA / SPECIAL FEATURE

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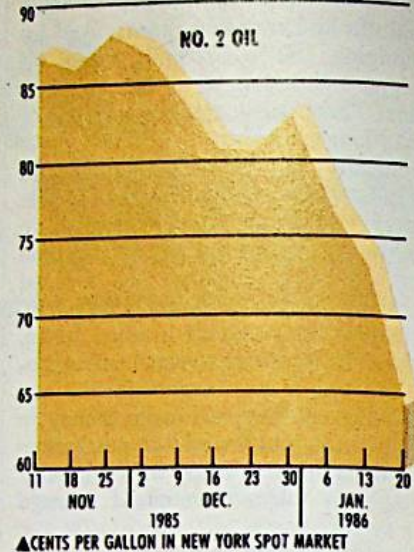
AS CRUDE-OIL PRICES WEAKEN...



...THE IMPACT SPREADS TO THE GASOLINE PUMP...



...AND TO HOUSEHOLD OIL TANKS



water under the Sahara for a country-wide irrigation system.

Although Dong Ah has the \$3.3 billion first-phase contract, the project also depends on two U.S. companies: Houston-based Brown & Root Inc., which designed the project, and Dayton-based Price Bros., which is supplying pipemaking technology. Korean industry sources say the company is concerned about the imminent withdrawal of 20 Brown & Root engineers. As a driving force behind the project, they will be difficult to replace. "We can't just stop midstream and go to another company," concedes one Libyan hydrogeologist involved in the project.

Another blow came when the project's Libyan manager in Benghazi fled across the border into Egypt, having diverted \$2 million into private bank accounts in Europe. Dong Ah is working as hard as it can to complete the project before it is stalled or halted.

Another Asian company deeply involved in Libya is Kobe Steel Ltd. of Japan. Kobe is the general contractor on an \$866 million steel-wire facility—the largest project the company has ever handled. Kobe wants the factory to be completed at all costs. That is one reason Tokyo isn't likely to support Reagan's sanctions. Overall, Japan sold \$410 million worth of products to Libya in 1984, including \$111 million worth of automobiles.

GETTING BURNED. There's an element of blackmail in Qaddafi's dealings with companies of many different nations. Spanish executives trying to collect \$55 million that Libya owes them for construction projects say Libya promises to pay—but only if Spain purchases more

crude oil. Even giants such as Austria's Voest-Alpine, which is involved in a variety of big projects, are being pressured to accept barter arrangements for payment. And Libya promised to use oil to pay Turkish contractors but still owes at least \$100 million. Declares one Western diplomat: "The Turks have been burned."

Of course, some business is still getting done. Reinhard Zeitlhuber, a young sales manager for Johann Pruttscher, a Vienna-based laboratory equipment manufacturer, is still winning contracts from Al-Fatah University in Tripoli. But he is working harder for them than he did in the past: Zeitlhuber spends three weeks at a time in Libya, living out of a suitcase at an Italian work camp. "You

Falling oil prices hurt Libya—but massive mismanagement has compounded its plight

get a job done," he says, "and then you have to wait for months to get the money. It's incredibly difficult."

Even without the payment problems, doing business with a revolutionary government, where officials quickly rise and fall and no clear lines of authority are apparent, is daunting. "People's Committees," a kind of revolutionary neighborhood association, are gaining authority over day-to-day business decisions. That means "you just don't know who you're dealing with anymore," as one Tripoli-

based manager puts it. The heads of Libya's 50 nationalized companies regularly change, and even minor decisions are often postponed until Qaddafi can review them.

Swift changes in regulations can prove damaging. The airlines that fly into Libya have been particularly affected. Last year the central bank banned all transfer payments out of Libya by foreign carriers, blocking \$120 million, until the International Air Transport Assn. forced it to release the funds—at a discounted rate.

HANDING OUT BRIBES. And in August people's committees pushed through restrictions forbidding the airlines to carry Libyan nationals. UTA, a private French carrier, has seen its monthly business plummet from \$1.2 million last summer to a mere \$54,000 in December. Says UTA Tripoli manager Jacques Vergé: "We are in a disastrous situation."

Handing out "commissions," or, in plain English, bribes, to government officials—a standard practice in the Middle East—has also become much more treacherous in Libya. Most middle-level corruption was stopped after a recent crackdown that included televised executions. One European manager was appalled to see, on television, a Libyan colleague who worked for a company there taken before a firing squad and executed last summer.

But the rules do not apply to high government officials, many of whom have family links to Qaddafi. Commissions of 5% to 10% of a contract's value are the norm. But it is a subtle game. "While we Belgians are shy about this sort of thing," claims one executive from Brussels, "the Italians march right in

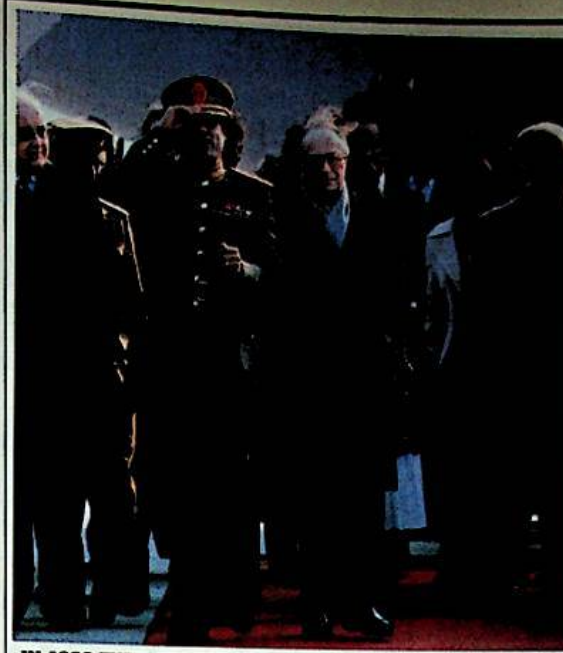
and say, 'How much?'" That tactic doesn't always work. One non-American company allegedly tried to bribe the wrong official to win a contract, and 12 of its executives were promptly thrown into jail.

If Libya is not paying its bills and the business environment is deteriorating, why is Reagan unable to persuade other nations to join his economic blockade? Some countries, particularly Italy, have grown to depend on their links with Libya. The state-owned Libyan Arab Foreign Investment Co. holds a 14% stake in Italy's Fiat. The giant auto maker sells about \$108 million worth of vehicles to Libya each year and has a small stake in a Libyan bus and truck company. And Libyan interests have just completed the \$140 million takeover of Italy's Tamoil, formerly Amoco Italia, which runs about 850 service stations.

Their own vulnerability to Qaddafi's whims aside, most non-Americans do not agree with Washington that international commerce is the proper forum for moral causes. Others do not believe that a connection between Qaddafi and terrorism has been proved. Few Austrians, for example, criticize former Chancellor Bruno Kreisky decision to roll out the red carpet for Qaddafi in 1982—even

though on last Dec. 27, terrorists believed to be supported by Libya attacked innocent holiday travelers at the airport in Vienna.

Non-Americans also have grown cynical about embargoes because they are fiendishly difficult to coordinate and history demonstrates that they rarely work. Britain used sanctions in 1965, hoping to isolate the breakaway colony



IN 1982 THEN-CHANCELLOR KREISKY WELCOMED QADDAFI TO VIENNA. LAST YEAR TERRORISTS HIT THE AIRPORT

of Rhodesia, now Zimbabwe. But with the active connivance of international companies, Rhodesia found it relatively easy to circumvent the boycott. American sanctions against the Soviet Union, Poland, Nicaragua, and Iran also have proved equally futile.

WOEFUL LACK. Another stumbling block for the Reagan Administration is that its sanctions have not achieved a sudden, dramatic impact on U.S. companies. Although some of the estimated 1,500 U.S. citizens in the country plan to leave by the Feb. 1 deadline, the majority of U.S. companies are determined to stay. Dozens of engineering and service companies operate in Libya using offshore subsidiaries and non-American employees, which exempts them from Reagan's dictum. A handful of American oil companies in Libya, such as Occidental Petroleum,

could pull out, but even U.S. Commerce Secretary Malcolm Baldrige acknowledges the American sanctions will have only an "incremental" effect.

Seen in retrospect, the Jan. 7 speech in which Reagan imposed the sanctions was a classic case of "shoot now, ask questions later." The State, Treasury, and Commerce Depts. were caught unprepared to implement any economic

MAJOR COMPANIES DOING BUSINESS IN LIBYA

Country	Company	Activity	Value of operations
FRANCE	Schlumberger	Oil field services	\$75 million in contracts
	Usinor	Supplying pipeline equipment	\$65 million in contracts
ITALY	AGIP	Operates Bouri oil fields	More than \$2 billion invested
	Fiat	Vehicle sales	\$108 million per year
	Cogefar	Fuel storage facilities	\$30 million per year
	Belleli-Micoperi joint venture	Oil platforms	\$230 million contract
JAPAN	Kobe Steel	Steel wire plant	\$866 million contract
SOUTH KOREA	Dong Ah Construction Industrial	Lead contractor for 'Man-Made River'	\$3.3 billion contract
	Daewoo	Public facilities, utilities in Benghazi	\$337 million in contracts
SPAIN	ENAGAS	Buys oil, gas	\$100 million annually
	Constructores Internacionales	Housing construction	\$70 million contract
U.S.	Occidental Petroleum	Oil field interests	\$765 million in annual sales
	Price Bros.	Pipeline equipment	\$150 million contract
	Marathon Oil	Owns 16.3% of Oasis Oil Co.	\$500 million in annual sales
	Conoco	Owns 16.3% of Oasis Oil	\$500 million in annual sales
	Amerada Hess	Owns 8% of Oasis Oil	\$250 million in annual sales
	Kaiser Engineers	Engineering work on Zawara aluminum smelter	Project cost: \$800 million to \$1 billion
WEST GERMANY	Krupp	Leads consortium building steel plant	Project cost: \$500-\$600 million
	Siemens	Engineering equipment	\$100 million sales a year
	Bilfinger & Berger	Tripoli ring road, other projects	\$174 million in contracts

DATA: COMPANY REPORTS, BW ESTIMATES

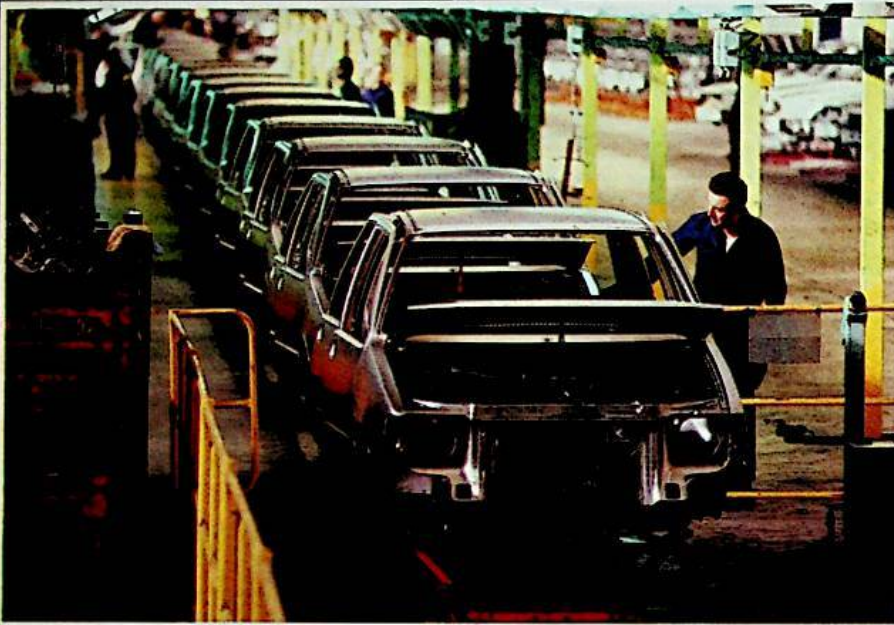
Cover Story

measures and suffered from a woeful lack of hard data on which companies were involved in Libya. In addition, there was no prior consultation with European allies, most of which dismissed Reagan's plea out of hand. The tour of European capitals by Deputy Secretary of State John C. Whitehead produced few tangible results.

Of course, the White House could turn up the heat on many non-American companies if it were willing to risk a repeat of the furor that accompanied U.S. sanctions against the Soviet pipeline four

Libya's oil income plummeting, Qaddafi will find it nearly impossible to shift gears and start spending in the hope of making friends. Already, say Libyan officials, the General People's Committee, the rough equivalent of a Cabinet, is preparing a tighter-than-ever budget to be presented when it meets late next month.

The fading fortunes of Libya and other Middle East oil producers must be a particularly bitter pill for Qaddafi. It was the emergent Libyan leader, after all, who in 1970 began shrewdly playing in-



FINANCIAL TIES: LIBYA'S EUROPEAN HOLDINGS INCLUDE A 14% STAKE IN ITALY'S FIAT

years ago. One company that would be particularly exposed is Fiat, which is a contractor for NATO military projects and which is seeking research contracts from Reagan's Strategic Defense Initiative. In addition, Fiat has teamed up with United Technologies Corp.'s Sikorsky Aircraft in an attempt to purchase a 29.9% interest in Westland PLC, an ailing British helicopter maker.

HARDBALL TACTICS. But the Administration could cite the company's Libyan connections as an excuse for excluding it from Western military contracts and joint ventures. Further, the presence of two Libyan directors on Fiat's board could be portrayed as a security risk. Fiat, obviously concerned about the possibility of such pressure, says the Libyan involvement "is only financial with no decision-making power." Dozens of other international companies could be subjected to similar hardball tactics. But at least for now, the Reagan Administration clearly wants to avoid any disputes like those that surrounded the pipeline sanctions.

Reagan's best ally, it turns out, may ultimately be plunging oil prices. With

dependent oil companies such as Occidental against the Exxons and Mobils. This tactic led to OPEC's dramatic success in quadrupling oil prices in 1973-74, starting the oil cartel's incredible rush toward wealth.

That wealth attracted a flood of workers and technicians from all over the world. In Libya alone, there are an estimated 30,000 workers from Western nations, 50,000 from Soviet-bloc countries, 21,000 Koreans, and hundreds of thousands of other Third World nationals toiling together in a modern-day Tower of Babel. They have turned deserts into green pastures, built factories in a country that lacked industry, and erected housing for Libyans accustomed to living in hovels.

Despite the arrival of thousands of Soviet-bloc workers, Libya's economic rot will go on

Now, in one of history's watersheds, that oil power is collapsing. For almost a decade and a half, the West kowtowed to OPEC's financial might. But the power is shifting to the consuming nations. And Qaddafi is finding that the petroleum industry's global realities are a more formidable enemy than Reagan's sanctions.

Where will Qaddafi turn? Thousands of arriving Soviet-bloc personnel will be able to take up some of the economic slack. Signs of that presence are mounting (box). As the cool Mediterranean breezes roll in and sweeten the air of Tripoli, schoolgirls walk slowly along the quay within sight of the black conning tower of a Soviet-built submarine.

And the biggest excitement in the small downtown area built by the Italians earlier in the century is the line outside a store operated by the government. There the crowds are waiting to purchase, at \$35 a shot, the big consumer item of the week: a Polish-made steam iron.

The price Qaddafi will pay is that his country will fall ever deeper into Moscow's embrace. And the Soviet-bloc workers probably won't be able to revive Qaddafi's biggest projects nor keep his economy operating at full tilt, any more than they have been able to do so in Vietnam or Cuba. Libya's economic rot will continue.

JUNGLE INSTINCT. Can Qaddafi survive? The Libyan leader has a jungle animal's instinct: In today's Libya, everyone and everything is watched by the secret police. "He has trained a part of the population to be fanatical, and he has a small team that is devoted to him," says one Western executive who knows Qaddafi. "But he has foreign guards following his guards, because he can't trust the Libyans."

Because of at least six serious coup attempts, Qaddafi travels inside Libya only in armored vehicles. Recent pictures of him driving a tractor were carefully planned publicity shots tailored for television news shows.

In the past, when the colonel wanted safety and friendship, he visited with members of his tribe, the Qadafodam, a small clan that hails from the coast near Benghazi, Libya's second city. But in November, Army officer Hassan Eshqal, a tribe member and distant cousin, was executed for plotting a coup against Libya's leader. Even his home is no longer safe for Muammer Qaddafi.

By John Rossant in Tripoli, with William J. Holstein in New York, Boyd France and Barbara Starr in Washington, Lazmi Nakarmi in Seoul, Frederic A. Miller in Bonn, Sarah Miller in London, Ellen Lask in Rome, and bureau reports

FURTHER AND FURTHER INTO MOSCOW'S EMBRACE

Dr. Joseph Nowak is a menace to the West. He doesn't look threatening, strolling down Tripoli's main drag, but the sandy-haired, mild-mannered internist from Prague is part of a team of Czech doctors at a hospital near Tripoli. That makes him part of the growing Soviet-bloc presence in Libya, which is rapidly becoming Moscow's most strategically placed Arab ally. Some 50,000 East-bloc citizens far outnumber the shrinking Western colony. "The whole Libyan economic pie is getting smaller," worries a West German diplomat, "but the Soviet slice is getting a lot bigger."

That spells a major strategic dilemma for Washington. As President Reagan seeks to cut off Libya economically and isolate it diplomatically, he risks pushing Colonel Muammer Qaddafi deeper into Moscow's embrace. Israeli defense sources say Soviet planes already operate from bases inside Libya. And now Qaddafi is trying to play on European fears that stern U.S. measures will only push him further East.

Libya is already virtually a full member of the Warsaw Pact. At least 8,000 Soviet military advisers are in the country, and they are present at every major Libyan military site, from what was once Wheelus Air Force Base, a huge U.S.-built installation just outside Tripoli, to the Hun military base, which the Soviets carved out of the desert two years ago. Soviet ships pass information to Qaddafi about the movements of U.S. and Israeli planes and ships.

IMAGE CONSULTANT. Qaddafi's \$5 billion in annual military purchases are made almost exclusively behind the Iron Curtain. Last month alone, almost 2,000 Russians arrived in Libya to install and man batteries of sophisticated SAM-5 missiles that Qaddafi recently bought from Moscow. Several thousand East Germans train Libyan security services, and a full-time East German "image consultant" stage-manages all of Qaddafi's public appearances.

The Soviets hope they can create in Libya what they have lost in countries that expelled Russian advisers, such as Egypt and Somalia. Just across the Mediterranean from NATO's southern



WOMEN RECRUITS TRAINING WITH SOVIET-MADE WEAPONS

flank, Libya is well-positioned. And it already has fallen more deeply into a web of Soviet dependency than Syria. "The West has been very blind to the threat posed by Qaddafi," says one Western defense executive. "Now there is a [Soviet] base in Central North Africa. It already is causing a lot of problems, and it will cause more in the years to come."

The growing Soviet influence is economic as well as strategic. For the first time, East-bloc companies are getting work in Libya's civilian sector. "The competition these days is definitely coming from Poland and Bulgaria," says the manager of an Italian construction company that was outbid by Polish contractors on a road contract near Benghazi. East-bloc wages are so low that female dependents among Libya's 12,000 Bulgarians and 18,000 Romanians do housekeeping for Western managers based in Tripoli.

What's more, Libya's economy is organized more and more along Soviet lines. Some 50 state-owned companies control all business activity. Not sur-

prisingly, they are turning more to similar East-bloc government-run companies that, unlike their Western counterparts, can easily accept the kinds of barter deals that cash-poor Libya is increasingly using. Already, 1 out of every 2 bbl. of Libya's oil is bartered.

The one area where Western companies still dominate is the oil sector—but even that may change. Reagan's sanctions could eventually make it too difficult for American oil-field service companies, such as Baker International Corp. and Pool Co., to stay. Even if some U.S. companies manage to hang on, many of the 1,500 U.S. citizens will leave. Virtually all 100 U.S. employees of the government's Sirte Oil Co., for example, will be leaving by Feb. 1.

THORNY ALLY. If American expertise vanishes, Tripoli will increasingly rely on East-bloc technology. Oil rigs built and manned by the Soviets are already operating at one former British Petroleum Co. concession south of Benghazi, and Bulgarian and Romanian geological survey teams are working in the vast Libyan desert. Says Mansur Benniran, chair-

man of Sirte and a 1970 University of Wyoming graduate: "We are really happy with Soviet drilling rigs."

Qaddafi, though, can occasionally be a thorn in the Soviet side. His October trip to Moscow, say Libyan sources, was marred by bickering over Mideast policy: The Soviets are thought to be displeased with Qaddafi's unpredictability at a time when they are trying to present a more responsible, peaceful image in the West. Says one well-placed source in Tripoli: "Moscow has to find a way to calm Qaddafi down."

The Soviet strategy in countries such as Afghanistan has been to build up an economic and military presence, gradually assuming greater influence over the domestic affairs of the host nation. As the case of Afghanistan illustrates, if the current leaders prove too difficult, the Soviets show little reluctance to depose them. Instead of fearing Western "imperialist aggressors," Qaddafi could one day find himself worrying about his socialist "comrades."

By John Rossant in Tripoli, with Neal Sandler in Jerusalem