Hope at last

A 14-PAGE SPECIAL REPORT ON REBALANCING THE AMERICAN ECONOMY
Hope at last
The world's biggest economy has begun a much-needed transition. Barack Obama could do more to help: leader

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Russian security services said that two female suicide-bombers blew themselves up on Moscow’s metro system, killing 39 people. There was no claim of responsibility, but blame immediately fell on Islamic insurgents from Russia’s north Caucasus region. Vladimir Putin, Russia’s prime minister, vowed to drag the bombers “from the bottom of the sewers”. Two days later, two explosions killed around a dozen people in the north Caucasus region of Dagestan. See article

The presidents of Russia and America confirmed an agreement to cut their respective nuclear arsenals by about a third. The deal was received more warmly in Washington than in Moscow; Sergei Lavrov, Russia’s foreign minister, emphasised that Russia could withdraw from the arrangement if America pursues plans for a missile-defence shield. See article

The Serbian parliament formally apologised for the 1995 Srebrenica massacre in which almost 8,000 Bosnian Muslims were killed. It declined to describe the killings as genocide. Meanwhile, John Sheehan, a former supreme allied commander of NATO, said his recent statement blaming the presence of openly gay UN peacekeepers for making the massacre possible, was wrong. See article

The conservative coalition led by Silvio Berlusconi outperformed expectations in Italy’s regional elections, winning four of the 13 regions at stake from the left-wing opposition. The Northern League, Mr Berlusconi’s coalition partner, did particularly well. See article

Pope Benedict XVI remained resolute as criticism mounted of the role he played, when a cardinal, in the child-abuse scandals engulfing the Catholic church. In his Palm Sunday sermon, the pope said his faith helped him avoid being intimidated by “the petty gossip of dominant opinion”. See article

The Large Hadron Collider, Europe’s newly repaired particle accelerator, officially overtook America’s Tevatron as the world’s most powerful. It collided two streams of protons at an energy of 7 tera electron volts, three-and-a-half times the previous record. See article

Done and dusted

Barack Obama signed a “reconciliation” bill that fixes some measures in the recently passed health-care act. The reconciliation bill was part of the Democratic leadership’s parliamentary manoeuvre to avoid a filibuster in the Senate. Meanwhile, the two parties cranked up the rancour over health care, with each accusing the other of exploiting voter anger on the issue. See article
In a busy week for a reinvigorated Mr Obama, the president prepared a plan that would allow new drilling for oil and gas off America’s east coast, from Delaware to Florida, in waters off northern Alaska and other offshore areas, in some places for the first time. Environmentalists were not pleased.

Rallying the troops

Barack Obama flew unannounced to Afghanistan where, besides visiting American troops, he held a meeting with his Afghan counterpart, Hamid Karzai. American officials said he told Mr Karzai his government had to do more to root out corruption. See article

The National League for Democracy, Myanmar’s main opposition party, which won an election in 1990, announced it would not register to take part in an election to be held later this year because it refuses to recognise the constitution under which the ballot will be held. Many of its leaders, including Aung San Suu Kyi, who is under house arrest, are anyway barred from contesting the poll. See article

More than 40 sailors were missing, and 58 rescued, when a South Korean navy ship sank off North Korea after an explosion. A diver died searching the wreckage. The defence minister said the explosion might have been caused by a mine laid by North Korea during the Korean war, from 1950-53.

After two weeks of mass anti-government demonstrations in Bangkok by red-shirted supporters of Thaksin Shinawatra, an exiled former prime minister, protest leaders held televised talks with Abhisit Vejjajiva, the present prime minister (above). But Mr Abhisit rejected their demand for an immediate dissolution of Thailand’s parliament and talks broke down with no agreement. See article

Narendra Modi, chief minister of the Indian state of Gujarat, was questioned for several hours by a panel investigating the riots in his state in 2002, in which more than 1,000 people, mostly Muslims, were killed. Mr Modi denies charges that he and his government connived in the pogrom.

The people have spoken

The final results of Iraq’s general election gave the Iraqi National Movement led by Iyad Allawi, a former prime minister and secular-minded Shia with Sunni support, 91 seats out of the parliament’s 325, pipping the incumbent prime minister, Nuri al-Maliki, whose State of Law alliance got 89. A Shia religious front, including followers of Muqtada al-Sadr, got 70. The two main Kurdish parties together got 43. Various coalition combinations are being mooted. A new government may take months to emerge.

Israeli politicians argued over the fallout from Binyamin Netanyahu’s recent unfriendly encounter in Washington with Barack Obama. The American president’s advisers were said to be hoping that a new ruling coalition might emerge in Israel, with or without Mr Netanyahu as prime minister.
The head of the Catholic church in Venezuela accused President Hugo Chávez’s government of using judges and prosecutors to punish political opponents, after Guillermo Zuloaga, the majority shareholder in Globovisión, the last remaining anti-government television channel, was charged with making “offensive” comments about the president. Two opposition politicians have also recently been arrested.

Colombia’s FARC guerrillas released two soldiers they had been holding hostage. One of them, who was captured as a teenager, had been held in captivity for 12 years.

The first oil-well drilled in the sea off the Falkland Islands for more than a decade appears not to have found commercial quantities of oil, according to Desire Petroleum, a British company that last month brought a drilling rig to the islands. The presence of the rig prompted Argentina, which claims the British territory, to place restrictions on shipping. More wells are to be drilled.
A court in Shanghai handed down stiff jail sentences to four employees of Rio Tinto who had admitted taking bribes from private steel mills seeking to secure supplies of iron ore. Stern Hu, the mining company’s head salesman in China, was given a ten-year sentence and fined 1m yuan ($146,000). The mining company, which originally said there was no evidence of wrongdoing, dismissed the four after the verdict, citing “clear evidence” they had accepted bribes. Parts of the trial relating to “commercial secrets” were held in camera. See article

Getting rid of benchmarks

BHP Billiton said it had reached agreement with most of its customers to sell iron ore on a shorter-term basis, the clearest indication yet of an end to the 40-year-old system of mining companies and steelmakers negotiating prices in annual contracts. But China prefers the old system, which is less market-oriented and keeps costs down for its firms.

The profits of China’s big industrial companies were 120% higher in January and February than in the first two months of 2009. China’s statistics bureau advised that profits had “merely” returned to the level that prevailed before the start of the financial crisis, and that some sectors, notably steel and oil exploration, had yet to rebound.

After months of negotiations, Ford agreed to sell Volvo to Geely, a privately held Chinese company, which is paying $1.8 billion for the Swedish brand. The purchase is the biggest foreign acquisition yet by a Chinese carmaker. See article

A deal was finally struck to acquire AXA Asia Pacific. National Australia Bank will pay A$13.3 billion ($12.2 billion) for the insurer’s assets and sell the non-Australian business back to AXA, its French parent. Last November AXA made a similar bid in partnership with AMP, an Australian wealth manager, but AXA’s Asian subsidiary rejected the offer.

What goes up can come down

America’s Treasury department announced plans to sell the 7.7 billion shares it holds in Citigroup before the end of the year, at market prices and in an “orderly and measured fashion”. The Treasury acquired the shares in 2009 as part of a bail-out of Citi. It had wanted to sell the stock at the end of last year, but the bank’s share price fell by enough to cause it to worry that taxpayers might not make a profit.

Royal Bank of Scotland was fined £28.6m ($43m) after it confessed to fixing the price of some loans to professional firms, such as solicitors and property agents, in collusion with Barclays between October 2007 and early 2008. Barclays escaped a penalty because it blew the whistle to the Office of Fair Trading.

Greece returned to the bond market, just days after the European Union said it would come to its aid with IMF backing if needed, though its €5 billion ($6.7 billion) seven-year bond attracted less interest from investors than two previous offerings. The Greek government’s borrowing costs also remained high; it is paying a coupon of 5.9% on the bond, twice what Germany pays for similar borrowing. See article

The share prices of Irish banks wilted as the government unveiled tougher capital requirements that are expected to lead to more nationalisations. The government also gave details about its new “bad bank”, which will take over many toxic loans given primarily to property developers. See article
AT&T said it would book a $1 billion charge because of adjustments to subsidies for drug benefits contained in the recently signed health-care act. Other companies have also announced (much smaller) charges for the measure, which does not come into effect until 2013. The government insists that the measure simply closes a tax loophole.

**Hotter than Easter eggs**

Analysts prepared to crunch the numbers from the first sales of Apple’s iPad, which goes on sale in American shops on April 3rd. Techies were queuing up to test applications and graphics on its 9.7-inch (25cm) screen. And publishers were nervously waiting to see what demand would be like for downloadable titles at Apple’s new online bookstore.

Britain’s Press Complaints Commission censured a blog for the first time. In his blog at the Spectator, Rod Liddle, a journalist, had claimed that the “overwhelming majority” of violent crimes in London were carried out by young black men, to which a reader objected. The PCC said it “expects the same standards in newspaper and magazine blogs” that it would find in print and that facts must be substantiated.

After axing NASA’s planned mission to the moon, the federal government found some work for the space agency’s engineers by asking them to conduct tests into the recent glitches found in Toyota’s cars.
America’s economy

Hope at last
Mar 31st 2010
From The Economist print edition

The world’s biggest economy has begun a much-needed transition. Barack Obama could do more to help

GREAT storms and floods have a way of altering landscapes. Once the waters recede, some of the changes are obvious: uprooted trees, damaged property, wrecked roads. Later come further changes, as people seek to avoid a repeat, erecting new flood walls or rebuilding elsewhere.

As in the physical world, so in the economic one. The financial deluge that broke over America has passed and the recession it caused, the worst since the 1930s, is ebbing. This year the American economy is expected to grow by around 3%, after shrinking by 2.4% in 2009. Rainbow-spotters hope that employment is at last beginning to grow again. And the economy emerging from recession is not the same as the one that went in. There is obvious damage: high unemployment, millions of foreclosed homes and a huge hole in the public finances. Less obviously, a “rebalancing” is under way: from consumption, housing and debt to exports, investment and saving. As our special report this week argues, this is enormously promising for America and the world; but it is far from assured. A lot depends on politicians—and not just the ones in Washington.

America has relied for decades on its consumers’ willingness to spend, borne up by borrowing and the false comfort of bubbles in asset prices. Now Americans are saving more and borrowing less because the collapse in home prices has eviscerated their wealth. Bankers and regulators who once celebrated the democratisation of credit now ration it. Businesses from General Electric to Citigroup that prospered from the consumption culture are rethinking—and often shrinking—their loan books. Property developers are building smaller, simpler houses. The country’s geography is changing. Recession has slowed the rush to sun and sprawl. People are moving out of Florida and into North Dakota. Foreclosures and costlier commutes have laid low the distant suburbs, or exurbs.

Dearer, scarcer credit is not the only reason. Energy, though not as frighteningly expensive as in 2008, is also no longer cheap. Americans are choosing cars over light trucks, utilities are being told to use more renewable fuel, and domestic deposits of oil and gas locked deep beneath the sea or in dense rock are...
suddenly profitable to extract. If these trends continue (admittedly, a big if), America could import barely half as much oil in 2025 as seemed likely just five years ago.

**United States of exports**

With consumers forced to live within their means, American firms will have to sell more to the rest of the world. That may seem a tall order, but with a competitive dollar and favourable growth in other countries, exports in which America already excels, such as high-value manufacturing and services, should do well. The result will be a more balanced American economy and, by extension, a healthier global economy.

Or so it should be. But the smoothness of this transition cannot be taken for granted. Policy decisions both inside and outside America will determine whether this rebalancing is painful or easy. Put crudely, if Americans save more and spend less while other big countries do the opposite, the world economy will prosper. If Americans become thriftier while foreigners fail to spend more, it will stagnate.

The world’s surplus economies have been propelled by American consumers’ appetite for everything from cars and electronics to furniture and clothing. If the United States is going to save and export more, countries in emerging Asia will have to rely more on their own shoppers and on each other. That means changing a mindset that equates economic health with bulging trade surpluses, and also ushering in a plethora of microeconomic reforms to boost Asian workers’ incomes and encourage consumption. It is now in everybody’s interest to push China to overhaul its health care, pensions and corporate governance.

And, yes, a stronger yuan would also speed up global rebalancing. Yet it is also dangerous for America to make a fetish of China’s currency (see article). Slapping bilateral tariffs on China, which some Democrats want to do to punish it for the low yuan, would hardly help rebalance anything: America would merely import stuff from elsewhere. And the cost in terms of beggar-thy-neighbour protectionism and diplomatic poison would be dire. Far better for Mr Obama to seek a multilateral solution while focusing on rebalancing at home.

**How to become thriftier without anybody minding**

From that perspective the macroeconomic imperative in Washington is clear: a credible medium-term plan to reduce the deficit. That would avoid premature and dangerous tightening while calming bond markets enough to hold down long-term interest rates. The combination of tight fiscal policy and low interest rates is usually a recipe for a weaker currency.

Plenty of microeconomic reforms could also help with rebalancing. America taxes income and investment too much and consumption too little. So far Mr Obama’s policies have mostly worsened the tilt. Health-care reform applies for the first time a payroll tax (for Medicare) to investment income. His administration has rejected a tax linked to the carbon content of fuel. It has also increased the subsidies, guarantees and preferences for mortgages that helped inflate the housing bubble. The federal government now stands behind 60% of residential mortgages and seems open to the idea of creating a permanently expanded backstop.

Rather than reinforce these biases, Mr Obama should remove them. Getting rid of the tax concessions for housing would help both control the deficit and speed up rebalancing. Housing assistance should be aimed at homeowners who cannot easily move to jobs in brighter parts of the country because their homes are worth less than their mortgages. By helping people reduce their mortgage debts, Mr Obama has taken a step in the right direction.

The world’s biggest economy has begun a long overdue rebalancing. American consumption and borrowing can no longer be the engine of either America’s economy or the world’s. That is the hope. The fear is that politicians everywhere are incapable of dealing with the consequences.
It is right to condemn the Moscow bombers, but also to look for new ideas for the north Caucasus

Sorrow and condemnation are the right responses to the deaths of innocent people at the hands of terrorists, whether in London and New York or in Madrid and Moscow. This week’s terrorist bombings on the Moscow metro killed at least 39 people and injured many more.

For all its problems, the Russian capital held together. There was no panic, medical help was swift and the work of the emergency services was better co-ordinated than in the past. Moscow, which has lived through a theatre siege in 2002 and several previous bombings, including two in the metro in 2004, has learned to cope (see article). Muscovites took the attack in their stride, and even the authorities responded more humanely. President Dmitry Medvedev observed a minute’s silence and he visited one of the bombed metro stations to lay flowers. In a country where leaders have a habit of disappearing from view at times of disaster, this counted for something.

There were a few ugly incidents, including several reported attacks on metro travellers who looked Muslim. And marauding taxi drivers took advantage of the chaos to raise their prices tenfold. Equally unpalatable were the attempts by some politicians to capitalise on the tragedy to advance their own pro- or anti-Kremlin agendas. It only adds to the offence that there is no room for a public debate about the causes and consequences of such attacks.

The Russian authorities are surely right to suspect that the two female perpetrators had links to Muslim terrorists from the north Caucasus. Despite two ferocious wars in Chechnya, despite the imposition of Ramzan Kadyrov as an autocrat in charge of the republic and despite Vladimir Putin’s earthy pledge “to rub out the terrorists in the shithouse”, violence across the region has not abated. Rather, it has spread from Chechnya to other republics, especially Ingushetia and Dagestan, which have lapsed into a state of near-civil-war. Bombings, shootings and kidnappings are common. Most go unsolved. Attacks by insurgents are no longer treated in Moscow or in the outside world as terrorist attacks on Russia.

Solving the Caucasus conundrum
Few parts of the world have as miserable a history as the north Caucasus (see article). Last September Mr Medvedev identified it as Russia’s biggest domestic problem. After this week’s attacks, he and Mr Putin pledged again to destroy the terrorists without wavering and to the end. Yet he surely knows that political repression and police and military action alone will not be enough to bring peace to the region—or to the rest of Russia.

There are two obvious transmitters of terrorism through the north Caucasus and into the Russian heartland. The first is the lawless and brutal behaviour of Russia’s security forces, which tends only to strengthen popular support for a small group of terrorists. The second is widespread corruption, which allows the terrorists not only to move with mystifying ease around Russia but also to secure a steady source of income. Corrupt officials steal money that Moscow sends to the region, as Mr Medvedev himself has conceded, and they buy off terrorist cells to leave them alone.

Yet to tackle these two faults would require broader reforms in Russia. And even a big change in policy might not stop terrorist attacks. Defusing mines that were created over decades will take time. The bombs on the Moscow metro were not the first and, sadly, are unlikely to be the last. Even so, it would be tragic if Russia’s leaders used them to justify further centralising power, more crackdowns on political freedom and greater powers for the state’s security forces. Far from making Russia safer, that would only make it more vulnerable.
South Korea’s industrial giants

The chaebol conundrum

Mar 31st 2010
From The Economist print edition

Korea Inc is back and booming. So it’s time to stop coddling the all-conquering chaebol

Perhaps it is the result of being sandwiched between the imperial dynasties of China and Japan. It may have something to do with having a nuclear-armed hermit to the north. Whatever the reason, South Koreans nurture a deep sense of insecurity. That makes them good capitalists. So good, in fact, that if any rich country can claim to have done well in the recent global crisis, it is theirs. Last year, despite its dependence on exports and the collapse of world trade, South Korea’s economy grew faster than any other in the OECD.

South Korea’s remarkable resilience is partly down to clever economic management. The government provided lashings of stimulus. But it was not just domestic demand that kept the economy going. The export prowess of those peculiar corporate beasts, called the chaebol (see article), was also responsible.

In the years after the Asian financial crisis of 1997-98, these unwieldy conglomerates, known disparagingly as Korea Inc, were regarded as villains, because of their habits of crony capitalism. Their shabby corporate governance and their dominance of the economy were widely criticised. Since then, bosses have been jailed, transparency increased and corporate governance improved.

Since the global economic crisis they have been regarded as saviours in South Korea. Though the country’s exports slid, its biggest companies, such as Samsung Electronics and Hyundai Motors, gobbled up market share from competitors in Japan, Europe and America. Granted, they benefited from a cheap won. But they also made a fine job of selling things like electronics, chips and ships in fast-growing emerging markets to make up for some of the sales lost in the West. Samsung’s profits this year are forecast at a record $10 billion, and its sales at $130 billion, which would confirm its lead over Hewlett-Packard as the world’s biggest technology company by revenue.

BlackBerry and Apple crumble

The national paranoia has served them well. Though Samsung, for example, is a world leader in
televisions and flash memory chips, it continues relentlessly to measure itself against its competitors. Having rebuilt their balance-sheets over the past decade, the chaebol have invested enough in technology, design and branding to remain far ahead of low-cost competitors in China and elsewhere. What’s more, they artfully avoided Japan’s trap of fetishising expensive, state-of-the-art technology for its own sake.

So the chaebol are certainly due an apology from those, including this newspaper, who thought they would be too unwieldy for modern business. But from South Korea’s point of view, they are a narrow base on which to build a country’s economic future. First, they face competition in new forms for which their hierarchical management structures and complicated, dynastic ownership are ill suited. Apple’s iPhone and the ubiquitous BlackBerry crept up on Samsung Electronics, exposing its shortcoming in smart-phones.

Second, the size and strength of the chaebol risk stifling entrepreneurialism elsewhere. By and large, their local suppliers are the only medium-sized South Korean companies to have thrived in recent years. Some young businesses such as internet search and gaming have done well, but these are in fields where the chaebol cannot yet be bothered to tread. If they ever do, they may smother rather than nurture independent talent.

President Lee Myung-bak still seems to be promoting the chaebol. He has just pardoned Lee Kun-hee, the boss of Samsung, who was convicted of tax evasion in 2008, enabling him to retake the reins of Samsung Electronics. The president has also successfully championed his chaebol chums in a contest to provide nuclear power to Abu Dhabi. And his government wants to relax holding-company laws that would make it easier for the conglomerates to own financial firms.

It is one thing to provide leadership. It is another to choose favourites and pick winners. If President Lee wants to promote anyone, it should be South Korea’s underdogs—the small companies that risk getting squashed by the country’s privileged monsters. The chaebol have proved themselves highly successful capitalists. Let them take care of themselves.
Britain’s European problem

David Cameron’s splendid isolation

Mar 31st 2010
From The Economist print edition

The extent to which Britain’s Tories and Europe’s leaders don’t understand each other is frightening

SOMETIMES politics can be like watching a car crash in slow motion. Take for instance Britain and the European Union. The imminent British election campaign will barely mention Europe, but it could well produce a Conservative government with the rare distinction of being both the most Eurosceptic in the EU’s history and the least loved in mainland Europe. The new prime minister, David Cameron, will then go to Brussels with a series of demands that his European peers—for good and bad reasons—will take great pleasure in rejecting. Britain’s already awkward relationship with Europe will hit a new low (see article). That so much of this is avoidable makes it even worse. Both the Tories and the current leaders of the EU need to start paying a little more attention to what each other is up to.

Begin with British Euroscepticism. At its best, it can set a good example. Think, for instance, of the impetuous way in which Greece, Portugal and Spain rushed unprepared into Europe’s single currency, the euro. Britain has a better record than most of applying the EU’s rules, whereas many others sign up for commitments that they then gaily flout. There are also understandable geographical and historical explanations for British ambivalence towards Europe. But there is something else, too: a suspicion of the entire European project that has sunk especially deeply into today’s Conservative Party.

This newspaper has no regrets about opposing both the draft EU constitution and the Lisbon treaty. It remains appalled about the way the reform was pushed through without a referendum in Britain. But given the choice between putting up with a mildly awful treaty (and the moderately ineffective politicians it has installed in Brussels) or getting out of the EU, we would far sooner stay in. By contrast 40% of Tory candidates favour either “fundamental” renegotiation of Britain’s membership or withdrawal. Add in an often xenophobic Tory press and Mr Cameron’s decision to desert the main centre-right European People’s Party (EPP) for a more extreme new group and it is not hard to see why many continental Europeans and some Britons worry that a Tory government would be a platoon of little Englanders. The German chancellor, Angela Merkel, is conspicuously skipping any meeting with Mr Cameron in London this week.

Accommodation needed
Mr Cameron’s public pronouncements on Europe rightly raise eyebrows. But there is no point in exaggerating the problem. When contemplating Tories, too many “sophisticated” European politicians abandon their usually acute pragmatism. To begin with, Europe has cost several Conservative leaders their jobs; that is not an incentive for Mr Cameron to make it a central part of Tory policy. And he has sensibly ditched any notion of holding a referendum on Lisbon, now it has been ratified. What he is seeking is opt-outs from swathes of social and employment policy and from chunks of justice and home-affairs legislation—something he may stand precious little chance of getting, but it would hardly be the end of the EU if he did.

In truth, both sides to this looming quarrel should do more to accommodate each other. On the European side, it would be a mistake to sit back and wait for a sea-change in Tory attitudes once the party is in power. Britain is not about to join the euro or the Schengen passport-free zone; nor is Mr Cameron about to take his party back into the EPP. Every club member has his eccentricities. Rather than working out how to skewer Mr Cameron, European leaders would do better thinking what they can offer him that might get him off the hook with his more rabid backbenchers. One example might be accepting that it would be wrong in principle to impose new financial regulations by a majority vote against the wishes of the country with the biggest financial-services industry in Europe.

Mr Cameron, however, is the one who has to do the most thinking. When it comes to negotiation, it would be hard to retreat from asking for those opt-outs, but he should not make too much of a failure to win. (There is precious little new social legislation in the pipeline, and Britain already has the right to opt out of most new judicial measures.) A reprieve for the City from the proposed financial rules would be a coup. He could also make much more of the areas where even the Tories consider that Europe can add value. These include a more coherent EU approach to foreign policy and greater co-operation in defence. The only two EU countries that count militarily are France and Britain: it makes obvious sense for them to work together, especially in procurement, as even the Eurosceptic shadow defence secretary, Liam Fox, understands.

Sooner or later, though, Mr Cameron has some home truths to tell his own backbenchers. These surely include the fact that on many issues Euroscepticism has won. After the damp squib of Lisbon, further big treaties look unlikely. Thanks to a changed intellectual climate, to enlargement that took in ten largely free-market countries from central and eastern Europe, and not least to Britain’s own influence, the EU has become both more liberal and keener on competition—not a million miles away from the club the Tories always wanted. If they would only look and learn, the Conservatives could find some strong allies in Brussels, not just implacable enemies.
The opposition’s boycott of planned elections is understandable and principled—but still regrettable

OFFERED a choice between political suicide and a crippled half-life as a legal party, Myanmar’s main opposition force this week, unlike Hamlet, reached for the bare bodkin. Heeding the reported advice of its detained figurehead, Aung San Suu Kyi, the National League for Democracy announced in effect its own termination by refusing to register for the elections the ruling junta has promised to stage later this year.

A boycott was the only option if the party was to remain true to its democratic ideals. But it was also, probably, a mistake.

There is no shortage of reasons to justify an electoral boycott. The constitution, drafted without the League’s input and under which the election will be held, was foisted on Myanmar through a farcical “referendum” in 2008. It entrenches the army’s role, guaranteeing it a quarter of parliamentary seats. Many others will be filled by “retired” army officers. Laws bar Miss Suu Kyi from office both as the widow of a foreigner, and, under a rule that also debars many of the League’s other leaders, as the holder of a criminal conviction. For Myanmar’s press, as stifled as any in the world, the opposition and its point of view might as well not exist.

In 1990, the previous time the generals had an election, the League won by a landslide. The junta prevented it taking power, but was mightily embarrassed. It seems determined not to make the same error twice. After 20 years of brutal harassment and persecution of the opposition in all its forms, there is absolutely no chance of a free and fair election. Its leaders, Miss Suu Kyi above all, are cut off from the news, advice and debate to make informed decisions. The “civilian” regime that emerges from the polls will probably be dominated by the very same thugs and incompetents who have made such a benighted mess of a fertile, resource-rich country.

So it is understandable that the League should decline to afford either the constitution or the election any credibility by taking part. And their decision will at least make it harder for the outside world to pretend that these elections open more than a tiny crack in the junta’s totalitarian façade. America and Europe were in any case always going to find it difficult to pretend, but Myanmar’s Asian neighbours might have. And they probably have more influence, which is not saying much.
A crumb is better than no bread

A tiny bit of influence, however, is better than none, which is also why the League should contest the election. Its activists tell foreign diplomats in Yangon that they can continue their struggle for democracy as an NGO. That seems unlikely, given the junta’s record of unmitigated repression. The alternative to registration may well be political extinction.

The League will also be excluded from the first set of significant changes in Myanmar’s government since the present bunch of generals took over, after the crushing of a popular uprising in 1988. Some observers believe change will be far-reaching. They point to the growth of a small but wealthy business class, the limited devolution promised to some of the border areas inhabited by rebellious ethnic minorities, and the generational shift under way in the army itself.

The “senior general”, Than Shwe, is 77 and, apparently worried about the comfort and security of his twilight years, is distributing power among a coalition of interest groups. The crack he has opened, some argue, will widen inexorably. The pluralist genie will be out of the bottle. Even this seems hopelessly wishful thinking. But, at least, some change is coming to Myanmar. Almost any, short of all-out civil war, would be better than none. And it would help if Miss Suu Kyi and her party had some role, however circumscribed, in shaping it.
On banks, Thailand, pornographic imagery, Jerusalem, Manchester, health care

Mar 31st 2010
From The Economist print edition

Letters

A manageable size

SIR – I read your leader on financial companies that are “too big to fail”, and your statement that “on the left, some want banks cut down to size” (“In praise of Doddery”, March 20th). Many on the left would be surprised, then, to find themselves thinking along the same lines as Adam Smith. In “The Wealth of Nations”, he called for free competition: “By dividing the whole circulation into a greater number of parts, the failure of any one company, an accident which, in the course of things, must sometimes happen, becomes of less consequence to the public. This competition, too, obliges all bankers to be more liberal in their dealings with their customers, lest their rivals should carry them away.”

Controlling size in any industry is neither left nor right, but appropriate. Too big to fail is too big to manage as well as too big to regulate, as recent events have demonstrated all too clearly.

Professor Michael Mainelli
Executive chairman
Z/Yen Group
London

Thailand and its monarchy

SIR – Struck by the interest The Economist has shown in Thailand’s monarchy, I am obliged to set certain facts straight (“As father fades, his children fight”, March 20th). The Thai monarchy is above politics. Portraying it as a partisan actor is simply wrong and misleading. While some groups may advocate their cause by claiming royal support or advancing the notion of the palace’s involvement in politics, The Economist should not fall into this trap, let alone perpetuate the same misperception. It is too simplistic to pigeonhole these groups, as both have supporters and detractors who do not fit neatly into the “rich versus poor” or “urban versus rural” divide.

Succession is a difficult issue for Thais, but this is not because of the lèse-majesté law. Having had such a father figure as monarch for so long has meant that change is unsettling and it is normal for people to be apprehensive. To express doubts about the heir apparent based on rumours and wild conjectures is not the way to initiate debate about the issue. Thailand’s monarchy has been continuously evolving for more than 700 years and will always remain one of the kingdom’s main institutions holding the country together.

Finally, the present administration did not assume office through a “parliamentary fix”. Abhisit Vejjajiva was voted in as prime minister in the same House of Representatives and through the same provisions under the constitution as were his two predecessors. As in other parliamentary democracies, it is not uncommon for coalition parties to switch their support as dictated by pragmatism, something you think is now lacking in Thailand.

Vimon Kidchob
Director-general
Department of Information Ministry of Foreign Affairs
Bangkok
SIR – I found your article about a plan to outlaw Japanese manga comics that draw children sexually to be disturbing, but perhaps not in quite the way you intended (“Outraged innocence”, March 20th). As a parent, I am as appalled as anyone at the idea of children being sexually exploited; it is logical to prosecute people who trade pornographic images of actual children as it is the users who create a market for the pictures of abuse. However, this does not mean it is right to limit the ability of people to view drawings of “non-existent minors”.

Making certain activities illegal to protect “public morals” in the absence of any actual victim is a slippery slope. If a government can prosecute those who draw imaginary children, how soon will it be before they begin the equally logical prosecution of the publishers and buyers of written novels that describe the abuse of children, such as, say, “Lolita”?

And what prevents the law from being expanded to ban descriptions of other illegal acts, such as drug abuse or terrorism, or even political agitation? Once created, this malleable ability to make illegal any discussion that is determined to be against the “public good” can be stretched infinitely.

Ken Harvey
Hong Kong

SIR – You described Ramat Shlomo as “a Jewish suburb in East (Palestinian) Jerusalem” and that some Jewish homes in the city were being built “albeit in territory internationally recognised as Palestinian” (“Where did all the love go?”, March 20th). No objective observer would define Ramat Shlomo as being in Palestinian Jerusalem. It is a neighbourhood in northern Jerusalem with 18,000 Jews, bordered by the predominantly Jewish area of Ramot and the Har Hotzvim industrial park.

More to the point, unlike the West Bank, eastern Jerusalem is not “internationally recognised” as anything. Under the 1947 partition, the land was supposed to become a UN protectorate, not part of Palestine. No subsequent UN resolution, much less a binding one, has transferred the land’s theoretical sovereignty to the Palestinian Authority. At most, the Palestinians inherited only Jordan’s title to the city, via Jordan’s 1988 decision to relinquish its claim. Though even on this, Jordan’s occupation of Jerusalem was never recognised, except by Britain.

Jacob Oslick
Great Neck, New York

SIR – When writing about “Manchester’s big ideas” (“More, please”, March 20th) you may have given the impression that it was me who claimed that too many of our businesses were somewhat insular—in the sense that our international trade links need developing further. Actually that issue was first identified by a study, the Manchester Independent Economic Review. As a mature and open city we got the message and are working hard to get more of our firms to be international world leaders, driving up our productivity.

I think Manchester is a place to watch. So did the MIER and now you do too.

Sir Richard Leese
Leader of the council
Manchester

* SIR – Your welcome article on the continuing rise of Manchester might have pointed to the innovative contribution of Michael Heseltine and a pioneering political partnership that was so instrumental in laying the foundations for the present. Creating an Urban Development Corporation, initially against the wishes of local politicians, Mr Heseltine worked effectively with a series of first-rate leaders, officers and Labour politicians, a combination which helped turn a national political tide of non-co-operation with the Tories into models for rebuilding cities and industrial areas after the global manufacturing changes of the 1980s.
The culmination of this partnership was his idea for a successful international competition to re-design the bombed out city centre following the IRA’s attack in 1996.

It is nice to recognise sometimes that the shoulders of giants are still worth acknowledging, and that, at a time when politicians are derided, their efforts can genuinely change lives and a region for the better.

Alistair Burt, MP
Deputy chairman of the Conservative Party with responsibility for development
London

Healthy debate

SIR – It is a great disappointment that The Economist painted the health-care debate as a battle to bring America into the club of civilised societies (“Pass the bill”, March 20th). For a long time you have advocated free-market principles and it is a shame that you abandoned them in the one area where they are so desperately needed. America’s health care is the best in the world, and we should be advancing ideas that will expand it to everyone, efficiently, through the free market. That only Democrats supported such a huge intrusion of government, and had to resort to parliamentary tactics hitherto reserved for arcane budgetary matters, speaks volumes about the merits of such monumental “social” legislation.

Paul Grimes
Chicago

SIR – Lexington (March 20th) said that when in opposition, Nancy Pelosi, the Democrats’ leader in the House of Representatives, tried “to demonise Republican proposals without offering an alternative”, such as objecting to George Bush’s proposal to partially privatise Social Security. Those of us who subsequently lost a large chunk of our private savings because of the unbridled deregulation of financial markets are grateful that Mr Bush was stopped from investing our pensions in collateralised-debt obligations and subprime mortgages.

David Wright
San Francisco

* SIR – It is not true that “the left’s fondest ambitions” became law in the health-care act. Those of us on the left who support the act because it is better than doing nothing loudly lament not only its omission of a public option, but more importantly the fact that it is not a single-payer, publicly financed, privately delivered, health-care plan. Such a plan would have curtailed lobbyists for the insurance industry, huge compensation packages for health-care chief executive, advertising, marketing and administrative costs.

Reverend Judy Deutsch
Sudbury, Massachusetts

SIR – Thank you for enlightening us about health care. Were it not for your cogent arguments I would never have realised that what America needs are increased taxes, a massive expansion of the federal government, less personal responsibility, more price-fixing and hundreds of billions of dollars added to the deficit to finance one of the biggest entitlement programmes in our history. Now I better understand why our forefathers risked their lives to separate themselves from Britain.

Cary Alberstone
Camarillo, California

* Letter appears online only
Britain and Europe

Not playing their games
Mar 31st 2010
From The Economist print edition

The awkward relationship between Britain and the rest of Europe may be about to get a lot worse

THIS newspaper recently conducted an unscientific survey of around two dozen Berliners who might be described as Germany’s elite. The various politicians, bureaucrats and businesspeople disagreed about many subjects. But on one thing they were firm. The election of a Conservative government in Britain would be a disaster. Their contempt for the Tories as “myopic, ignorant little Englanders” was matched only by their fear that David Cameron’s party was hellbent on destroying the European Union.

This emotion is common in Europe nowadays. It may be misplaced, but it is not without foundation. In Britain’s political spectrum the Liberal Democrats are the keenest Europeans, even wishing to join Europe’s single currency, the euro. Labour in power has had a more ambivalent attitude: Tony Blair in 1997 talked of putting Britain at the heart of Europe, but reluctantly stood aside from the euro in 1998, while Gordon Brown has tended to lecture Europeans for their supposedly faulty economic policies (quite unlike his own, of course). But the Tories are far more hostile. They opposed the Lisbon treaty and its previous incarnation, the EU constitution (as did this newspaper). And last year they pulled out of the main centre-right political group, the European People’s Party (EPP), because of its federalist ambitions.

In November 2009, when it became clear that Lisbon would be ratified before a British election, Mr Cameron set out a new policy on Europe (see article). Many of his proposals, his advisers promise, will have only domestic consequences; indeed, some will be similar to measures in, for example, Germany and Ireland. But the devil is in the details, and there is plenty of scope in these for explosive clashes with other EU countries.

Moreover, all the signs are that the new intake of backbench Tories will be bursting for a row over Europe. Back in the years of Margaret Thatcher and John Major, the Conservative Party was divided on the subject, but now it is largely united—in Euroscepticism. Almost the only divide is between those who dislike the EU but think it would be better to stay in, and those who would prefer to leave. According to a
survey last July by ConservativeHome, a website, over 40% of prospective Tory candidates favour either a “fundamental” renegotiation of Britain’s EU membership or outright withdrawal. The strength of backbench opinion makes a Tory bust-up with the EU a lot more likely.

The devil and the deep blue sea

Why is the Tory party so Eurosceptic? One answer is that it reflects public opinion. So the real question should be why so many of the British (and more specifically, the English) are so hostile to the European project. Eurobarometer polls consistently put Britain at or near the bottom of the heap in answers to such questions as whether EU membership is a good thing or how much trust people have in the EU institutions (see chart). The explanation for such views is to be found partly in the country’s geography and history, partly in its experience as a member and partly in ignorance and prejudice.

Geography and history do much to explain British reservations. “Our Island Story”, a popular children’s history book of a century ago, speaks volumes by its very title. Britons’ experience of the second world war as their “finest hour” contrasts starkly with that of almost all other Europeans. Churchill told de Gaulle in 1944 that, faced with a choice between the continent and le grand large (ie, the transatlantic relationship), the British would always choose the second. That remark played its part in de Gaulle’s veto almost 20 years later of Britain’s first membership application for what is now the EU.

History resonates still. It is clear from Michael Charlton’s “The Price of Victory” (1983) that British politicians and officials never had any intention of joining the nascent moves towards a European union in the 1950s. Mrs Thatcher (as she then was) spoke for many when, just over ten years after her 1988 speech in Bruges attacking a potential European superstate, she told a meeting of Scottish Tories that “in my lifetime all our problems have come from mainland Europe, and all the solutions have come from the English-speaking nations across the world.”

Hard experience has left scars, too. The biggest reason why British governments in the 1960s sought belatedly to join the then European Economic Community was their feeling that a dynamic Europe was outperforming Britain economically. Yet 1973, when Britain eventually got in, was coincidentally also the very year in which Europe lost its relative dynamism—and thus a lot of its attraction.

This was compounded by the emergence of what became known as the British budget problem. The European budget was (and is) relatively small, but it would have been hard to design it in a way more calculated to disadvantage Britain. Most of the spending went on farm subsidies under the common
agricultural policy (CAP); much of the revenue came from customs duties and farm-import levies. With a small farming industry and a lot of imports, Britain was bound to lose out. Indeed, from the moment of joining, Britain was on course to become the biggest net contributor to the budget despite being one of the club’s poorest members.

Even before Mrs Thatcher came to power in 1979, rows over the budget had become a theme of Britain’s presence in Brussels. She promptly spent five years wielding her handbag, before prising out of her colleagues a permanent budget rebate at the Fontainebleau summit in 1984. But Britain remained the biggest net budget contributor after Germany. Money matters. Strikingly, hostility to the European project has increased markedly in several other countries (Sweden, Austria and now even France) that have subsequently become big net contributors.

The long saga of sterling and Europe has also been unhelpful. No sooner had British entry been agreed in 1972 than sterling entered the “snake”, a forerunner of the exchange-rate mechanism, only to fall out ignominiously just six weeks later: an eerie foretaste of Britain’s later membership of, and expulsion from, the European Exchange-Rate Mechanism (ERM) in the early 1990s. Both experiences have left British governments of either party deeply suspicious of any EU currency schemes.

On top of budget and currency concerns has come near-perpetual institutional change. Almost since the Italian EEC presidency called an “inter-governmental conference” against Mrs Thatcher’s wishes in June 1985, part of the EU agenda has been about negotiating or ratifying new treaties. Mrs Thatcher came to believe that she had been tricked into accepting the Single European Act in 1987. Mr Major accepted the Maastricht treaty five years later only after securing opt-outs from the single currency and the social chapter.

The Amsterdam summit in 1997 introduced Mr Blair to the niceties of EU treaty-making, and was followed soon afterwards by the ghastly four-night negotiation of the Nice treaty in 2000. And then came the constitutional treaty, drawn up by a convention chaired by a former French president, Valéry Giscard d’Estaing; when this was rejected in referendums in France and the Netherlands, it mutated into the Lisbon treaty instead.

The average Eurosceptic in Britain has acquired an impression of constant rule changes that always increase the power of EU institutions. This reinforces their existing prejudices, such as the belief that what Britain joined in 1973, and what Britons voted yes to in 1975, was in essence a free-trade area that only later transmogrified into a putative political union. True, the British government did not exactly spell things out (its white paper in 1971 said there was no question of losing essential sovereignty), but the European project, with its promise of ever-closer union, always had an overtly political dimension.

Making things worse is a profound ignorance of what the EU does and how it works. The mistaken belief that the EU is responsible for as much as 80% of all legislation in Europe (it is no more than 50%), and a lack of understanding of the role of national governments, including Britain’s, in passing EU laws, have fostered the belief that an unaccountable and undemocratic machine in Brussels is somehow usurping the ancient role of Parliament. The media reinforce this belief, especially such Eurosceptic newspapers as the Sun and the Daily Mail (neither of which troubles to keep a staff correspondent in Brussels).

Ignorance of how the EU works is, of course, to be found right across the continent. But it is deeper in Britain. Charles Grant, director of the Centre for European Reform, a London-based think-tank, notes that Britain is unusual in that “people can get to the top in the media, business and the City without knowing anything at all about the European Union.” Such knowledge can, he suggests, even be a career obstacle. The contrast between Westminster and Whitehall is telling. Parliament is full of people who are proud to have little or no understanding of the EU. Civil servants, on the other hand, quickly discern that the EU impinges on many of their activities—and soon learn how it functions.

**When ignorance is not bliss**

This is the background that the Tories, if elected in May, will inherit. It is one that chimes with their deepest instincts. That might seem to make it easier for Mr Cameron to achieve his seemingly modest objectives in the EU, as other countries will not want to increase Eurosceptic sentiment in Britain by obdurately refusing to negotiate. Yet a strong Eurosceptic presence on the backbenches might also make life much more difficult for a Tory government with a small majority. In any case, it is always hard in a 27-member union to get your way without compromise—the more so since many EU countries are fed up with Britain and, especially, with the Tories.
Many senior Conservatives hope, probably vainly, for a more harmonious relationship. In his interview with *The Economist* this week, Mr Cameron again made clear that he was not anxious to engineer an early row with Europe (see article). William Hague, the shadow foreign secretary, concedes that “the EU has moved in a positive direction” and also promises that, given the long list of other problems that will face a new Conservative government, “we will not add to the list a huge confrontation with our EU partners.”

He also defends Mr Cameron’s decision to leave the EPP, saying that the group’s relationship with Britain’s Tories was never satisfactory. He even argues that, far from losing influence, the Tories may have gained some through committee chairmanships that have gone to the new European Conservatives and Reformists group, which links the Tories with various oddballs, mostly from eastern Europe.

Yet this is tendentious. The mistake over leaving the EPP was not that the Tories have had to switch their seating arrangements in the European Parliament (although the party has always underestimated the significance of that body in EU lawmaking). Nor was it that the Tories are now tarred by association with some apparent extremists, notably from Latvia.

The real problem is that a majority of EU heads of government, including Germany’s Angela Merkel and France’s Nicolas Sarkozy, as well as José Manuel Barroso, president of the European Commission, belong to the EPP. This group now holds regular meetings ahead of all EU summits. When it came to choosing a new president of the European Council last November, it was the EPP that pushed Belgium’s unknown prime minister, Herman Van Rompuy. Because of his walk-out from the EPP (which infuriated Mrs Merkel, in particular), Mr Cameron as prime minister would be excluded from such discussions.

His exclusion will also make it tougher for him to achieve his EU goals. Two things will make these especially tricky. One is that any general opt-outs from social policy or from the charter of fundamental rights would require treaty change. But after the long struggle to ratify Lisbon, most EU countries are allergic to any suggestion of a new treaty in the near future. The second is that the Tories have no obvious bargaining chips that they can play to sway their EU colleagues, who will be reluctant to concede any further opt-outs to a Britain that many consider to be already far too semi-detached from EU policies.

Mr Hague and his team talk of using the imminent Croatian accession treaty, or perhaps the next round of EU budget negotiations in 2011-12, to secure their goals. Yet neither looks too promising. Britain has always been a strong believer in expanding the EU, partly in hopes of making it looser. But that makes any Tory threat to veto Croatia’s accession in furtherance of unrelated British demands far less credible. Mr Major had to back down in 1994 when he tried to secure his preferred voting system by temporarily blocking the entry of Austria, Finland and Sweden. As for the budget, the main demand of all other 26 countries will be to scrap the British budget rebate won by Mrs Thatcher. That makes it tactically tricky for Britain to use the budget to gain the other demands it wants to make of the EU—unless the Tories were to consider trading the Thatcher rebate for a social-policy opt-out, but this would be hard to sell politically and the price might not be worth paying anyway.

A better course is to move beyond an obsession with winning general opt-outs and aim at smaller, more achievable goals for which it is possible to find allies: for example, on the social-policy front, entrenching an exemption from the EU’s working-time directive. Several other countries also support this, so Mr Cameron should gain a sympathetic hearing.

Financial regulation is another possibility. It has long been accepted in the EU that, where a country has a “vital national interest” at stake—as Britain clearly has in financial services—it is unwise and perhaps even wrong to outvote it by a qualified majority. In the past this language was used to support what is known to Eurocrats as the Luxembourg compromise, which Britain and a few others have since interpreted as tantamount to granting countries an informal national veto.

This could be an early test for an incoming Tory government, because the first meeting of EU finance ministers after the election will consider a draft directive to regulate hedge funds and private-equity firms in the EU, of which 80% are based in Britain. The directive has already been heavily amended to suit the British, but the outgoing Labour government still had enough doubts about it to secure a postponement of the debate. An incoming Tory one will share such doubts in spades.

It is in areas such as these that the Tories should focus their energies. The EU operates through elaborate compromises and careful coalition-building, both of which come naturally to many other governments but seem outlandish to Britain’s politicians used to Westminster. Like so many predecessors, a new Tory government may find that it takes time to learn how to play this Brussels game. And, although Mr Hague insists that “the Conservative Party is now quite mature about Europe”, it may take time to educate its own backbenchers, too. A rough ride is in prospect.
The Conservatives' demands

Tory! Tory! Tory!
Mar 31st 2010
From The Economist print edition

Referenda, ratchets and opt-outs

DAVID CAMERON’S climbdown last November from a promise to hold a referendum on the Lisbon treaty, or at least “not let matters rest there”, was disguised by other bold promises. Some may be easy to deliver, but several could provoke rows with Britain’s EU partners.

The first promise is to pass a referendum act to provide that any treaty transferring powers from Britain to the EU must go to a referendum. Mr Cameron says this will put Britain in the same position as Ireland, where most treaties go to a popular vote. This may annoy the others, but they can hardly stop it.

Second is a promised sovereignty act to confirm that ultimate authority rests with Parliament. This time the parallel cited by Mr Cameron is with the German constitutional court, which has approved previous EU treaties, including Lisbon, only with assurances that Germany’s Basic Law and the German Bundestag retain ultimate sovereignty. A law will also provide that “ratchet clauses” in Lisbon permitting further transfers of power without new treaties can be invoked only with parliamentary approval. If the sovereignty act suggests that EU law loses its primacy over domestic law, however, the European Court of Justice might strike it down.

Third, Mr Cameron wants more opt-outs from EU legislation. The first is an opt-out from social and employment legislation. The model is the opt-out from the social chapter that John Major secured in the Maastricht treaty. But the social chapter as such no longer exists. Moreover, many EU countries think social policies are integral to the single market. They see any British bid to avoid them but to keep full access to the single market as a form of “social dumping”. The Tories might entrench an exemption from the working-time directive, eg, in the National Health Service, as several other countries want one too—but the European Parliament, which under Lisbon has equal legislative power with EU governments, may not agree.

Mr Cameron also wants a watertight opt-out from the charter of fundamental rights. Other EU countries think this was done in a protocol to the Lisbon treaty saying that the charter created no new rights in Britain, and may be reluctant to concede more. And he wants an opt-out from EU judicial influence over British criminal law. Since Britain already has opt-outs (and opt-ins) from justice and home affairs (JHA), this should be achievable. Indeed, in 2014, when JHA falls under the European Court, Britain could choose to opt out of it all—but that would mean losing things the British find useful, such as the common arrest warrant and asylum policy.
The passage of health-care reform has energised Barack Obama

“OUR long national Obamacare nightmare is just beginning,” clanged the Heritage Foundation’s daily alert, the “Morning Bell”, on March 29th. The conservative think-tank was referring to the long political fight that will now ensue between friends and foes of the far-reaching health reform the Democrats have managed at last to squeeze through Congress. But another sort of nightmare is also beginning to trouble America’s conservatives. It is the possibility that Barack Obama’s big win on health will inject new vigour into what had looked like a prematurely tired presidency, making it harder for the Republicans to thrash the Democrats as thoroughly as they had expected in November’s mid-term elections.

The White House has certainly been doing everything it can to spin the theme of a re-energised president. With scarcely a pause to savour his victory, Mr Obama made an unannounced weekend visit to Afghanistan, his first as president, enabling him to play the commander-in-chief in front of cheering troops while the Republicans at home were still whining about health reform. The administration hailed a new deal to reduce nuclear warheads as evidence that Mr Obama had succeeded in pushing the “reset” button in relations with Russia, which is also showing signs of being more amenable to the idea of tougher sanctions on Iran. And in the Middle East a tougher Mr Obama seems determined to win his second round with Israel’s prime minister, Binyamin Netanyahu, after losing the first round in 2009, when he asked Israel to freeze settlement in the occupied territories.

At home, too, Mr Obama is showing renewed confidence and a bigger stomach for the fight. As Congress headed into recess, the president who made so much of his desire for bipartisanship used his power to make “recess appointments” when Congress is not sitting to fill 15 senior administration positions whose confirmation had been held up for many months by Senate Republicans. Some of these appointments are highly controversial, such as that of Craig Becker, an academic and labour lawyer who will now join the National Labour Relations Board over the strong objections of the US Chamber of Commerce. On March 31st Mr Obama prepared to unveil a plan, anathema to greens, to open millions of acres of coastal waters to offshore oil drilling.

Having surmounted the formidable roadblock of health reform, the administration claims that it can now devote more attention to other pieces of ambitious legislation, such as Senator Chris Dodd’s plan to
reform financial regulation and the administration’s proposal to rewrite George Bush’s No Child Left Behind Act, and with a greater prospect of success. In an interview with Politico, an online newspaper, Mr Obama’s spokesman, Robert Gibbs, said the president “goes into these negotiations and into these legislative battles with a stronger hand, because people understand that he’s going to fight for what he believes in.”

Many in the media seem more than willing to buy this line. “Is it just me, or does Barack Obama seem different since health care passed?” asked Peter Beinart in the Daily Beast, another online paper, comparing the Democratic victory over health to Ronald Reagan’s presidency-energising sacking of the air-traffic controllers in 1981. It isn’t just Mr Beinart: the Obama rebound and the “spring offensive” have abruptly become a staple of Washington’s pundits. But it is one thing to argue that the health vote has buoyed up the administration. It plainly has. Whether it has impressed the voters is, however, a different and more important question. And if early polls are to be believed, the answer is: not yet.

A USA Today/Gallup poll on March 23rd, days after the vote in Congress, suggesting that most Americans might be swinging in favour of health reform, has not been borne out by later surveys. A poll published in the Washington Post on March 28th found no evidence that passage of the legislation had made it either more popular or less contentious: 50% opposed the changes and 46% favoured them. The president’s approval rating continues to hover around 48% or so, showing little or no sign of a post-health bounce. In a new USA Today/Gallup poll published on March 30th 64% of respondents said the health reforms would cost taxpayers too much.

Even if health reform does not become more popular as the mid-terms approach, passage of the legislation has at least given Mr Obama and his party a chance to change the subject, and left Republicans wondering about the extent to which they should do so too.

The party line is currently that the new law must be repealed and replaced. Senator John McCain has said that the Republicans will punish the Democrats for their tactics during the health battle by withholding co-operation for the rest of the year. But the Hill newspaper notes that several Senate Republicans have said that they remain willing to collaborate across the aisle. They include Lindsey Graham of South Carolina, who intends to continue talking to the Democrats over legislation on energy and immigration reform, and Olympia Snowe of Maine.

Outside Congress there are even some Republicans who dare voice the heresy that the party would have done better to collaborate on health as well, instead of opposing it to a man and then losing anyway. David Frum, a former speechwriter for George Bush who was brave enough to refer to health care as the Republicans’ “Waterloo” in a much-noticed column, was unceremoniously sacked a couple of days afterwards from his job at the American Enterprise Institute.
EVERY ten years, says the constitution, America’s government must count every person living in the United States. For a country of more than 300m, this is an immense logistical feat: the Census Bureau mailed out or hand-delivered about 134m questionnaires for census day on April 1st. The census is also almost always controversial. Little wonder, given the three ways in which the results help to shape the distribution of political and economic power.

As after every census, the population changes tallied will, first, alter the state-by-state apportionment of seats in the House of Representatives and therefore the electoral college, the body that picks the president after elections. According to the non-profit Population Reference Bureau, the southern and western states will do well; Texas is likely to gain three seats, with Arizona, Florida, Georgia and Utah each gaining one. The losers (one seat each) are likely to be Iowa, Louisiana (thanks to Hurricane Katrina), Massachusetts, Michigan, New Jersey, New York, Ohio and Pennsylvania.

Second, once the census numbers are in, state legislatures will begin early next year to redraw their internal electoral districts, as well as those for the House of Representatives in Washington, DC. Officially, this redrawing is done to reflect population changes; unofficially, the new demographic data are used to gerrymander the districts in such a way as to maximise the ruling party’s chances of winning again. A third big consequence of the census is to determine how much loot states bag from the federal government. Andrew Reamer of the Brookings Institution in Washington, DC, estimates that in the 2008 fiscal year alone census data were used to apportion $447 billion of federal assistance (such as Medicaid payments) and $420 billion of federal grants.

The census is the subject of perennial squabbles. Two Republican senators, David Vitter of Louisiana and Bob Bennett of Utah, led an unsuccessful attempt this time to add questions on immigration status to the new form. The Democrats complain that poor people and non-whites are routinely undercounted, a bias which some have proposed to correct by letting the Census Bureau use statistical sampling to adjust the head count. For this census, however, the bureau has tried to avoid that bias by enlisting the tens of thousands of trusted intermediaries—such as churches, charities and firms—to explain the importance of being counted.
Seven former directors, appointed by both Republican and Democratic presidents, have called for the agency to be made more independent. A bipartisan bill being promoted in both chambers would give directors a fixed term of five years, let them report directly to the secretary of commerce, and allow them to testify independently to Congress. But with so much at stake, quarrels over the census are unlikely to vanish.
America and the yuan

The truth hurts
Mar 31st 2010 | WASHINGTON, DC
From The Economist print edition

Will the Treasury call China a currency manipulator?

TO MOST people, to say that China holds down the value of its currency to boost its exports is to state the obvious. Not, though, to America’s Treasury Department. By law it must report twice a year on which countries fiddle their exchange rates at the world’s expense. China was last fingered in 1994. Ever since then, the Treasury has concluded that the designation would do more harm than good. Speculation is growing that it may decide differently in its next report, due on April 15th.

The mood in America resembles that in 2005, when the Senate voted to hit China with tariffs of 27.5% and the Treasury ratcheted up its rhetoric. China abruptly moved to a managed float for the yuan. It was allowed to appreciate by 20% over the next three years before a halt was called during the banking panic of 2008.

China seems more determined to resist pressure this time, though, and can rightly point out that its fiscal stimulus has halved its current-account surplus since 2007. America’s trade deficit with China has edged a bit lower (see chart), though further declines seem unlikely, now that its own recovery is under way.

Nonetheless, the weight of opinion in America is running heavily against China. Unemployment has doubled since 2005 and Barack Obama wants exports to lead the recovery. That will be harder if China sticks to its export-centric yuan policy.

Businesses have also become less reliable defenders of China, rankled by measures such as an edict last autumn which, according to American technology companies, virtually shuts them out of Chinese government procurement. The hacking attacks on Google and the trial of Rio Tinto executives have hardly helped. “A whole slew of multinationals I’ve talked to are increasingly fed up with how they are being dealt with on micro, industry, product-specific stuff,” says Fred Bergsten, director of the Peterson Institute for International Economics, a think-tank.

Charles Schumer, a Democratic senator, and Lindsey Graham, a Republican, authors of the 2005 China tariff bill that probably pushed China to move, have introduced a variant that would force the Treasury to make the designation and then seek redress through the International Monetary Fund, the World Trade Organisation, and unilateral duties. One manufacturing-union group has produced maps showing just how many jobs each congressional district and state has lost to China.
A popular view in Washington is that the Treasury could call China a manipulator to wrest control of the issue from hotheads in Congress. The practical consequences are small: it requires the United States only to consult with the offending country, something the two already do frequently. It would also fulfil Mr Obama’s promise to use America’s trade enforcement tools more vigorously. But Nicholas Lardy, also of the Peterson Institute, thinks that—far from restraining others—a Treasury designation of China as a manipulator would be “like throwing red meat to the Congress and enhancing the possibility they pass a currency bill.”

The administration’s best hope is that China moves of its own accord before events in Congress or elsewhere force a confrontation. Tim Geithner, the treasury secretary, is surprisingly confident that China will act. Sander Levin, the usually interventionist-minded chairman of the House Ways and Means Committee which oversees trade matters, advocates multilateral rather than unilateral pressure. So perhaps the administration will give China one last chance and seek a multilateral remedy at the G20 in June. If China still fails to respond, the Treasury, by the time of its autumn report, will no longer be able to deny the obvious.
Tribes struggle to develop new projects on the plains

ROUTE 83, south of Minot, North Dakota, is a particularly barren stretch of a barren state. Last year, however, nearby fields sprouted a new crop: a $250m, 80-turbine wind farm. Not far west is Fort Berthold, home to the Mandan, Hidatsa and Arikara Nation. Wind hurtles across the reservation, careening around houses and over hilltops. The Indian tribe has just one turbine to catch it.

The tribes of the northern plains are mostly destitute; their lands include three of America’s ten poorest counties and six of its poorest 25. Virtually every tribe, however, is rich in wind. Tribes in the Dakotas and Montana alone have enough wind to generate more than 886m megawatt hours a year. Even if only one per cent were developed, this would bring in $3.6 billion over 20 years, according to the National Renewable Energy Laboratory (NREL). Now a growing number of tribes on the plains hope that wind will bring prosperity, at last. They are not alone. Indian nations across the country are exploring renewable energy, from solar to geothermal. A new bill would speed development. But tribes may have to wait a while yet.

Some problems with development are not unique to Indian country. Fort Berthold has inadequate transmission, a challenge for wind projects everywhere across the plains. But Fort Berthold, the rare reservation lucky enough to sit on oil, points to other problems too. Rigs form a dense ring around the tribe’s borders; only recently has drilling begun within.

Efforts to develop tribal energy face a maddening set of obstacles. Because tribes are sovereign governments, some investors are wary of internal political shifts. Because the federal government holds tribal lands in trust, projects can be choked by bureaucracy. Dale Osborn of DISGEN, a Colorado-based developer, is trying to build a wind farm on the Rosebud reservation in South Dakota. “It took the Bureau of Indian Affairs over a year to look at a document that a good lawyer could do in five days,” he laments. And because tribes do not pay taxes, they may not receive tax credits for renewable projects. The Campo reservation in California is the only one with a working commercial wind farm. It is not owned by the tribe and has a huge nearby market, San Diego.
To date, the federal government has provided modest support for tribal energy. From 2002 to 2008 the Department of Energy spread $16.5m over 93 projects, mostly demonstration and feasibility studies. NREL provides education and technical assistance. Such efforts, and the work of a growing number of independent groups, are helping tribes to become more sophisticated about development, but they can only do so much. Most promising is a draft Indian energy bill presented in March by Byron Dorgan, North Dakota’s junior senator. The law would, among other things, streamline the issuing of permits and let tribes have an ownership stake while transferring tax credits to outside partners. But it depends heavily on the fate of broader energy legislation.

Without action from Washington, projects will continue to move slowly. On the Fort Berthold reservation, waning private interest has prompted the tribe to pursue wind development on its own. On Rosebud, Mr Osborn is waiting for adequate transmission and a power-purchase agreement. Another Rosebud project is an environmental study; the American burying beetle is of special concern. Ken Haukaas, who leads Rosebud’s wind development, feels aggravated. “Every day, with the wind blowing heavily, I look at all that money blowing by.” Of all the victims of stalled climate legislation, no one may be more frustrated than American Indians.
Legalising marijuana

Joint effort
Mar 31st 2010 | LOS ANGELES
From The Economist print edition

California leads again

RICHARD LEE, a marijuana entrepreneur, has in recent years turned part of Oakland into the cannabis capital of California and perhaps the world. Among his businesses is Oaksterdam University (a play on Amsterdam, where he got the idea), which teaches students all aspects of the weed, from the horticultural to the medical and legal, and has since spawned copycats elsewhere.

But this year Mr Lee wants to do more. He has sponsored a voter initiative, which has just been cleared for the November ballot, for the legalisation of marijuana in California. Adults would be allowed to own up to an ounce (28.5 grams) at a time for recreational use and could grow some in their homes. The state, its cities and its counties would be able to regulate and tax it.

If the measure passes—a poll last year found 56% in favour—California may once again lead the nation not only in usage but also in policy. Californian voters were the first, in 1996, to allow medical use of marijuana. Since then, 13 states and the District of Columbia have followed, and several more are considering it, including Arizona and South Dakota, both of which will also vote on the matter this year.

California's ballot measure would mark a new phase in decriminalisation, says Ethan Nadelmann, the founder of the Drug Policy Alliance, which lobbies for more enlightened drug laws. Why vilify or even lock up adults who wish simply to enjoy in moderation a substance no more toxic than alcohol, when you could instead tax and regulate the trade? It would help state budgets, which are in crisis. A tax-collecting agency in California, which confronts a $20 billion deficit, has estimated the potential revenues at more than $1 billion, plus savings from not locking people up.

That said, there would be legal hurdles. Since 1961 an international treaty has banned non-medical use of narcotic drugs, and America’s federal law considers even medical use of cannabis a crime. But Eric Holder, America’s attorney-general, last year signalled that cracking down on cannabis would not be one of his priorities. This suggests that marijuana could follow the path that alcohol took in the 1930s. Then, also during an economic crisis, the federal government stood back as the states relaxed Prohibition, until the 21st amendment officially ended it.
Lessons from a state that has let its pupils down

AS THE Obama administration spreads enthusiasm about a proposal to replace a patchwork of state education standards with national ones, it might also heed a cautionary tale. In the 1990s California too established rigorous standards. “We thought they were the highest,” up there with those of Massachusetts and Indiana, says Mike Petrilli of the Thomas B. Fordham Institute, an education think-tank in Washington, DC. But California never translated those standards into results. Its public schools are, with some exceptions, awful. Moreover, the state’s fiscal crisis is about to make them even worse.

California’s 8th-graders (14-year-olds), for example, ranked 46th in maths last year. Only Alabama, Mississippi and the District of Columbia did worse. California also sends a smaller share of its high-school graduates to college than all but three other states. One of its roughly 1,000 school districts, Los Angeles Unified, which happens to be the second-largest in the country, has just become the first to be investigated by the federal Office for Civil Rights about whether it adequately teaches pupils who have little or no English.

Eli Broad, a Los Angeles philanthropist who is trying to reform education, blames a combination of California’s dysfunctional governance, with “elected school boards made up of wannabes and unions”, and the fact that the state’s teachers’ union is both more powerful and “more regressive” than elsewhere. The California Teachers Association (CTA) is the biggest lobby in the state, having spent some $210m in the past decade—more than any other group—to intervene in California’s politics.

The CTA has used its money to defeat almost any reform that might have turned the standards into reality. It helped to defeat ballot measures that, for example, would have given California a school-voucher system and changed the probation period for teachers. It ensured that the state has “laughably easy teacher tests”, as Mr Petrilli puts it. It is also the biggest donor to the state’s Democratic Party.

Another factor is money. California’s infamous Proposition 13 of 1978 cut property taxes, the main source of revenue for municipalities and school districts. Other ballot measures, such as Proposition 98 in 1988,
were meant to restore school spending, with horrendously complex funding formulas. But although schools account for the largest part of California’s budget, California entered the recession ranking 46th in spending per pupil. It has the largest classrooms in the country, with 23.4 students per teacher in 2008, almost twice the national average. Schools in black and Latino districts fare much worse than those in white areas.

Now spending is being cut further, as California has to keep plugging budget holes. Funding per pupil in the state has dropped almost 11% in the past two fiscal years, and is certain to drop further. This fiscal year, the school districts have been able to use federal funds from the stimulus programme to mitigate the effects. But those funds end in the fiscal year that starts in July.
Desegregation and schools

No easy answers
Mar 31st 2010 | RALEIGH
From The Economist print edition

Has Wake County thrown out the baby with the bathwater?

IN 1971, a young black lawyer brought up in rural North Carolina under Jim Crow laws argued on behalf of a boy from Charlotte called James Swann before the United States Supreme Court. In that case, Swann v Charlotte-Mecklenburg Board of Education, the court held that school districts may use busing, quotas and other such methods to ensure integration. Nearly 40 years later that same lawyer, Julius Chambers, stood once again before nine people, this time the Wake County board of education, and this time as a concerned citizen rather than an advocate, to plead a case: that the county ought to retain its programme of assigning pupils to schools based on levels of family income. His suit failed: on March 23rd the board voted 5-4 to abandon that policy.

That vote ended a decade-long experiment. In 2000 Wake County’s school board decided to integrate its schools by income level rather than race. No more than 40% of students at any one school should be receiving free or subsidised lunches (which are given to children from poor families). Evidence dating back more than 40 years shows that schools with too great a concentration of poor pupils are undesirable. Teachers do not stay, and poor pupils tend to perform worse when they are put with others who are poor.

Under the new plan, Wake’s schools seemed to do well. In 2007-08 pupils in the third to eighth grades (eight- to 13-year-olds) outperformed the state average on standardised reading and maths tests in every grade, and high-school pupils did the same in every subject in statewide end-of-course exams. The average SAT score for the county’s high-school leavers that year was 54 points above the national average and 76 points above the state average.

Yet the picture grows less rosy on closer inspection. Black pupils lagged behind white in every grade and subject. Poor students fared markedly worse than their wealthier counterparts, and their graduation rate was 54% in 2009, lower than the state average. To some, this indicated that the assignment plan was hiding rather than solving problems: pupils were still failing, but they were just dispersed.

Most pupils attended schools near their homes, but some travelled across the county. Parents complained of a lack of choice and of high-handed treatment from the school board: one aggrieved father who grew up in bureaucracy-racked India said the board’s behaviour reminded him of home. When the board forced some pupils to attend “year-round” schools (where holidays are arranged as four three-week breaks...
throughout the year, rather than one long one), a group of parents sued. They lost, but within the court’s
decision was a critical bit of advice: they could always elect more sympathetic board members. So they
did: of the five candidates who voted to scrap the assignment policy, four were elected last October.

The vote attracted controversy: at last week’s meeting, three demonstrators were arrested. Earlier in the
month, Ron Margiotta, the board’s chairman, referred to jeering opponents as “animals out of their
cages”. Taunts of racism were thrown around. Now that the vote has been taken, tempers seem to have
cooled, even if the future of Wake’s schools remains unclear.

John Tedesco, who chairs the board’s reassignment committee, has talked of splitting the county into
neighbourhood zones. Parents in poor zones will be given the option of sending their children to schools in
wealthier districts. Mr Tedesco maintains that the current plan was inefficient and placed an undue burden
on parents. It also failed: 30% of schools exceeded the 40%-poor-student threshold in 2008.

Yet those facts—like the stubborn racial gap and the low graduation rate for poor pupils—could just as well
argue for improving as ending the current system. After all, it is difficult to imagine that poor pupils would
fare better in impoverished schools. One possible future can be seen in Charlotte-Mecklenburg County,
which scrapped its integration programme in favour of neighbourhood schools in 2002. Its schools have
become more segregated, with minorities concentrated in poor schools: in 2006 16 of its elementary
schools were at least 75% non-white, with at least 90% eating subsidised lunches. Parents in poor areas
were offered the choice of transferring their children to wealthier schools, but capacity limits made many
such requests impossible to grant.

Mr Tedesco bristles at the notion that Charlotte is the future; he believes that with better management
and more efficient spending Wake can avoid Charlotte’s errors, and he may be right. But Wake’s school
system faces a $20m shortfall, which makes the board’s task all the more daunting.
Public housing

The big green apple
Mar 31st 2010 | HUNT’S POINT, THE BRONX
From The Economist print edition

Environmentally-sound homes for the poor are a model for everyone else

BOILER rooms are often dirty and steamy, but this one is pristine and cool. Fox Point is a spanking new 47-unit residential building in the South Bronx, one of the city’s poorest pockets. Two-thirds of its residents are formerly homeless people, whose rent is paid by the federal Department of Housing and Urban Development. The rest are low-income families. The boiler room houses a microturbine system, which generates energy for electricity and heat. It reuses heat that would otherwise be lost to the atmosphere, reducing carbon emissions while also cutting costs.

Fox Point is operated by Palladia, a non-profit group that specialises in providing housing and services to needy people. Palladia received financial support and technical expertise from Enterprise Community Partners, which helps build affordable housing by providing financing to community and housing developers.

Enterprise believes “green” and “affordable” are one and the same. It has created a national framework for healthy, efficient, environmentally clever and affordable homes which it calls the Green Communities Criteria. These criteria include water conservation, energy efficiency and the use of environmentally-friendly building materials. The criteria are aligned with LEED, a green rating system. Meeting the criteria increases housing construction costs by 2%, which is rapidly paid back by lower running costs. Even the positioning of a window to optimise daylight can help save energy.

Michael Bloomberg, New York’s mayor, plans to create 165,000 affordable and sustainable housing units to house 500,000 New Yorkers. Almost 80% of New York City’s greenhouse-gas emissions come from buildings, and 40% of those are caused by housing. So he recently announced that the city’s Department of Housing and Preservation and Development (HPD), which is responsible for developing and maintaining the city’s stock of affordable housing, will require all its new projects to adhere to Enterprise’s green criteria. Similar measures have been adopted by other cities, such as Cleveland and Denver, but New York’s HPD is the largest municipal developer of affordable housing in the country.

These sound ideas are spreading. On March 18th, Tom Menino, the mayor, announced that Boston’s Housing Authority will receive $63m for energy-efficiency improvements, the largest public-housing energy efficiency project in America’s history. In Chicago, Lathrop Homes, one of the earliest public-housing developments in the city, is about to get its own green makeover; it aims to be the country’s first public-housing development to get the full LEED certification. That should be good news both for the city and its poor.
Lexington

The anti-Crist
Mar 31st 2010
From The Economist print edition

The newest Republican star is following Barack Obama’s playbook

THE hall is packed. The mood is euphoric. The sandwiches are rapidly disappearing. Marco Rubio is about to address another crowd of conservative Floridians. They do not chant or faint like Barack Obama’s fans used to. But some see parallels between this young, handsome wannabe senator and the young, handsome wannabe senator who wowed the Democratic convention in 2004. “There’s the same enthusiasm,” gushes Vicki Pollina, a volunteer whose badge proclaims: “Yes, He Can”.

In May last year, when Mr Rubio announced that he would seek the Republican nomination for an open US Senate seat, no one thought he had a chance. The sitting governor of Florida, Charlie Crist, was considered a shoo-in. He had pots of money, universal name-recognition, the backing of leading Republicans and an impressive electoral record, having won three statewide contests (for education commissioner, attorney-general and governor). Mr Rubio was just shy of his 38th birthday. As speaker of the Florida House of Representatives, he was hardly a nobody, but he was not in the same league as a man whom Senator John McCain considered making his running-mate. Early polls of Republicans put Mr Rubio more than 30 points behind. By Christmas, however, he had drawn level, and recent polls put him anywhere between 11 and 34 points ahead. Dana Milbank, a wag at the Washington Post, calls him “the anti-Crist”.

A big part of his charm is his life story. His parents were both Cuban. His mother was one of seven sisters. His father sold coffee in the streets of Havana from the age of six. They fled to America with “no English, no money [and] no friends”. They worked punishing hours in humble jobs—he as a bartender, she as a cashier—to give their children a better life. Mr Rubio, with his stellar career, cheerleader wife and four adorable children, says he owes everything to God, to his parents’ sacrifices and to America.

“[I]n no other country on earth is my story even possible,” said Mr Obama in 2004. Mr Rubio echoes the sentiment: “[T]his is the only place in the world where a company that started as an idea drawn out on the back of a cocktail napkin can one day be publicly traded on Wall Street.” Of course, there are plenty of other countries where the children of immigrants sometimes win high office or where entrepreneurs thrive. But like Mr Obama, Mr Rubio embodies a narrative that makes voters feel good about themselves. He also shares the president’s knack for sounding simultaneously optimistic about his country and outraged at the mess the other party has made of it.
The Democrats plan to abandon free enterprise and “convert America into a submissive member of the international community,” he says. They think Americans need a “guardian class [of] really smart people who went to the right schools to tell us what to do.” And that’s not fair, says Mr Rubio, “because not everyone can go to the University of Florida.” The crowd explodes with laughter. Several ladies wish he had married their daughters.

Florida’s Republican primary in August will be dominated by conservatives and tea-partiers, since only registered Republicans can vote. Mr Rubio is wooing them by vowing to stand up to Mr Obama: on taxes, on health care and on cap-and-trade. Mr Crist, by contrast, publicly embraced the president last year after accepting stimulus funds for Florida. That televised hug features often in Mr Rubio’s ads. So does the economy: Florida’s downturn and property crash have been unusually severe. Mr Crist is the governor, so Floridians blame him—far more than is fair.

Like Mr Obama, Mr Rubio is good at seeming to agree with people without actually doing so. A voter asks if he supports the Fair Tax, a plan to abolish all income taxes and replace them with a consumption tax. Mr Rubio says he does. The crowd cheers. But, says Mr Rubio, “We have to be practical.” Revoking the government’s power to levy income tax would take a constitutional amendment, and that is unlikely. So Mr Rubio would aim merely to flatten and simplify the tax code. The radicals come out thinking he is one of them, when in fact he has told them to get stuffed.

No justice for the governor

Mr Crist has been a pretty good governor, and he is hardly the lefty squish Mr Rubio makes him out to be. But he has been thoroughly wrong-footed by his cherubic challenger. During a televised debate on March 28th, it was the upstart who sounded more serious. To stop Social Security (public pensions) from going bust, Mr Rubio suggested raising the retirement age. Mr Crist promised only to reduce waste and fraud—a pathetic cop-out—and devoted most of his energy to making personal attacks on Mr Rubio, accusing him on flimsy evidence of using his political power to enrich himself.

Nationally, Democrats are praying that the tea-party movement will push the Republicans so far to the right that they become unelectable. In some races, that may happen. In Arizona, for example, Mr McCain faces a tough primary battle against a dingbat who frets about man-on-horse nuptials. In Utah, Senator Bob Bennett, a pragmatic conservative, could be forced out by the hard right. Many new candidates claiming the tea-party tablecloth will run in Republican primaries this year.

Yet the Democrats should not take much comfort from this, because few genuine kooks will prevail. Republican primary voters aim to pick candidates who can beat Democrats, such as Scott Brown in Massachusetts. In Florida, the polls say Mr Rubio would beat Kendrick Meek, the likely Democratic candidate, by nearly ten percentage points. Granted, Mr Crist would beat him by a wider margin, but Mr Rubio has not yet tried to court the centre. Judging by his legislative record, he is no extremist. And since Republicans currently lack both charisma and Hispanic support, Mr Rubio could be just their cup of tea.
Brazil’s presidential campaign

Falling in love again with the state
Mar 31st 2010 | SÃO PAULO
From The Economist print edition

Just rhetoric, or is the government learning the wrong lessons from the country’s economic rebound?

WITH each new figure it becomes clearer that Brazil’s brief recession of 2009 was a fall onto a trampoline. The economy is still bouncing upwards: it grew by 2% in the fourth quarter of last year compared with the previous three months, and forecasts are for growth of up to 6% this year. With an election due in October, this is cause for much official self-congratulation. The economy’s new-found resilience has also revived the belief of Brazil’s leaders in the economic role of the state.

To mark this year’s 30th anniversary of the founding of the ruling Workers’ Party (PT) its presidential candidate, Dilma Rousseff, gave a long interview for a celebratory book in which she argued that “during the crisis, after the failure of Lehman Brothers, it was [state-controlled] institutions like the Banco do Brasil, Caixa Econômica Federal and the National Development Bank (BNDES) that prevented the economy from being shipwrecked.” Furthermore, the government pursued “a clear policy to strengthen Petrobras”, the state-controlled energy giant, “rather than to weaken it.” In other words, Brazil’s state capitalism succeeded where the private sector failed.

This might be dismissed as pre-campaign rhetoric to win over members of a party that Ms Rousseff joined only in 2001. For much of its life the PT believed in old-fashioned socialism. It was only after Luiz Inácio Lula da Silva, its founding leader, dumped this that he was elected president, at the fourth attempt, in 2002.

For all the rhetoric, the election is unlikely to alter fundamentally the balance between private enterprise and the state in Brazil. The government lacks capital to build roads, ports and airports, and will continue to look to the private sector to do so. When Ms Rousseff is not praising Brazil’s state companies she often talks about the need for partnerships between the state and the private sector. And some believe her running mate might be Henrique Meirelles, the orthodox governor of the Central Bank.

But there is plenty of evidence that Lula, who many expect would remain the power behind the throne if Ms Rousseff were to win, himself now believes that a bigger role for the state in the economy would be good for Brazil.
Lula has created eight new state companies. Most are fairly small outfits for specific tasks, such as energy research. A recent proposal to revive Telebrás, the defunct state telecoms monopoly, to provide broadband internet services to the poor, looks different. The private sector does not provide services in poor, rural areas, because the investment involved would be unprofitable. This irritates the government, which considers access to the internet to be a matter of “citizenship”. But rather than subsidise customers to encourage telecoms companies to invest, the government wants to go into this business itself.

The state’s economic clout is expanding in other ways. In January Petrobras, which already has its hands full with a massive investment for deep-sea oil, raised its stake in Braskem, a big private-sector chemical company, by 2.5 billion reais ($1.4 billion). Lula has announced that Eletrobrás, a state-controlled electricity company once seen as almost vestigial, should be expanded to become a “Petrobras of the electricity sector”. Meanwhile, BNDES and the pension funds of the big state companies have increased their holdings in many of Brazil’s largest private firms. In the case of BNDES, this has been part of a government policy to create Brazilian champions that are big enough to compete abroad.

For some opponents this is all retrograde. Paulo Renato Souza, the education minister in the São Paulo state government and a close ally of Ms Rousseff’s main rival for the presidency, José Serra, says: “We have had 15 years of continuity, but in the past year things have changed. This is the old PT, the party that we saw in the elections of 1994 and 1990.” Amaury de Souza, a political consultant, argues that “the government used last year’s crisis as an excuse to push a particular ideology.”

Yet the government’s view of how Brazil withstood the financial crisis is at least partly right. It was useful to have state-controlled lenders when credit from abroad dried up at the end of 2008. Banco do Brasil, the biggest state bank, stepped into the breach. This helped to confirm the views already held by Ms Rousseff and the finance minister, Guido Mantega, that the state should use its power to “induce” growth, rather than make itself leaner with more privatisations, according to a civil servant in the finance ministry.

But this is not the whole picture. Brazil’s top private banks fared well too. There were no big bank failures, and no need for government bail-outs—testament to the health of the banking system that emerged from a previous crisis in the mid-1990s. High reserve requirements, which force banks to park much of their capital with the Central Bank, helped too.

The rush to reinvent state companies also ignores the success of privatisation. Petrobras became a world-beater in offshore drilling only after two-fifths of its shares were floated on the stock exchange and it began to act more like a private company. Since its privatisation Vale, which the government often berates for not adding value to the raw materials it exports, has transformed itself from a medium-sized conglomerate to one of the world’s biggest mining companies. Embraer, which makes aeroplanes, has a similar story.

On the other hand many of the old state behemoths were costly failures. Siderbrás, a steelmaker, went bankrupt twice. Telebrás and its regional subsidiaries were so inefficient that they spawned a vigorous secondary market for telephone lines. In their 30-year life they installed 10m fixed lines and registered 1m mobile phones. Since they were disbanded 15 years ago, Brazil has installed 40m fixed phones and now has 174m registered mobiles.

In any event Ms Rousseff has started an important debate, which should reverberate over the next six months. As Fernando Henrique Cardoso, who preceded Lula as president, puts it, this is over whether Brazil would do better with a “bureaucratic capitalism in which the state orders and resolves things” or a “competitive, liberal capitalism”.

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Argentina’s bond swap

Eating their words
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From The Economist print edition

The government tries to make peace with international capital markets

BACK in 2005 when he oversaw a deal to restructure some $82 billion in bonds on which the country had defaulted four years earlier, the country’s then president, Néstor Kirchner, hung tough. The government offered new bonds worth only about 35% of the old ones. This prompted creditors with around a quarter of the debt to hold out for better terms, even though Mr Kirchner ordered Congress to pass a law forbidding any further payment. The creditors obtained court orders barring Argentina from raising fresh debt in international markets. But the economy was recovering strongly, and the world was awash with liquidity: the government managed to sell bonds worth $8.5 billion in the local market and $7.6 billion to Venezuela, albeit in some cases at high interest rates. It even paid off the IMF, partly to avoid being forced to deal with the holdouts.

That was then. Mr Kirchner’s wife, Cristina Fernández, who succeeded him in 2007, is in difficulties. Recession, from which Argentina is now recovering, pushed the public finances into the red. The Kirchners’ hopes of holding on to power at a presidential election due next year are threatened by their unpopularity. Venezuela’s Hugo Chávez has financial problems of his own. Argentina is feeling the price it has paid for excluding itself from the world financial system.

Ms Fernández first expressed interest in reaching a deal with the bondholders ten months after taking office. But with investors panicking the world over, yields on Argentina’s bonds surged to prohibitive levels (see chart). So the government has tried to tap some unorthodox sources of revenue. First it nationalised private pension funds, allowing itself to draw on their $30 billion in assets. An attempt to raid the Central Bank’s reserves in order to repay $6 billion in debt falling due this year foundered on resistance first from Martín Redrado, who was sacked as the bank’s governor over the issue, and then from Congress, where the opposition now holds a majority.

With markets calmer, Ms Fernández wants to make peace with the bondholders. At her request, Congress lifted the ban on reopening the debt restructuring. This month her officials filed a new offer with regulators in the United States, Italy and Japan. Although the details have not yet been made public, the terms are likely to be similar to those offered in 2005, while also including an extra bond to cover interest due over the past five years, according to Alberto Bernal of Bulltick Capital Markets, an investment bank. As with the previous deal, the new bonds may come with a warrant that will pay extra if the economy grows faster than forecast.
Investors have welcomed the news. The risk premium on Argentina’s bonds has fallen. Analysts reckon that around three-quarters of the holdouts will accept the deal, meaning that 94% of all the defaulted debt from 2001 will have been swapped. Officials will hope that such widespread acceptance would persuade American judges to ignore the pleas of vulture funds still seeking to obtain the full face-value of bonds they bought after the default. And Argentina would then be free to borrow again.

Whether the government and Argentine companies will be able to do so as cheaply as their counterparts in Brazil and Chile depends on Ms Fernández changing other policies. She would need to clean up the government’s dodgy economic statistics, and stop harassing private business. There is no sign of this. So Argentina’s debt is likely to continue to be bracketed with that of Ecuador and Venezuela as the riskiest in Latin America until Ms Fernández’s term ends in 2011.
Bolivia's president and his opponents

People's justice
Mar 31st 2010 | LA PAZ
From The Economist print edition

Will opponents get a fair trial?

LAST December Evo Morales, Bolivia’s socialist president, easily won a second term and with it a mandate to implement a new constitution. This, he has promised, will “refound” his country along lines that are fairer to people of indigenous descent, who make up around half of the population. One of the big changes involves the judiciary. Bolivia is to become the first country in Latin America in which judges are to be ratified by popular election, with an initial ballot due in December.

Whether that will produce a more independent and effective judiciary remains to be seen. But the government is making its preparations. The ruling Movement to Socialism now has a clear majority in Congress: it has used it to push through a series of new laws to govern the courts. One gave the president, rather than the legislature, sweeping powers to appoint judges and prosecutors, pending their popular election. In February Mr Morales swore in 13 judges to the top courts, all but one of whom are regarded as political allies.

Other presidents have made judicial appointments, but never on this scale. Opponents suspect that Mr Morales’s intention is to use the courts to stage show trials. Criminal charges have been filed against the previous four presidents and a vice-president. These variously include damaging the state through privatisation contracts, unlawful killing in the military repression of protests and treason.

This last charge, which carries a penalty of up to 30 years, is against Eduardo Rodríguez, a former head of the supreme court who acted as a caretaker for eight months and oversaw the election that brought Mr Morales to power in 2005. He is accused of allowing United States’ military advisers to destroy 32 obsolete Chinese-made missiles which had passed their date for safe use. Mr Rodríguez, now a law professor, denies taking the decision to decommission the missiles. Mr Rodríguez and the other former presidents are convinced they will not get a fair trial. Mr Morales recently called the four a “band of criminals”. One of the new bills would reverse the burden of proof in corruption trials, and deny the possibility of appeal in these cases to the Constitutional Tribunal.

The government is right that justice in Bolivia has often ground slowly, and too often corruption has gone
unpunished. Its supporters point out that both judicial appointments and the anti-corruption law were blocked for four years in Congress by the opposition. Denis Racicot, the representative in Bolivia of the United Nations High Commissioner for Human Rights, has welcomed the new constitution’s granting of more rights to indigenous people. He also hails progress in the trial, in absentia, of Gonzalo Sánchez de Lozada, a former president accused over the deaths of 67 people during protests organised by Mr Morales’s supporters in 2003. (Mr Sánchez de Lozada, who is in the United States, has said he cannot get a fair trial in Bolivia).

But in a recent letter to Congress, Mr Racicot expressed concern about the anti-corruption bill’s reversal of the burden of proof and retroactive application to former heads of state. Several other former officials have gone into voluntary exile because they fear a political witch-hunt. They include Manfred Reyes Villa, whom Mr Morales defeated in last year’s presidential election. Several candidates in regional and mayoral elections due on April 4th are also under investigation by prosecutors.

Mr Morales’s supporters are likely to do well in these elections. Buoyed by revenue from his nationalisation of natural gas and by the gratitude of poorer Bolivians for his efforts to improve their lot, the president remains overwhelmingly popular. He has the opportunity to mould a genuinely fair and effective justice system. Sadly, he seems to be bent on political revenge. If he runs into difficulties in future, he may find that others can play the same game.
Canada in Afghanistan

Document war
Mar 31st 2010 | OTTAWA
From The Economist print edition

The government continues to zigzag

WHEN Stephen Harper, Canada’s Conservative prime minister, abruptly prorogued parliament in late December his opponents charged that he wanted to avoid awkward questions about how Canadian forces in Afghanistan handled detainees. With parliament finally sitting again last month, the Liberal opposition complained to the speaker of the House of Commons, Peter Milliken, that withholding this information was a violation of parliamentary privilege. Mr Milliken is unlikely to rule on this until after the Easter break. But meanwhile the government on March 25th deposited with the house several boxes containing 2,500 pages of unsorted and heavily edited government documents.

This amounted to another zigzag from Mr Harper on the issue, which concerns whether officials knew that some of the detainees handed over to their Afghan counterparts might be tortured. The Conservatives argued that making the material public would compromise national security. But the government then asked a retired Supreme Court justice, Frank Iacobucci, to review all documents going back to 2001 (when Canadian troops first went to Afghanistan under a Liberal government) to determine what could be released. The document dump seemed to pre-empt Mr Iacobucci’s review. But the hundreds of fully or partially blacked-out pages highlight the monumental task he faces.

The government has a point on the need for some confidentiality. For example, releasing everything might identify, and compromise the safety of, Afghan informants who told the International Committee of the Red Cross about the abuse of prisoners. It might also release confidential information passed to Canada by other governments. The opposition says committee members can review all the documents privately and decide what to release. But there are no agreed rules for how to do this. Nor have there been any negotiations among the parties about how to approach the task. Some in Ottawa question whether members of the committee from the separatist Bloc Québécois can be counted on, even if sworn to secrecy.

On the other hand, the opposition distrusts the open-ended nature of the national-security argument mounted by the government. Opponents accuse Mr Harper of running a rather secretive government, blocking requests under the freedom of information law and gagging ministers on many issues.

Even heavily edited, the documents make it clear that mistakes were indeed made in Afghanistan. It took time to develop a system to track prisoners and ensure they received proper treatment. But the documents also paint a picture of the difficulties Canadian forces faced in Kandahar in 2006: soldiers were being killed by roadside bombs, and the force lacked facilities to hold prisoners. Had Mr Harper simply admitted as much at the outset, the issue might quickly have faded away. It may yet do so. Precedent, or rather the lack of it, suggests that the speaker is unlikely to order the release of secret documents without the government’s approval.

Mr Harper inherited the Afghan mission, but has promised to end it next year. At a meeting about the Arctic in Ottawa this week, Hillary Clinton, the American secretary of state, urged Canada to keep at least some of the troops beyond that date, albeit to train local forces. But the Afghan deployment is unpopular and Mr Harper leads a minority government. That counts for a lot.

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AN OVERNIGHT flight from Washington to Kabul is a lot of travelling for a 25-minute meeting with a man you don’t particularly like. But Barack Obama’s decision to fly unannounced around the world for a brief stopover in Afghanistan showed, once again, that the Americans just cannot get by without their troublesome ally, Hamid Karzai. Described last November in leaked diplomatic cables from the American ambassador as “not an adequate strategic partner”, Mr Karzai has been kept at arms-length by Mr Obama.

Early in his presidency, he dropped the matey weekly video-conferences that George Bush used to hold with his Afghan opposite number. Now Mr Karzai seems in demand again. Mr Obama met him at his palace in Kabul, and shared a dinner with his cabinet. He invited Mr Karzai to the White House in May, as part of the Americans’ effort to bully and cajole him into playing his part in their high-risk counterinsurgency plan, devised by General Stanley McChrystal, the American commander in Afghanistan.

So far that has involved sending 30,000 extra troops, strenuous efforts to reduce civilian casualties and the clearing out of insurgents from Marja, an area in Helmand. The summer will see an intensified attempt to drain away insurgent influence from the crucial southern town of Kandahar. But the big flaw in the McChrystal plan, it is generally acknowledged, is the Afghan government. Counterinsurgency experts point out that, historically, most campaigns fail when the host government is not determined to win.

On a number of fronts Mr Karzai has disappointed American expectations. He belatedly passed a decree this year beefing up an anti-corruption body, but American diplomats complain of a distinct lack of commitment to the cause. And his only other significant reform has been to emasculate the election watchdog that did much to challenge his victory in last year’s presidential poll.

Mr Obama’s officials say that, in the private meeting, he told Mr Karzai that America wanted to see more action on tackling corruption and on improving the quality of the country’s public servants. But the Americans know there are some things they want that Mr Karzai will not do—such as move Ahmed Wali Karzai, his half-brother, who is plagued by allegations (which he denies) of drug-trafficking, away from his stamping-ground in Kandahar. Now, says a NATO official, the president will simply have to keep his
brother on a “short leash”.

America also wants to see the Afghan government push plans to win over “low-level” Taliban fighters, deemed susceptible to job-creation schemes such as new roads and irrigation projects. But the government has been making slow progress in building a system that might spend the foreign money that has been pledged to such reintegration programmes.

Some diplomats have also detected a coolness in Mr Obama towards a planned “consultative peace jirga”, essentially a large meeting, to be held in May, of national representatives. The hope is that they will come up with an agreed approach to peace talks with the Taliban. But few expect the jirga to reach agreement on what compromises with the Taliban the Afghan government should be prepared to accept.

The Americans want to see peace talks, but only after the insurgents have been ground down on the battlefield and they are left, as one Western official puts it, with a simple choice: “reconcile or die”. Mr Karzai seems to see things differently. He has shown an extraordinary readiness to meet active insurgents, as he did in late March, when a delegation from a militant group, Hizb-e-Islami, came to Kabul with a 15-point peace plan.

Critics argue that heads of states should talk to a group such as Hizb-e-Islami, which has been responsible for many attacks on NATO troops and the capital itself, only at the culmination of a peace process, not its beginning. But the meeting excited those hoping for quick progress towards a negotiated settlement. They say Hizb-e-Islami’s demand for foreign troops to leave the country this year, and for an interim government, are just an opening gambit. Gulbuddin Hekmatyar, the movement’s leader, has long been known to want to return from hiding in Pakistan.

Optimists also argue that the interests of Hizb-e-Islami and the West in some respects actually converge: both sides want foreign troops out and the country’s government cleaned up. But since the West does not want to be seen to lose the war, it remains reliant on Mr Karzai, the only “strategic partner” on offer.
Televised talks lower the temperature

THE glare of public debate was a departure from Thailand’s usual brand of political dealmaking. And it hardly made prime-time entertainment. But the three-hour televised peace talks on the evening of March 27th between Thailand’s prime minister, Abhisit Vejjajiva, and his red-shirted opponents did at least suggest that a tense political stand-off on the streets of Bangkok might yet be resolved peacefully. Neither side, however, was ready to budge much; a second meeting on March 28th likewise failed to yield a compromise; and it is unclear if there will be more talks to break the impasse.
The red shirts, who have been camped out in the Thai capital for three weeks in a huge show of strength, want Mr Abhisit to call new elections at once. They were not impressed by his offer of a nine-month timetable to wind down parliament, in which Mr Abhisit’s Democrat Party heads a six-party ruling coalition. The two sides might yet close the gap on a timetable.

Mr Abhisit had pooh-poohed the popularity and legitimacy of the red shirts, so sitting down with their leaders was a concession. It came amid friction between the army, squarely behind Mr Abhisit, and the protesters, who accuse the top brass of dictating government policy. A spate of unsolved bombings of government and military facilities has added to the tensions. The talks on March 27th followed sabre-rattling by both sides, including a threat by demonstrators to storm an army base where Mr Abhisit has been holed up.

Bangkok’s royalist elite has been chastened by the red shirts’ pulling power. Far from being a rural army-for-hire, as critics claim, it clearly has plenty of urban supporters. Not all red shirts are fans of Thaksin Shinawatra, the fugitive former prime minister, who backs the movement. But they are ready to join forces to evict a government that, in their eyes, lacks a democratic mandate. To imagine, as some do, that the red shirts will all go home to tend their fields is wishful thinking, argues Chris Baker, a historian and biographer of Mr Thaksin. The movement has staying power and Bangkok’s snooty elites “have been kidding themselves,” he says.

A commitment to hold elections soon should end the protest. But Mr Abhisit’s coalition partners, mostly cast-offs from Mr Thaksin’s former party, want to stay in power—and build up campaign funds—for as long as possible. The generals have their eyes fixed mainly on their annual promotions in October, when the army chief must retire. Mr Abhisit told the red-shirt leaders that an election should be held after constitutional amendments were completed and a budget was passed in the autumn. That sounds like flim-flam. And an excuse might yet be found for further delay, beyond the end of parliament’s term in December 2011.

Behind the sparring over election dates are calculations over who stands to gain. Many believe that the Puea Thai party, the heir to Mr Thaksin’s electoral machine, would win a plurality in an election, as its predecessor did in December 2007. Red shirts reckon they have a clear majority. But there is a counter-argument. The share of the vote for Mr Thaksin and his proxies has been in steady decline since a 2005 landslide victory. Court-ordered break-ups of two ruling political parties have depleted his stock of credible allies. To this way of thinking, the red-shirt protests represent the flailing of a desperate man. It is a fine theory that would seem worth putting to the electoral test. But Mr Abhisit and his backers do not seem convinced.
The government spars with aid agencies; the displaced still suffer

NEARLY a year after the end of Sri Lanka’s long civil war, life remains grim for hundreds of thousands of Tamils in the north of the country, displaced in the final months of fighting. Now they face a new threat. International agencies are running out of funds to meet their needs, after the government’s rejection of a United Nations-led mechanism for channelling humanitarian assistance to the country. By March 25th only $15m had been promised for the year, just 4% of the estimated total required for humanitarian aid in the camps and return areas.

To tide over the immediate crisis, the UN’s Office for the Co-ordination of Humanitarian Affairs (OCHA) is poised to announce a three-month package of assistance for “urgent life-saving activities”. The money, from an OCHA emergency fund, will cover the supply of water, food, emergency shelter, sanitation and health care to those still in displacement camps.

Aid agencies, however, say that more than a short-term cash injection is needed. Until permanent housing is built, many of the displaced will go back to their villages to live in shacks with little hope of paid employment and scant access to basic services. The agencies urge the government to secure funds for the whole year. But this process has been stymied by an ugly spat over the procedure for raising aid.

For the past few years OCHA has overseen an annual Common Humanitarian Action Plan (CHAP), on the basis of which aid pledges were made. Habitually released to donors in January, this defined priorities for aid and estimated the sums needed. But in March the government decided abruptly that this year there will be no “consolidated appeal” because the CHAP mechanism was useless. It wants the funding channelled instead through a presidential task force headed by President Mahinda Rajapaksa’s brother, Basil.

Rajiva Wijesinha, formerly of the ministry of human rights, says that the government found the assumption that Sri Lankans were “living through the UN, are fed and clothed by the UN” intensely irritating. Even during the worst days of the war, he insists, the government kept functioning and did “most of the clothing and feeding of our people”. But the decision also stems from increasingly acrimonious relations between the government and UN agencies. Some agencies were openly critical of the colossal human loss incurred in the army’s final assault on Tamil Tiger rebels in 2009. The atmosphere has worsened since the UN’s secretary-general, Ban Ki-moon, decided in March to appoint a panel of experts to look into alleged war crimes.

The presidential task force this week distributed to some agencies a bulky paper outlining its plans for the shattered north. It argues the humanitarian phase must give way to one of recovery and development. But UN sources in private say the plans are too long and complex and fail to make clear the priorities for funding. They worry that, as the government fumbles with a new procedure, competing disasters such as the earthquake in Haiti are fast eating into a dwindling pool of resources.

With donors still uncertain where to send the money—and for what—services to displaced Tamils are in peril. On March 8th the UN’s refugee agency, citing funding shortfalls, stopped distributing shelter cash-grants to families returning from camps to their bombarded villages. The agency has less than half the $39.8m it says its programmes need in 2010.

A report from the office of the UN’s resident co-ordinator in Colombo says agencies providing shelter are also struggling to secure funds to build housing fast enough to keep pace with the numbers going home. Aid agencies are talking to donors to secure funding for operations at Menik Farm, a huge displacement site in the Vavuniya district still housing 84,152 people. In March inmates shared water enough for just 66,000 people. The agencies are still distributing dry rations. But there has been no money for perishables such as vegetables and fish since January.
The simmering anger of urban China

ALTERCATIONS between unlicensed street vendors and law-enforcement officers are commonplace in China. Sometimes they escalate into scuffles or riots. But a night-time rampage by hundreds of citizens in the southern city of Kunming, capital of Yunnan province, on March 26th-27th has aroused fresh concerns about a malaise in Chinese cities.

The violence in Kunming reportedly left dozens injured. Ten government vehicles were overturned and some set on fire by crowds enraged by rumours that a vendor had been killed by an officer of Kunming’s “City Administration and Law Enforcement Bureau”. This agency, commonly known by its Chinese abbreviation chengguan, is a junior cousin to the police force. It is responsible for matters such as clearing the streets of illegal pedlars and supervising house demolitions. Chengguan officers are renowned for their thuggish, fine-gouging ways.

The vendor, as it turned out, had not been killed. But the rioters could be forgiven for assuming the worst. In the past couple of years even some state-controlled newspapers have made common cause with critics of chengguan activities across the country. In January 2008 a man in the central province of Hubei was beaten to death when he attempted to film officers trying to stop a protest by villagers against a dump for urban waste. "Another citizen has fallen. When will we stand up and restrain the chengguan system?" wrote a newspaper columnist at the time.

The Chinese press has reported others having fallen to the chengguan since: a pedlar left severely brain-damaged after a mauling in Shanghai last July; a man beaten to death in Beijing in October after being accused of illegally using his motorcycle as a taxi. One case prompted a letter to China’s legislature. A woman in the province of Sichuan died last November after setting herself on fire in protest when officers burst into her home to enforce a demolition order. In response, a group of Beijing law professors wrote proposing tighter controls on demolition procedures.

Protests triggered by chengguan brutality have rattled the authorities, hypersensitive as they are to any urban unrest that might turn against the government. Last May hundreds of university students protested in the eastern city of Nanjing against the alleged beating of a classmate. The following month police rescued several chengguan who were captured by rioters in a town in the southern province of Guangdong. In Kunming last October protesters put the corpse of a pedicab-driver, who had allegedly been killed by chengguan, on a gurney and wheeled it to a chengguan office where they burned paper as a traditional funeral offering (the authorities said he had died naturally). That same month a Shanghai man became famous when he chopped off part of a finger in protest at what he said was an attempt to frame him as an illegal taxi-driver.

The latest flare-up in Kunming has also attracted considerable press attention. One newspaper website described the eruption as symptomatic of public resentment against local officialdom that could blow up like “a bomb at any time”. Another newspaper attacked the Kunming authorities for releasing only bare details and not taking questions at a press briefing on the incident. A third suggested the official version of events, that the vendor had simply fallen over, might be a “lie” (a word even used in the headline). It quoted witnesses saying an officer had pushed over her pedicab, pinning the woman under it. A gas canister had then rolled on top of her, knocking her unconscious.

In recent weeks, a speech on social unrest by a prominent Chinese scholar, Yu Jianrong, has been widely circulated on the internet in China. In it Mr Yu describes the emergence in recent years of a new type of social unrest, which he calls “venting incidents”: brief, unorganised outbursts of public rage against the authorities or the wealthy. China’s efforts to enforce “rigid stability”, he argues, were not sustainable and could result in “massive social catastrophe”. Even government officials, he notes, are giving warning in private of worse to come.
Japan’s favourite tree

An Easter story from Japan
Mar 31st 2010 | TOKYO
From The Economist print edition

Can Japanese technology be used to revive the holy spirit?

THE mighty, shimmering Ginkgo towered over the shrine steps and, as legend has it, had stood witness to history being made in Japan for over 800 years. When it thudded to the ground in March, it was as if the nation shook. Visitors flocked to the ancient capital of Kamakura to pay their respects and take photos. “Rest in peace, old one. Your tale is now done,” sighed the writer of a blog, with tender poignancy.

But this is Japan, whose age-old belief in nature is at least evenly matched by an unyielding faith in technology. Under orders from the prefectural government, scientists set about replanting the tree and cloning it. That is not as tricky as it sounds. The cloning of trees by grafting a cutting onto a living root is hardly modern science. But in Japan’s Shinto faith there are spiritual complications because this tree is, in essence, divine—it is, says Shigeho Yoshida, chief priest of the Tsurugaoka Hachiman shrine where the Ginkgo stood, “a holy tree”.

In the Shinto faith, he patiently explains, nature is to gods and man what God is to nature and man in Western religions. So when scientists say they are cloning the tree’s gene, he believes they are really propagating a holy spirit. That is a sacred task. Only when he was assured that this was natural science, not the laboratory sort, did he feel comfortable enough to give his blessing.
But it is still a touchy issue. The Kanagawa prefecture has not only sought to revive the tree in the shrine’s grounds. It wants to plant offshoots elsewhere, possibly as a tourist attraction. Mr Yoshida is a bit scandalised. What’s more, he felt the old Ginkgo may have been trying to send a message by tumbling down. “So many people came, called and sent e-mails offering their condolences. Perhaps the tree fell to draw everyone’s attention away from their focus on materialism and money.” For all the materialism, trees are still touchingly revered in Japan. It is cherry-blossom season, a time of all-night sake-drinking parties under the sakura. Even salarymen take photos of the blossom to send to their girlfriends by mobile phone.

But the Ginkgo is special. The story goes that in the 13th century, an assassin hid behind it before severing the head of his uncle, the last shogun of the Minamoto line. Centuries of bloodshed followed. Mr Yoshida says the tree’s demise has drawn 20,000 people to the shrine. He hopes more will come if it revives. With all the press coverage, that could give Japan, a year hence, a taste of its own Easter story. Just don’t mention the word “resurrection”, which is part of neither Shintoism, nor Buddhism, the country’s other religion. Mr Yoshida can barely bring himself even to whisper the word.
As millions of animals die by famine, some herders long for the bad old days

IN A country where livestock outnumber people by an order of 16 to one, animal welfare is no small matter. In Mongolia this year the animals are not faring well at all, and the 2.8m human inhabitants are feeling their pain. Hundreds of thousands of Mongolians depend directly upon animals for their own livelihood.

The immediate cause of everyone’s distress is an untoward sequence of weather events. A bone-dry summer last year was followed by a winter of unusually high wind, low temperatures and heavy snow cover. This combination has meant the country’s yaks, cattle, horses, camels, goats and sheep have gone long months without grazing adequately. The dreaded *zud*, as Mongolians call this phenomenon, is nothing new. In recent memory it struck three years in a row, starting in 2000—but the damage from this year’s *zud* is proving to be the worst in decades.

Experts warn that the next four to six weeks will see more cold weather and devastated herds, as ever greater numbers of frozen, emaciated animal carcasses dot the vast Mongolian countryside. The United Nations reckons that this year’s *zud* has robbed 120,000 Mongolian herders of at least half their livestock and that as many as 500,000 herders have been affected. UN agencies have allocated $3.7m in emergency assistance to help remove animal carcasses, replace herders’ lost income and bring them health services.

According to the International Federation of Red Cross and Red Crescent Societies (IFRC), 19 of Mongolia’s 21 provinces have been afflicted and 4.5m animals—about one-tenth of the total livestock population—have perished in the past three months. The IFRC has launched an emergency appeal to provide food and other supplies, including medical treatment for conditions from frostbite to depression.

The disaster is also descending on the nation’s cities and towns, which already suffer from poverty, poor services and high rates of unemployment. Now it seems they must accommodate an influx of tens of thousands of rural migrants who have lost their herds.
Drought, cold and snow are the proximate causes of this season’s widespread misery. But weather alone is not to blame for its severity. In the 20 years since Communist rule in Mongolia ended, herding practices have changed drastically. Privatisation meant the dismantling of large collectives, and herders now find themselves missing some of the underappreciated benefits of scale—not to mention, in many cases, access to technical and management expertise of the kind that helped sustain operations through harsh winters.

According to Save the Children, another relief agency active in Mongolia, many distressed herders are advocating a return to the Soviet-style system. But even that would not set things right. The old system depended heavily on the Soviet army’s role as a reliable buyer of Mongolian animal products—as well as on direct subsidies ordered by the Politburo. Whatever the zud may bring in years to come, those days are gone for good.
Banyan

Indonesia's place in the global jungle
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From The Economist print edition

Its people agree that their democratic country should play a bigger global role; but what?

BY DINT of size, population and potential wealth, Indonesia has long loomed large over its own backyard. The archipelago nation bestrides the world’s busiest sea lanes. Some 231m Indonesians account for two-fifths of the population of ASEAN, the ten-country Association of South-East Asian Nations. A young and reasonably educated population offers perennial promise, as do vast deposits of oil, gas and minerals, forests and palm-oil plantations. For all that ASEAN operates according to its famed consensus, Indonesia has been its stealth leader.

But President Susilo Bambang Yudhoyono has bolder aspirations. A liberal internationalist, Mr Yudhoyono convincingly won a second term last year, and monopolises the foreign-policy apparatus. He has brought Indonesia closer to Australia, its big southern neighbour with which it has a troubled past. He was supposed to have signed a “comprehensive partnership” with Barack Obama by now, but the American president delayed the trip in order to push his health-care reforms through Congress.

Mr Obama will return in June. He spent four boyhood years in Jakarta and a huge welcome awaits his pulang kampung (homecoming). Before then, Indonesia will mark the fifth anniversary of another (this time “strategic”) partnership, with China, when the prime minister, Wen Jiabao, visits in late April. Indonesia, Mr Yudhoyono likes to say, has “1,000 friends and zero enemies”.

Indonesia now wants to raise its diplomatic game, acting the part of a regional power with a global impact. One sign of this is a desire to be ranked among the BRIC economic club of Brazil, Russia, India and China. Another is to send peacekeepers as far away as to Lebanon and Darfur. A third is Mr Yudhoyono’s admirable wish to make democracy and human rights a plank of foreign policy. But the country’s rising ambitions are best epitomised by more urgent talk about how Indonesia can capitalise on its membership of the G20 group of major economies.

A powerful impetus for all this comes from its Asian neighbourhood. In both economic vitality and security importance, Indonesia pales beside both China and India. China’s rise from regional to global power poses the biggest challenges for Indonesia, as its policymakers see it. But it is India’s élan, both in terms of its economy and a newly polished image, that has got Indonesians worrying about their own image.
Compared with Indonesia, India has even more atrocious infrastructure, more intractable insurgencies, more terrorist attacks, and often awful relations with neighbours. Yet investment and tourists pour unfairly in, Indonesians complain. Meanwhile their country, a largely peaceable place with few terrorist attacks since the Bali bombing of 2002, is deemed unstable—and with a negative Muslim identity to boot. Australia, for all the improvement in relations in recent years, nevertheless advises nationals to “reconsider your need to travel to Indonesia”. Total Australian investment in Indonesia is less than it was in 1996. An Indonesian cabinet minister says that his country needs to change perceptions by aping India’s “Incredible India” promotion that took Davos and the business world by storm in 2006.

Foreign perceptions are unhelpful in other areas too. The commonest description you hear when Indonesia is praised by Americans—that it is the world’s most populous Muslim democracy—is a tag that thinking Indonesians chafe at. They think it limiting and certainly misleading. Indonesia prides itself on being a secular state that happens to have a Muslim majority. Moreover, they say, America is fooling itself if it thinks that Indonesia’s brand of Islam can help the superpower with its problems in the Middle East, Iran or Afghanistan, where faraway Indonesia’s syncretic practice is as likely to be abhorred as admired.

As for the elevation of the G20 to global prominence, Indonesians sometimes appear hardly able to believe their luck. The question is what they can do with it. On the one hand, Indonesia weathered the global financial crisis that gave the G20 its sense of purpose. On the other, it did so because Indonesia is still shockingly ill-integrated into the global economy. Besides shoddy infrastructure, it has an economy distorted by subsidies, a business climate hostile to foreign investment and a bureaucracy and legal system shot through with corruption. With a bit of joined-up reform, which after six years of stops and starts Mr Yudhoyono may be on the point of beginning in earnest, Indonesia’s annual growth would surge from the present (admittedly respectable) 4.5-5.5% to rates closer to India’s or China’s.

Leadership begins at home

More than most admit, Indonesia’s international ambitions rest on shaky domestic foundations. Mr Yudhoyono has committed Indonesia to sweeping cuts in emissions of greenhouse gases, risking unpopularity among other developing nations. But thanks to widespread deforestation, much of it illegal, the country remains among the world’s biggest emitters.

And despite the admirable advances of democracy and of sound fiscal management, prosperity is not entrenched. One in seven Indonesians still lives below the poverty line, and many more perch perilously just above it. By several measures of development—life expectancy, health care, sanitation—Indonesia scores well below the middle-income country it is.

Poor governance at home has a bearing on soft-power aspirations abroad. A reputation mainly for having resources to plunder colours the views of Indonesia by India and China, huge buyers of Indonesian commodities. In countless areas, from illegal logging and fishing, to climate change, people-smuggling and extremism: a failure to prosper at home would turn the spotlight away from Indonesia’s desire to solve global problems, and towards its capacity to generate them.

Economist.com/blogs/banyan

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Hamas hangs on
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Hamas has done well to survive but it is threatened by rivalry among Islamists

AFTER four gruelling years under siege, the Gazans—and the Islamist movement, Hamas, that governs them—are still managing against the odds to survive. Some even prosper. The tunnels that snake under Gaza’s border with Egypt have multiplied so fast that supply sometimes exceeds demand. So stiff is commercial competition that tunnel-diggers complain that their work is no longer profitable. As a British parliamentary report recently noted, Israel officially allows Gaza to import only 73 of more than 4,000 items that are available in the strip. The rest is home-made—or acquired illicitly. For instance, cement, which cost 300 Israeli shekels ($80) a sack two years ago, has dropped almost tenfold in price, precipitating a spate of building for the first time since Israel’s attack a year ago reduced 4,000 houses to ruins. And eyewitnesses say that flashy 4x4 vehicles can actually drive through tunnels built from shipping containers.

Israel’s siege still causes misery. Yet some economists say the strip is growing faster than the West Bank run by Hamas’s rival Palestinian Authority (PA), albeit from a far lower base. The petrol pumped into Gaza by underground pipes and hoses from Egypt costs a third of what it does in Ramallah, the Palestinians’ West Bank capital, where Israel supplies it. Free health care is more widely available in Gaza. Imports travel faster through the tunnels than via Israel’s thickets of bureaucracy. The web of Israeli checkpoints that still impedes Palestinian movements and commerce on the West Bank is absent in Gaza.

As well as lower prices, Gazans benefit from civil-service payrolls. Several outfits pump cash into the strip’s economy: the local Hamas government; the UN, which employs 10,000 Gazans; and Salam Fayyad’s West Bank government, which is the largest employer of all. Payments to Hamas and its connected tunnel-operators boost the economy too. A car-dealer bringing in a new Hyundai saloon through the tunnels stands to make a profit of $13,000.

Above ground things look better, too. In the 14 months since the war ended, Hamas has swept up much of the wreckage. The Islamic University, bombed by Israel’s aircraft, sparkles again. New cafés have opened across Gaza City. Power cuts dog Gazan life, but Hamas profits from the taxes it collects on the fuel that powers a noisy surfeit of generators. America recently imposed sanctions on the main Hamas-owned bank, but the informal hawala banking system that straddles the border keeps the strip solvent.
Whereas Gaza was once plugged into Western economies, the siege has forced it to find other financial moorings. So confident is Hamas that it can survive without the PA’s banking system that it has just, for the first time, sent its police to raid a bank that had obeyed a PA order preventing a Hamas-run charity from having access to deposits.

All the same, Hamas's political isolation hurts. Egypt is frustrated by Hamas’s refusal to let Mahmoud Abbas, the Palestinian president, and his Fatah party resume control over Gaza. Egypt's president, Hosni Mubarak, fears that the Islamist influence of Hamas may seep over the border into his own country. So he has severed ties with Hamas, barred its senior officials from travelling in or out of the territory, and hampers foreign aid from Iran and other sympathisers. The Egyptian government has also ordered an underground barrier to be built along the border with Gaza, to block the tunnels. Mr Mubarak ignores Hamas's protests that it has no interest in weakening Egypt’s national security and that it has avoided getting tied up with Egypt’s Islamist opposition, principally the Muslim Brotherhood, of which Hamas was originally a branch.

Meanwhile, Gaza’s other neighbour, Israel, still launches incursions to enforce a buffer-zone inside the narrow strip and to keep it locked down. And in an effort to isolate Gaza’s rulers, Mr Abbas's PA, which is based in Ramallah, said it would attend international events, such as the recent Arab League summit in Libya, only on condition that Hamas is excluded.

Frustrated by their inability to break free of this stranglehold, Gaza’s leaders are showing signs of shedding their stoic discipline, which has generally, since the war ended in January last year, stopped Hamas people from firing home-made rockets into Israel. Hamas’s arguments against a resumption of American-brokered negotiations between Israelis and Palestinians are growing more vitriolic. The ceasefire with Israel may be fraying. A recent spate of rockets into Israel has punctured the calm, though Hamas’s Gaza strongman, Mahmoud Zahar, condemned it.

The people launching the rockets appear to be a mixture of hardliners within Hamas and assorted Islamist radicals from other movements. Both of them think the Hamas governors in Gaza have gone soft. They have been angered by an apparent campaign by Israeli agents to assassinate Hamas people abroad, most notably Mahmoud al-Mabhouh in Dubai in January. Two weeks ago a rocket from Gaza killed a Thai worker in Israel; it was unclear who fired it. An attack on an Israeli border patrol by assailants on a motorbike is said to have borne the hallmarks of training in Afghanistan. Hamas’s military wing, the Qassam Brigades, recently boasted it had killed two Israeli soldiers in Gaza. After months of quiet, Israel’s leaders are again threatening war and shooting back. Daily UN security reports on the strip, that have had almost nothing to report for months, are now full of descriptions of Israeli incursions by tanks and excavators that churn up the fields in the buffer zone.

Meanwhile Hamas has redirected its energy inward, setting off turf wars for control of business in the strip. Whereas the Qassam Brigades once ruled the roost, Hamas's boorish interior minister, Fathi Hamad, now wants his own forces to do so. He has also issued his own decrees to enforce Islamist customs, for instance by banning Valentine’s Day soirées and male hairdressers in female salons. Immigration officers overseen by Hamas inspect the bags of foreigners entering from Israel into Gaza; if they find whisky, a prized asset in the dry strip, they pour it into the sand.

Fratricide looms

Hamas's Islamist rivals try to impose their own local versions of Islamist rule. Jaljalat, a group whose name means “rolling thunder”, has grabbed attention by claiming to be linked to al-Qaeda. It has also realigned itself with the Qassam Brigades in a joint struggle against Mr Hamad’s interior-ministry forces. The prime minister in Gaza, Ismail Haniyeh, a Hamas man, seems to be backing those who want to curb his unruly interior minister.

The ensuing power struggle has turned violent. Bombs have blown up the cars of senior police officers, of the mayor of Rafah, close to the border with Egypt, and of a Qassam Brigades leader, so far without their owners inside. A string of explosions have disturbed Mr Haniyeh’s home district, Beach Camp. With signs of division in Hamas, Gazan clans who had gone quiet for the past year have resumed vendettas.

Hamas’s success in keeping Gaza’s economy and administration going testifies to its resilience. But old-timers speak of a familiar cycle. When Yasser Arafat returned to Gaza in 1994 to set up the Palestinian Authority, he brought a sense of order, security and hope. But his wayward henchmen began to spar over spoils, igniting feuds between rival security forces. Israel’s counter-attack against the intifada (uprising) that broke out in 2000 pulverised the PA’s security apparatus and punctured central authority. A year after
Israel’s assault on Gaza, some in the territory fear a similar cycle may soon ensue.
IT IS now widely agreed that “black economic empowerment” (BEE) and affirmative-action laws brought in after apartheid as the star policies of the ruling African National Congress (ANC) have failed. Even President Jacob Zuma seems to agree. Instead of redistributing wealth and positions to the black majority, they have resulted mainly in “a few individuals benefiting a lot,” he says, while leaving the leadership of most big companies in white hands. The black masses, the intended beneficiaries, have hardly gained.

Largely as a result of the emergence of this new BEE elite, post-apartheid South Africa is still one of the most unequal countries in the world. Although poverty has been alleviated by providing welfare benefits to more than one in four of South Africa’s 49m inhabitants, the gulf between rich and poor has widened. The richest 4% of South Africans—a quarter of whom are black—now earn more than $80,000 a year, 100 times what most of their compatriots live on.

Under apartheid, blacks were given an inferior education and on the whole restricted to much worse jobs. The Employment Equity Act in 1998 tried to make the workforce “more broadly representative of our people” across the board. But more than a decade later, whites still hold three-quarters of senior jobs in private business whereas blacks have 12%, the exact reverse of their share in the working population.

Among the 295 companies listed on the Johannesburg Stock Exchange (JSE), blacks account for just 4% of chief executive officers, 2% of chief financial officers and 15% of other senior posts. In non-executive ones, they do a bit better, accounting for just over a quarter of board chairmen and 36% of directors, but still nowhere near their share of the workforce. Even so, many whites grumble sotto voce that incompetent blacks are being promoted beyond their abilities.

As whites account for 40% of university graduates, a 12% quota for whites in skilled or top managerial positions is absurd, the South African Institute of Race Relations, a think-tank, says. Its head, John Kane-Berman, argues that BEE, in the way it has so far been implemented, has actually harmed blacks by
discouraging self-reliance and an entrepreneurial spirit. Instead it has fostered a debilitating sense of entitlement.

The idea of legislating for black economic empowerment was originally promoted by big white businessmen to ward off post-apartheid calls for nationalisation. If a few well-connected black people were given chunks of the action, big business would, they hoped, be left alone. In that sense, BEE has been a roaring success, as whites still own the bulk of the country’s wealth. Although renewed calls for the nationalisation of the mines and banks have recently been heard within ANC ranks, Mr Zuma, urged on by the new black capitalists, has repeatedly said that this is not on the government’s agenda.

Under BEE laws, white-owned companies with an annual revenue of at least 5m rand are given ratings for enabling blacks to own shares, improve their skills within the company, move up the managerial ranks, and so on. The higher the company’s score, the more likely it is to win lucrative public contracts. Everyone is supposed to win. Black individuals or companies could buy large holdings in white companies in the hope of paying off their debts through dividend payments and rising share prices.

For as long as buoyant stock markets were rising, this worked nicely. But when the global financial crisis caused shares to plummet, many BEE companies crashed, making new investors wary. In 2007 there were a record 111 BEE deals, worth 105 billion rand, involving companies listed on the JSE. In 2008 this fell to 84 deals, worth 61 billion rand. Last year, however, there were just 13 deals, worth 20 billion rand.

Moeletsi Mbeki, an analyst and entrepreneur who is a brother of the former president, Thabo Mbeki, claims that BEE has struck a “fatal blow against the emergence of black entrepreneurship by creating a small class of unproductive but wealthy black crony capitalists.” Yet most leading businessmen, white and black, still regard the policy as vital for the country’s future, though they admit it has been badly implemented. All seem to agree that the policy should be made to benefit a wider range of blacks, not just business people.

President Zuma promises a review. He complains that the country’s economic “transformation”, meaning the redistribution of power and wealth to the black majority, has been “disappointingly slow”. Last month he launched a new council to advise on a much “broader-based” BEE. Meanwhile, worried whites, whose skills are still sorely needed, are continuing to emigrate in droves.

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A South African rabble-rouser

Free speech versus hatred
Mar 31st 2010 | JOHANNESBURG
From The Economist print edition

Should a leader of the ruling party celebrate the shooting of Boers?

SONGS from the years of struggle against apartheid still rouse every rally of the ruling African National Congress (ANC). But the words of one have been held to breach South Africa’s constitution. Often hailed as one of the world’s most liberal, it advocates free speech but bans “advocacy of hatred that is based on race...and that constitutes incitement to cause harm”.

Julius Malema, the firebrand leader of the ANC Youth League, whose prominence and influence belies his 29 years, recently chose to perform “Ayesaba Amagwala”, a Zulu ditty with lyrics that say “Dubula ibhunu”, meaning “Shoot the Boer”, the Afrikaans word for farmer that is often held to refer to whites in general.

Some 3,000 white farmers and their family members are reckoned to have been murdered since the advent of democracy in 1994. So Mr Malema’s choice of song provoked a wave of outrage, with opponents accusing him of condoning such violence. According to the South African Institute of Race Relations, a think-tank, research suggests that at least 90% of the attacks on white farmers were “purely criminal”. Labour disputes accounted for others. Only 2% were said to be motivated by “racial animosity”.

Mr Malema’s latest rendition has raised the question of whether his right to free speech should be trumped by the constitution’s ban on spreading hatred. The race-relations institute’s Kerwin Lebone says the ban should prevail. “These kinds of things are necessary if we are to protect what was achieved in 1994,” he says. “Otherwise, what’s the point?”

Last week a high court ruled that “Dubula ibhunu” was unconstitutional and illegal, leaving Mr Malema open to prosecution if he repeats the display. He has already been convicted of hate speech by the Equality Court (set up in 2000 to enforce laws against discrimination) after saying that the woman who accused President Jacob Zuma of rape (for which he was acquitted in 2006) had “had a nice time”. “Apartheid took us to prison for singing these songs,” says a defiant Mr Malema. “If I am to be sent to jail under the new democratic order for singing them, then so be it.”

Opposition and civil-rights groups have asked Mr Zuma and the ANC to rein in Mr Malema, but the ruling party insists the songs are part of liberation history and will appeal against the court ruling. Mr Zuma sounds equally loth to rebuke his young charge in public. He faces division within the ANC and seems unable or unwilling to berate him privately. Mr Zuma will also recall the hoo-ha during his own struggle to win the presidency, when he would sing his favourite anthem, “Awuleth’ umshini wami” (“Bring me my machinegun”), with fist-pumping panache.
Uganda's oil

A bonanza beckons

Mar 31st 2010 | KAMPALA
From The Economist print edition

Hope and peril for the Great Lakes

A DETERMINED push by Western wildcatters and big oil companies from fast-growing Asian economies such as those of China and Malaysia may change the fortunes of several countries in remoter and trickier bits of Africa once largely ignored by foreign investors. One of the most spectacular recent finds has been in Uganda. The reserves of the Albertine rift, which takes in the Ugandan and Congolese shores of Lake Albert (see map), are said to need $10 billion for development. All being well, Uganda will soon become a mid-sized producer, alongside countries such as Mexico. Foreign investment in Uganda may nearly double this year to $3 billion. The country expects to earn $2 billion a year from oil by 2015.

The windfall may well change the country’s politics. But oil can be a curse. It is far from certain that all of the country’s 30m people will benefit. Oil executives and loyalists of Uganda’s president, Yoweri Museveni, say the bonanza offers a chance to overhaul the country’s rickety infrastructure and to train a professional workforce. A deal in the offing will link Tullow, an Irish company much involved in the oil discovery, with Total, a French giant, and the cash-rich China National Offshore Oil Company (CNOOC).

However oil-rich Uganda becomes, Mr Museveni, who came to power in 1986, will still have headaches. He has spent much of his time in office papering over tribal and other divisions. A rebel militia, the Lord’s Resistance Army, which has terrorised northern Uganda for more than two decades, has finally been driven into Congo, where it continues to perpetrate massacres. But other disputes fester. Oil riches could exacerbate rather than resolve them.

The Buganda kingdom, the largest of the country’s four big ones, helped vote Mr Museveni, an Ankole, into office. Now the Baganda are less keen on him. They believe that more power should be devolved to their traditional rulers. And they want a lot more money—oil money—spent on their unemployed young men. They can make things awkward for Mr Museveni’s ruling National Resistance Movement, especially around Kampala, the capital. Another kingdom, Bunyoro, is demanding a big cut of the oil revenues; most of the oil wells are being drilled on its land.

As well as grumbling monarchies, Mr Museveni must satisfy his party’s own grandees. Sinecures help, starting with his own family. Mr Museveni has appointed a son, Muhoodzi Kainerugaba, to command an army unit with specific responsibility for guarding the oil wells. It may be the first step in a handover from
father to son. A bigger worry is the apparent lack of oversight on Mr Museveni and his government that oil may bring. Foreign aid-giving governments already tend to look the other way when Uganda’s democracy falters, its environment is fouled up, or aid money is stolen. Yet foreign leaders have already begun to fawn. South Africa’s president, Jacob Zuma, was the latest to visit Kampala with oil deals presumably in mind.

But China is likely to be the biggest winner. Mr Museveni seems dazzled by Chinese promises to help build an oil refinery and to help turn oil into Ugandan-produced plastics and fertiliser. That may be bad news for Uganda’s opposition, which wants to oust Mr Museveni in next year’s election. And several jealous Western governments and companies want to stall China’s advance into the Congo basin, with its vast reserves of minerals and timber.
Nigeria's new cabinet

Signs of life
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From The Economist print edition

A surprisingly brisk presidential broom

WHEN Goodluck Jonathan took over the presidency in February from the ailing Umaru Yar’Adua, few believed he would even try to make much of a difference before the next election, due next year. After all, he had been a largely passive vice-president and before that an unexceptional state governor. But there are early signs of unusual animation.

Mr Jonathan was quick to assert his authority. On March 17th he surprised many by firing all 42 cabinet ministers inherited from his predecessor. He has since started submitting nominees for his own team. The senate, which must give approval, began screening them on March 29th. A new cabinet is expected to be unveiled before parliament’s Easter recess.

Many Nigerians hope that the acting president, bolstered by his own team, may gee up Africa’s most populous country (150m-strong) and its biggest oil and gas producer south of the Sahara. Mr Jonathan says his main aims are to tackle Nigeria’s woeful electricity supply, change a flawed electoral system and deal with the militant gangs in the oil-rich Delta region, who are threatening to flout the terms of an amnesty granted last year by Mr Yar’Adua and return to violence.

So the prospect of a new cabinet has raised hopes. The previous team was seen as weak and divided. “Lethargy had begun to set in”, admits a senior member of the ruling People’s Democratic Party. Some new blood could certainly pep things up. But Mr Jonathan’s proposed cabinet suggests he is keener to balance political interests rather than embark on radical reform. About a third of his nominees so far are from the previous cabinet, some of whom dealt with the most sensitive subjects such as the amnesty in the Delta region. This suggests that policies may not change dramatically. Some proposed new members had been sidelined under Mr Yar’Adua. But a nephew of the sickly leader is also a nominee.

Another is Olusegun Aganga, a previously London-based bigwig at Goldman Sachs, an American bank, who is tipped to become finance minister. Nigeria is in the midst of banking reforms following last year’s bail-out of the sector at a cost of $4 billion. In a country where oil revenues make up a good 85% of government income and where energy-industry reforms have repeatedly stalled, the choice of oil minister will also be crucial. The nominees’ ministries will not be revealed until the individuals have been approved.
Even if Mr Jonathan wants to be bold, time is against him. He is unlikely to stand in next year’s election because of the ruling party’s unofficial rotation system: Mr Jonathan is from the Christian south and it will be the Muslim north’s turn to nominate a candidate to serve out the once-expected second term of Mr Yar’Adua’s presidency. “This cabinet will only ever be in a holding position, like an aircraft that does not fly higher or lower but hovers in one place,” says Bismarck Rewane, a financial analyst. “Its tenure is too short.”
Sierra Leone’s army

From butchers to peacekeepers
Mar 31st 2010
From The Economist print edition

What used to be one of Africa’s worst armies turns over a new leaf

IN A UN camp in Nyala, in the southern part of the Sudanese region of Darfur, a fully equipped gym has been shipped in from Sierra Leone. With the baking heat cooled only a bit by air-conditioning units, Sierra Leone’s once-reviled army is pumping iron as it takes on a surprising new role as a guardian of global peace.

The former British colony’s first international peacekeeping tour marks a remarkable turnaround for a country that only nine years ago had to submit to the world’s largest peacekeeping force, when 17,000 UN troops were sent in to hold the ring after a gruesome civil war that had gone on for a whole decade. But Sierra Leone is now considered safe enough at home to send 160 of its soldiers to help the mixed force of nearly 22,000 soldiers and police from the African Union and the UN that are keeping the peace in Darfur. This contribution is expected to earn Sierra Leone $2m a year.

The Sierra Leonean peacekeepers are drawn from the same army that carried out two coups during Sierra Leone’s civil war. Nicknamed “sobels”—soldiers by day, rebels by night— many of them were found by the country’s Truth and Reconciliation Commission to have tortured, raped and even forced their victims to eat each other during the conflict.

Since then, a lot has changed. A British-led training team arrived in 1999 and remains there today, five years after the UN peacekeepers withdrew. The British have spent more than $30m to revamp the army, reducing it from 20,000 men to 8,500, including the former rebels. “That’s the only way you can heal these wounds,” says the forces’s second-in-command. “We gave them all uniforms so nobody knows who you are, unless you say so. No one is pointing fingers any more.”

The Sierra Leoneans are sending some of their best troops to help out in Darfur. “It’s payback time to the international community,” says Brigadier Alfred Nelson-Williams, chief of Sierra Leone’s defence staff. Britain, Canada, the Netherlands and America have coughed up $6.5m to equip and pay for the batch of peacekeepers. Their equipment will dwarf that of their entire army back home. “There are some extremely capable officers who would survive very well in the British army,” says Colonel Hugh Blackman, commander of the British-led training team. If the Sierra Leoneans perform well, their peacekeeping force in Darfur could swell to 850 men.
After the Moscow bombings

Another Russian tragedy
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From The Economist print edition

Two horrifying terrorist metro bombings in Moscow, but still there is a need for a new approach to the north Caucasus

BY EARLY evening on March 29th Moscow’s metro was functioning normally. It was emptier than usual and some people crossed themselves as they boarded. Blood stains, pieces of shattered glass and flowers marked the sites where 12 hours earlier two bombs had killed at least 39 people. The first explosion struck just before 8am at Lubyanka station, near the headquarters of Russia’s security service, the FSB. Within 40 minutes a second bomb went off at Park Kultury. Both bombs, say the authorities, were detonated by young female suicide bombers. They put the blame on the north Caucasus, a mostly Muslim region. Some Russian reports say the Moscow police may have had a warning. Yet terrorists can slip through any net, especially given the woeful state of the Russian police.

The security services soon identified the two suicide bombers and their minders on security cameras as they boarded their trains. The response of the emergency services was fast and efficient, evacuating people, providing access to ambulances and setting up a special headquarters. Indeed, in large measure the city coped well with the attacks.

That may be because Moscow’s metro has had several terrorist attacks in the past two decades. The deadliest was in 2004, when 41 people died. That black year saw two bombs on the Moscow metro, two lost aircraft and, worst of all, the siege of a packed school in Beslan, North Ossetia.

Since then Moscow has had no terrorist attacks and has lived in relative comfort, insulated from the simmering violence of the north Caucasus. The war in Chechnya was over and the republic appeared relatively calm under its strongman president, Ramzan Kadyrov. This former rebel had secured elements of autonomy, and massive subsidies, for Chechnya from Moscow.
However, in recent years, violence has spread from Chechnya throughout the region. (Alexander Bortnikov, head of the Russian security service, was careful to identify the sources of the Moscow bombing as the north Caucasus, not Chechnya.) Russia’s president, Dmitry Medvedev, has described the situation in the north Caucasus as Russia’s biggest domestic political problem. Two days after the Moscow attacks, a pair of bombs exploded in Dagestan, which neighbours Chechnya, killing many and injuring scores.

Arbitrary killings, disappearances, torture, inter-clan warfare and corruption have become normal in the region. As Russia’s own officials have admitted, some of the money and weapons come from corrupt bureaucrats who pay off terrorists. The corruption and brutality of those who identify themselves as representatives of the state have also helped the terrorists to recruit radicalised youths.

Last month Doku Umarov, a terrorist leader and the self-proclaimed emir of the north Caucasus, warned that war was coming to Russia’s cities. Several high-ranking leaders of militant organisations led by him have been killed in counter-terrorist operations in recent weeks. Some observers see the Moscow bombings as an act of revenge. Others say they would have been in preparation for months.

Few Russians outside the north Caucasus pay attention to the violence in the region. Although it is part of the Russian Federation, few Muslims from the region feel comfortable and welcome outside their home. Yet as the Moscow metro bombings show, the north Caucasus is part of Russia—and changing the situation there requires reforms in the whole country.

Even after the Moscow attacks, there is little public discussion about the roots of the violence in the north Caucasus. Instead, politicians and commentators have talked up the explosions to their own political advantage. Apologists for the Kremlin blame the civilian deaths on liberals who destabilise the country.
with their criticism of the authorities. The government has used previous terrorist attacks to justify scrapping independent television broadcasts and cancelling regional elections. This makes the apologists’ pseudo-patriotic slogans of unity with the Kremlin all the more alarming. Yet the Kremlin’s opponents, just as worryingly, all but accuse it of orchestrating the attacks as an excuse to grab more power.

Few Russian public figures rose above immediate political concerns. An exception was Lyudmila Alexeyeva, a veteran human-rights defender, who was one of only a few to agonise over whether to join an anti-government protest on March 31st. In the end, as she wrote in her blog, she decided to pay her respects to the dead instead. Depressingly few politicians or other public figures in Russia even recognised her dilemma.
Germany and the euro

May the best man share

Mar 31st 2010 | BERLIN
From The Economist print edition

What the Germans see as economic virtue, some of its partners see as vice

IT WAS Greece that let public spending rip, lied about it and is now trying to stave off default. But the Greek crisis has somehow morphed into the German problem. Angela Merkel, the German chancellor, led resistance to a bail-out of Greece. For her pains, she was lionised at home (Bild, a tabloid, depicted her as a sword-bearing reincarnation of Bismarck) but denounced by her neighbours. “Angela, have a little courage,” pleaded Viviane Reding, vice-president of the European Commission. Other countries see Germany’s huge current-account surpluses as almost as big a problem as Greece’s deficits. They keep expecting a history-chastened Germany to contribute generously to the European project and to demand less than its due. Now it stands accused of turning away.

On March 25th European leaders patched up their differences over Greece. Under a deal cooked up by Mrs Merkel and the French president, Nicolas Sarkozy, Greece’s euro partners will come to its aid as a last resort (see article). That would be the bail-out that Mrs Merkel wanted to avoid, but it may never happen. Any help will require the unanimous approval of the 16 euro-area members, giving Germany a veto. IMF involvement will shield Germany from blame for imposing tough conditions. The hope is that the mere talk of a rescue will be enough to ease speculative attacks on Greece.

Yet the contradictions that caused the crisis, which go back to the euro’s birth in 1999, remain unresolved. Germany greeted the single currency as a levelling of the commercial playing-field and has been honing its competitiveness ever since. Greece and other Mediterranean countries saw the euro as an opportunity to engage in business as usual, but with the benefit of lower interest rates. There is broad agreement that Greece and the rest must change. The question is, must Germany, Europe’s biggest economy, change too?

To most Germans the idea verges on the ridiculous. Germany entered the single currency handicapped, they say, by a strong D-mark and the cost of unification. Employers and trade unions co-operated to keep a lid on labour costs. The government contributed by liberalising the jobs market. It also cut social-security contributions, partly making up the shortfall with higher value-added tax. Between 2000 and 2008 unit labour costs declined by 1.4% a year in Germany while rising by nearly 1% a year in France and
Britain. Germany breached the euro’s budget-deficit ceiling of 3% of GDP, but eliminated its deficit by the eve of the crisis.

But this abundance of virtue looks like vice to several of Germany’s EU partners. Germany’s duel with China to be the world’s top exporter demands that it suppress incomes and so Germans’ ability to consume. Its current-account surpluses—and the mirror-image deficits of others—are a prime cause of instability. When France’s finance minister, Christine Lagarde, recently called for surplus countries to “do a little something” to promote European growth, she was casting doubt on Germany’s export-driven model.

She did not explicitly propose France as a role model but IMK, a German research institute close to the unions, does. France’s wage growth has kept up with productivity and inflation. Its exports have grown more slowly than Germany’s, but private consumption has advanced at almost triple the rate. Between 1999 and 2007 French GDP grew a third faster and employment twice as fast as Germany’s. Gustav Horn of IMK reckons that Germany’s focus on exports created 400,000 jobs, but weak demand cost another 1m.

Many Germans detect a plot to nobble their exporters. A sprinter should not have to “put lead weights in his shorts”, snarled the economy minister, Rainer Brüderle. The idea of imitating France, with its budget deficits and sickly manufacturing sector, seems bizarre. German officials reject the most obvious ways of shrinking the current-account surplus. Markets, not governments, set wages, they say. To push them up artificially would merely raise unemployment, which would depress consumption and imports still further.

One answer, Mrs Lagarde argues, would be to cut taxes, an idea supposedly favoured by Germany’s coalition government, which combines Mrs Merkel’s Christian Democratic Union with the Free Democratic Party. But a new balanced-budget amendment to the constitution will force Germany to slash spending or raise taxes next year—the opposite of what is needed to correct Europe’s imbalances and shore up growth.

There are other ways to shrink the gap between Germany’s high savings rate and relatively low investment, the underlying reason for its current-account surplus. A new OECD survey of Germany says the key is to boost investment, for example by encouraging innovation, which Mrs Merkel is keen to do; and by liberalising entry into professions such as law and accounting, which she may not want. But these are not quick fixes. Europe will be stuck with Germany’s surpluses for years to come.

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When it comes to communiqués, it’s all in the translation

WHEN is a bail-out not a bail-out? The question is not idle. Leaders of the 16 euro-area countries have agreed to rescue Greece but only on painful terms, in order to comply with the euro’s rules against bail-outs for the profligate. The pain was the work of Germany’s Angela Merkel, who came to an EU summit in Brussels on March 25th with a long list of demands, before accepting that Greece could not be left to the markets’ mercy.

The deal avoided the disaster of a Franco-German breakdown over Greece. But it did not deal with the underlying faults in the single currency, which has not worked as hoped to promote convergence among its members’ economies. A working group has been set up to examine ways of co-ordinating economic policies more closely among the 16 euro-area countries. In a sign that markets are only half-convinced by the summit deal, Greece raised €5 billion ($6.7 billion) in seven-year bonds on March 29th, but at an interest spread that had risen a fraction, to over 300 basis points above Germany’s (see chart).

At the summit, Mrs Merkel mostly got her way. Overcoming objections by the French and the European Central Bank, she secured agreement that the IMF would provide a “substantial” part of any rescue package. She also insisted that help be available only when market financing was deemed “insufficient” by experts from the European Commission and ECB. To avoid a subsidy to Greece, bilateral loans from other euro-area countries would be at near-market rates, to provide an incentive to return to market financing “as soon as possible”, agreed the leaders. And the Germans called for tougher sanctions on countries that flout the euro’s budget rules.

Mrs Merkel’s aides said she was merely defending the stability of the euro, the foundation-stone of Germany’s membership of the single currency, and a principle enshrined in judgments of the German constitutional court. Others noted polls showing large majorities of German voters opposed to rescuing Greece, where many public-sector workers and others have a right to retire a decade earlier than Germans.

France’s Nicolas Sarkozy hailed Mrs Merkel’s agreement that the European Council should be an “economic government” for Europe. Germany say this means more rigour, but the French think it means more political intervention in monetary and fiscal policies. The Irish and Dutch objected, saying that the term would alarm their voters. So in a typical compromise it was subjected to what the president of the European Council, Herman Van Rompuy, calls “asymmetric translation”. A French-language declaration
talks of *gouvernement économique*. But the English version calls for enhanced “economic governance”.
Italy’s regional elections

Berlusconi’s bounce
Mar 31st 2010 | ROME
From The Economist print edition

A surprisingly good result for Italy’s prime minister

THE regional elections on March 28th and 29th made a few things clear about today’s Italy. The most obvious is that it is not France. Defying many predictions, the prime minister, Silvio Berlusconi, did not receive a trouncing of the kind that Nicolas Sarkozy had suffered just a week earlier. Of the 13 regions that were at stake, Mr Berlusconi’s conservative People of Freedom (PdL) movement won six, a gain of four from the left.

This was a strong performance by the prime minister. The opposition seemed to have everything going in its favour: a string of sex scandals involving Mr Berlusconi last year; a display of extraordinary ineptitude by the PdL in late February when it failed to present its list of candidates on time in Lazio, the region that includes Rome; and an economic crisis that has seen GDP fall by 5.1% and destroyed more than 400,000 jobs. One poll conducted two weeks before the election predicted that the left might hold all but one of the 11 regions it won in 2005.

The Democratic Party (PD), Italy’s main opposition group, claimed to have drawn nearer to the PdL in total votes, although the gap between the two biggest parties was still reckoned to be almost four percentage points, close to the figure in the 2008 general election. And the left could claim that its vote was eroded in at least one marginal region by the Five-Star Movement, an outfit led by Beppe Grillo, an anti-Berlusconi comedian and blogger. Mr Grillo’s party had a good first outing, winning 7% of the vote in the left’s traditional heartland of Emilia-Romagna.

Yet this was still a disappointing result for the left. It lost four of its 11 governorships, and might have lost another, Puglia, had the right there held together. In Campania, the region around Naples, the left’s share of the vote plunged from 62% to 43%—a damning judgment on its ten years in charge of the local administration. The left also failed to keep hold of Lazio, despite fielding a strong candidate there: Emma Bonino, a former minister and European commissioner.

What went wrong? The mainstream opposition seems still incapable of capitalising on the dissatisfaction felt towards the government by many voters, especially the young. Instead of backing the PD or the smaller, feistier Italy of Principles (IDV) movement, many voters stayed at home. Only 64% bothered to vote, almost eight points less than five years ago. And contrary to expectations, the right was not the only victim of the low turnout.

The other explanation for the turnaround is even more disquieting for the left. Two weeks before the voting, Mr Berlusconi took to the hustings, and his personal charisma may have tilted the balance. The prime minister was not slow to draw conclusions, reportedly telling aides that in Lazio he had wrought a “sort of miracle”.

But there were two clouds on the horizon. First was the success of his ally, Umberto Bossi, whose populist and xenophobic Northern League won 13% of the vote, up from 8% at the general election, and took control of two northern regions, Veneto and Piedmont. Mr Bossi promptly announced that he would press for greater financial autonomy for the north as the price of his continued support for the government. This is unlikely to be the last demand he will make of the prime minister.

The second cloud was the defeat in Venice of Mr Berlusconi’s bubbly public-administration minister, Renato Brunetta. Mr Brunetta had hoped to become mayor because he wanted to promote his ambitious plans to rescue the city from decline. Now he will not get the chance.

Mr Berlusconi will doubtless see these results as a mandate for his continued attacks on the prosecutors and magistrates who have been pursuing him since before he entered politics 16 years ago. He may also feel emboldened to relaunch his plans for a presidential form of government. How far he can proceed down both these roads will now depend less on the opposition than on Mr Bossi.
Serbia and its neighbours

Patching things up

Mar 31st 2010  |  BELGRADE
From The Economist print edition

Serbia tries to repair its local relationships

FINALLY it was done. Serbia’s parliament had not seen such acrimony for years, but in the early hours of March 31st it passed a resolution condemning the July 1995 Srebrenica massacre, in which some 8,000 Bosniak (Bosnian Muslim) men and boys were killed by Bosnian Serb forces. The resolution passed by the slimmest of margins—only 127 deputies out of a total of 250 voted for it—and opposition parties are furious. It remains to be seen if President Boris Tadic and his government will pay a political price.

The resolution laid bare Serbia’s divisions. Some deputies voted in favour only because they had been promised a future motion that will condemn crimes committed against Serbs in the Balkan wars of the 1990s. Others thought the resolution was not strong enough because it did not use the word “genocide”. The resolution did not accept blame for the killings. Instead, it followed a 2007 ruling by the International Court of Justice, that Serbia’s authorities, although not guilty of the massacre, could have acted to prevent it.

Five years ago President Tadic went to Srebrenica to pay homage to the victims. Observers hoped that this would lead to a new, friendlier phase in relations between Serbs and Bosniaks. But Bosnia remains ethnically divided and relations between Sarajevo and Belgrade are still fraught. There have, however, been recent signs of warming relations between the other countries of the Yugosphere.

On March 20th Slovenia and Croatia jointly hosted the first locally organised conference of the heads of government of the seven states of the former Yugoslavia. Mr Tadic refused to go, angry that Hashim Thaci, the prime minister of Kosovo, would be given equal status. This followed the controversial arrest in London, at Serbia’s request, of Ejup Ganic, a Bosniak wartime leader Serbia holds responsible for a war crime in Sarajevo in 1992.

Yet Mr Tadic moved quickly to repair the damage from the two events. First he said he did not mind if Mr Ganic was tried in Bosnia. Then, on March 24th, he flew to the Croatian resort of Opatija for the first of two informal meetings with Ivo Josipovic, the new Croatian president, which turned into a virtual lovefest, complete with pictures of the pair holding hands. The two presidents agreed to try to set aside Croatia’s case for wartime genocide against Serbia and Belgrade’s countersuit, launched in January. The following day, Vuk Jeremic, Serbia’s foreign minister, hosted a good-humoured meeting of his Croatian, Bosnian and Montenegrin counterparts in Belgrade.

Do not be distracted by “surface tension” between the former Yugoslavs, says Ivan Vejvoda, head of the Balkan Trust for Democracy, who organised one of the two meetings between Presidents Tadic and Josipovic. The underlying trends are good. As Mr Jeremic points out, virtually unnoticed in the uproar over the Srebrenica apology was a Serbian commitment in the resolution to Bosnia’s territorial integrity (something also underscored by the Serbian and Croatian presidents in their meetings). This comes at a time when Milorad Dodik, prime minister of the Republika Srpska, the Serb part of Bosnia, is talking openly about secession. “There can be no serious threat to Bosnia’s integrity as long as Serbia supports it,” says Mr Jeremic.

Meanwhile, Serbia awaits a ruling from the ICJ on the legality of Kosovo’s declaration of independence. The court began considering the case in December, and should give its opinion later this year. When it does, Serbia will ask the UN General Assembly to pass a resolution demanding new talks on Kosovo’s status. The gloom may be lifting over much of the Balkans, but don’t expect any pictures of Mr Tadic and Mr Thaci holding hands.
FEW people have heard of Moldova—and when they have, it is usually for the wrong reasons. A frozen conflict with Russian-backed separatists in Transdniestria has hamstrung the country since 1992. A year ago a rigged election brought riots, followed by hundreds of arrests, scores of alleged beatings and rapes, and three deaths. The outrage led to a new election and the formation of a shaky pro-Western coalition government. Its youthful ministers are in sharp contrast to the greyness of the previous regime, nominally a Communist one but in fact crony-capitalist.

The new lot have thawed relations with Romania and launched a charm offensive in the West. A donor conference recently pledged €1.9 billion ($2.6 billion), half in grants and the rest in soft loans. China has dangled a $1 billion loan for infrastructure. The IMF has approved the government’s economic policies: after an 8.5% drop in 2009, GDP is likely to grow by 1.5% this year. Yet Moldova will still be Europe’s poorest country. Hundreds of thousands of Moldovans work abroad, mostly illegally. Their remittances keep Moldova afloat.

Outsiders see more changes at the top than Moldovans themselves feel in practice. Reining in the budget deficit, over 8% of GDP in 2009, will mean rises in heating costs and cuts in a bloated public sector. Wrangles in the deadlocked parliament over the election of a new president waste time. Failure, says the constitution, would mean another general election that few want.

More important to voters is travel to the rest of Europe. This has got harder since Romania joined the European Union in 2007. The Romanians promise a special regime for Moldovans living within 30km (about 19 miles) of the border. But they also want to join the Schengen passport-free zone next year, which would create still more expense and hassle for Moldovans. The goal of visa-free travel to the EU is a long way off.

Changing Western minds means enacting reforms, not just talking about them. Officials speak excitedly of Estonia and Georgia as models. One sign of intent might be to liberalise aviation rules, allowing budget airlines to fly to Chisinau. That would be popular with passengers but bad news for the protected national airline, Air Moldova.

The biggest change has been in media freedom, tightly restricted under the previous government. Two new television stations have started broadcasting. Romanian television will return soon. But big reforms in the corrupt, Soviet-style bureaucracy must wait, as it seems must the rule of law. Investigations into official misbehaviour during last year’s riots have brought some sackings and suspensions, but no deep-seated changes—or even a truthful account of what really happened.
HERE are three pieces of conventional wisdom that trigger head-nodding and murmured assent wherever Brussels grandees gather. The first is that, as economic and political clout flows away from the West, Europe can be a driving force only if it learns to speak with one voice and to defend common European interests. As the European Union’s new foreign-policy chief, Baroness Ashton, told members of the European Parliament, “if we pull together, we can safeguard our interests. If not, others will make decisions for us.”

The second is that Barack Obama has learned from the mistakes of his predecessor, and is pursuing a more European foreign policy. For a faultless exposition of this view, try a new paper on transatlantic policy produced by a group of former presidents of the European Commission, ex-prime ministers and EU commissioners, senior MEPs and two living prophets of Euro-integration, Jacques Delors and Joschka Fischer. Their paper (published by Notre Europe, a pro-European group) declares that “the American president is again admired in Europe”, after embracing principles like multilateralism, dialogue and negotiation, “by which the Europeans set such store”.

The third observation is less happy. Mr Obama’s policy of outreach has met with rebuffs as well as results. Notwithstanding the conclusion of a nuclear arms deal with Russia, other areas of the world are proving hard to manage. Spurning America’s offering of hands, Iran has stepped up its nuclear work and its repression. China subjected Mr Obama to slights in Beijing and at the climate talks in Copenhagen. Russia is playing tough on missile defence. Even nice and democratic Brazil has announced that it does not favour sanctions on Iran. When Mr Obama’s vice-president, Joe Biden, was welcomed to Israel with an announcement of new building in East Jerusalem, European newspapers churned out articles on the weakness of Mr Obama’s diplomacy.

Among Euro-grandees, George Bush still bears much of the blame. Mr Obama is “labouring to repair a decade of misguided policy”, the Notre Europe paper argues. It adds that America is living in a world where “military strength has become less important”, after Iraq taught everybody that “legitimacy of power” counts as much as power projection.
There is another way to ponder Europe’s conventional wisdom on foreign policy, and it is less comfortable for the Euro-establishment. Their big bet is that if the EU, with 500m citizens and a large, if declining, share of the world’s wealth, can speak with one voice and agree upon some common interests, it will count in the new world order. But Mr Obama’s administration does speak with one voice and in defence of agreed American interests. And yet other world powers seem not always to care.

There is room for some quibbling here. America’s unity of diplomatic approach is not total. The Middle East is a notably hard nut to crack. Nobody is quite sure what to do about the rise of China. But the equation still merits reflection. Europeans will have succeeded beyond their wildest dreams if they ever achieve half of America’s unity of purpose and presentation. America is also a military superpower, which still matters. (It is self-serving for Europeans to say that military strength counts for little these days. Iraq may have made the use of force trickier, but its possession still gets others’ attention.) Yet even America finds multilateralism and dialogue hard going. What does this mean for Europe, a squabbling, ageing continent that increasingly shuns military force?

Some in Europe used to dream that the rise of rival powers would weaken the American hegemon. Now they find themselves living in a tough new world inhabited by swaggering nation-states, in which collective solutions are harder, not easier, to achieve (European opinion was especially jolted by the Copenhagen climate talks, at which the EU barely registered).

John Hulsman, an American writer on foreign policy, recently noted that rising powers such as China, Russia, India and Brazil are, if anything, even more hostile to the idea of binding rules or treaties that impinge on their sovereignty than the Americans are. Citizens of these powers “see much of the current international architecture as a confidence trick designed to keep their country from assuming its proper place in the world,” Mr Hulsman commented.

The rise and fall of little voice

Does this mean the Euro-establishment is wrong about the benefits of speaking with a coherent message and forming alliances to get things done? That would be to go too far. If Mr Obama finds multilateralism hard work, that does not necessarily mean that unilateral swagger would be more effective. Nor would cacophony give the EU more clout than speaking with one voice. But Europeans need to be less starry-eyed about what they can achieve through dialogue and political integration. Some still dream that the EU’s pooled sovereignty can serve as a “model” for systems of global governance, transcending the nation-state. Right now, that looks like a fantasy. The 21st century is instead shaping up to be a brutal testing ground for relative power.

Here are some unglamorous things that Europe can do to count in this new world. Stick to the rule of law: being predictable is a source of strength. Whether negotiating free-trade pacts, or the accession of such neighbours as Turkey, the EU bureaucracy is designed to keep making the same demands, over and over again. Foreign partners that comply know their rewards will be market access, entry to the EU and so on. Above all, stay rich: so Europe must find new sources of growth. It does not matter whether a declining Europe speaks with dozens of voices or one: nobody will listen.
Interview with David Cameron

Does he have what it takes?

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The Conservative leader is still the favourite to be Britain’s next prime minister

HE HAS led the Conservative Party for more than four years and is the man most likely to lead Britain after the general election this spring. Yet people still wonder just who David Cameron is. This is not because he hides what he does or fudges what he thinks, as those on the receiving end of countless webcameron flashes and unending policy e-mails can attest. It is, rather, that his views are not always those of either his party or, perhaps, of his age.

The Economist talked to Mr Cameron on March 29th, in the last of a series of on-the-record interviews with the leaders of the three main political parties. Though only 15 years younger than Gordon Brown, prime minister and leader of the Labour Party, he seems of a different generation, with an easy, human touch that Mr Brown often struggles to achieve. He has more obviously in common with the similarly 40-ish, six-foot-tall leader of the Liberal Democrats, Nick Clegg. But Mr Cameron is an altogether slicker number, and a far more experienced political operator.

Those looking for the Big Idea from Mr Cameron will be disappointed. He has a very English scepticism about grand theories. His identity lies somewhere between liberal London, where he has spent his adult life, and the conservative Home Counties, where he grew up. Ironically for a man whose Euroscepticism has irked Angela Merkel, the German chancellor, he may at heart be what continental Europeans would recognise as a Christian Democrat. He espouses a social conservatism that dwells on broad issues, such as the cultural causes of poverty, not on the narrow lifestyle questions such as gay rights (on which he is anyway tolerant) that obsess some on the American right. He is an Atlanticist, though not a passionate one, and a gentle free-marketeer.

He does, however, have a distinctive analysis of his own country. British society, so his critique goes, is broken. The cause is the erosion of responsibility (his favourite word) by a hyperactive state. He is at his most animated when justifying his (arguably overstated) social pessimism, pointing to “our records against the rest of Europe on things like teenage pregnancy and drug abuse, alcohol, family worklessness, educational problems”. The analysis is open to criticism: the societies he sees as unbroken, including many in continental Europe, spend more on welfare than he would want to or can afford to.
The cure, he says, is giving power away, strengthening local government and empowering people directly by, for example, letting them set up their own schools. He is undogmatic about the precise size of the state, deploring instead its over-centralisation; he prefers a big society to a big state. It remains to be seen whether that will bring relief to the overburdened public finances.

As the election nears, the Labour government is seeking to make much of its own (not unblemished) experience in economic management, tarring the Tory opposition as obstructive novices. George Osborne, the shadow chancellor of the exchequer, is a favourite target. Mr Cameron sticks up for Mr Osborne’s performance during the financial crisis, inviting opponents to “push as hard as [they] can”. The Tories supported the bank bail-out in 2008, he notes. Their opposition to the fiscal stimulus may have been attacked by some economists, but others agree that it “added £12.5 billion ($18.9 billion) to our debt without making a noticeable difference to the economy”.

In a contest that he insists is a choice between the two main parties rather than a referendum on his alone, he has been clearer for longer about the fiscal squeeze required than Mr Brown. “Give me the equivalent of our asking people to retire a year later from 2016,” he says; at the party conference in October Mr Osborne was commendably ahead of the pack in outlining some specific measures to reduce the fiscal deficit. And Labour has been forced to face reality as a result. “You don’t hear investment versus cuts any more,” Mr Cameron says, referring to Labour’s favourite dividing line in elections past.

Nor, as the polls narrow, do you hear much detail these days about Tory plans to get a fiscal grip. Mr Osborne’s pledge partly to reverse the government’s planned increase in national-insurance (NI) contributions, announced this week, will be funded by cutting waste, a familiar theme on both sides of the aisle. This may be “doable and deliverable”, as Mr Cameron claims, but he will not say precisely how.

**The sting in the Falklands tale**

Mr Cameron once called himself the “heir to Blair”. Where he least resembles the former prime minister is on foreign affairs, to which he brings case-by-case policies rather than informing ideals. Mr Blair was both Britain’s most Atlanticist and most Europhile prime minister; Mr Cameron is likely to be less of either.

Is there a special relationship with America? Yes, he says: “On any number of issues you see Britain and America working ...closer than with other allies.” But he points out that “you have to remember...we are the junior partner. I think part of getting the relationship right is understanding how best to play the role.”

He is “happier than [he] was” with the way the war in Afghanistan is being fought, but “we are still in the situation where British troops are in charge of two-thirds of the population [in Helmand] but there are only 10,000 of us and 20,000 Americans.” There is muted praise for Hamid Karzai, the Afghan president: “At his best, he can do good things.”

What Mr Cameron is not happy with is America’s recent implication that Britain should negotiate with Argentina over the Falkland Islands. “I’ve always said the special relationship should be a frank and a candid one, and I think you should frankly and candidly say we’re disappointed.”

His view of Europe, too, is more nuanced than some might expect. He has been (rightly) criticised for pulling his party out of the centre-right grouping in the European Parliament to which the parties of Mrs Merkel and Nicolas Sarkozy, the French president, belong, and for cultivating the Euroscepticism of his party faithful. But he is a broadly restraining influence on it and, with so much to do at home, he will hardly relish fights with Brussels. “I think people in Europe will be pleasantly surprised that we will be activist and engaged from day one,” he says. “But we have a very clear view about the direction we ought to go in.” He wants to win op-outs from the European Union’s social chapter and charter of fundamental rights (see article). Few fancy his chances.

And what of his chances in the general election expected next month? The 17-point poll leads the Tories enjoyed last year have faded to margins less than half that size. The decline in the Tories’ popularity in recent months continues to puzzle, with some putting it down to a message that is too bleakly austere and others blaming it on something close to the opposite: a lack of Thatcherite punch and clarity.

In fact it probably owes more to the recent economic recovery, which seems strong enough to vindicate the government’s handling of the recession but not so strong that a change of management can be risked safely. Labour’s poll rating has increased by more than the Conservatives’ has fallen. And the crisis has challenged the opposition as well as the government. After rebranding themselves as a party that could
see beyond the market to social and environmental concerns, the Tories have had to re-brand themselves as sober stewards of a ruined economy. “I don’t feel too shocked by the tightening of the polls because… I’ve always believed it’s a very big mountain we have to climb,” says Mr Cameron.

The anti-politics mood unleashed by last year’s parliamentary-expenses scandal also makes it hard for any politician, however appealing, to electrify the public. The country’s propensity to fall for a leader the way it did in 1997 is no longer there. Being preferred to your opponents—which the Tories still are in every poll—may be the best any politician can aim for. “Labour would like nothing more than just to talk about the Conservatives and run away from their record,” says Mr Cameron. “We’re not going to let them do that.”
A television contest for the worst job in politics

WHAT person in his right mind would want to tackle Britain’s nightmarish public finances? Three contenders pitched for the job on March 29th in a television debate. Alistair Darling, Labour’s chancellor of the exchequer (shown left, above), sparred with George Osborne, his Tory opposite number (shown right), and with Vince Cable, for the Liberal Democrats.

The debate was held hours after the Conservatives had announced that they would reverse most of Labour’s planned rise in national-insurance contributions from April 2011. Mr Osborne said he would cut spending by £6 billion ($9 billion) this year and use the savings to pay for the lost tax revenues in future years. He made much of the fact that workers on lower-to-middle earnings would benefit from the reform.

Labour’s move to raise revenue by pushing up payroll contributions, a stealthier tax than most, had little to commend it. But the Conservatives’ decision to divert savings from their first spending cuts to staving off this tax rise, rather than reducing the huge deficit, left Mr Osborne open to attack. His rivals were not slow to do so. Both Mr Darling and Mr Cable accused him of fiscal irresponsibility at a time when his priority was in theory bringing down borrowing.

Yet their indignation was rather bogus. After all, Mr Darling had done much the same when he came back for a second helping of higher national-insurance contributions in his pre-budget report in December—and used the extra money to pad out public spending in 2011-12 and 2012-13. And Mr Cable makes much of his revenue-neutral plan to take 3.5m people out of income tax, even though the offsetting tax rises needed to pay for it could also be used to reduce borrowing.

The crucial missing element in Britain’s now protracted debate over its fiscal mess is where spending cuts will actually be made. Predictably, all three would-be chancellors in the next parliament spared viewers the gory details. That will be left until after the votes are cast.

So who won? Mr Darling is too familiar a figure now to extract much benefit from this kind of event, but he showed once again that he is a safe pair of hands. Mr Osborne may have been the most relieved because he made no gaffes and stood his ground under attack. But Mr Cable, who looks the part, won the
most applause from the studio audience. The losers were obvious: greedy bankers, who got it in the neck from all three.

The contest offered a foretaste of what is to come when, for the first time in a British general election, the leaders of the three main parties will slug it out in prime time. That will breathe some fresh air into a campaign that feels as if it has been going on for months before it has formally started. And, as was the case in the contest between the chancellors, it may be the Lib Dems, led by Nick Clegg, who benefit the most.
Talk of a return to the 1970s is overdone

AN UNPOPULAR Labour government clings to office. The public finances are in a mess, the pound is devalued and the economy is on the rocks. Abba, a big-haired Swedish pop group, is in the headlines. Platform shoes are in again, or so The Economist is told. And workers are striking. Civil servants and British Airways cabin crew have walked out. Tube-workers and gas-fitters have been balloted. Signallers and white-collar workers on the railways plan four days of disruption after Easter.

For the retro-minded, all this evokes the 1970s, Britain’s post-war nadir. It was the time of the three-day work-week (imposed in 1974 after striking miners caused a power shortage), and of nationwide strikes in the “winter of discontent” of 1978-79. Such was the power of organised labour that many feared overmighty trade unions would bring not just the government but also the country to its knees. Similar talk is heard today.

A quick look at the numbers confirms that modern fears are overblown. Despite the odd conspicuous walkout, industrial relations have been serene for nearly two decades (see chart). Official statistics going back to 1891 suggest that strikes have never been less frequent. Fewer days have been lost in the entire period since 1990 than were lost in a single year in 1984, when Margaret Thatcher’s government defeated the last big strike by the coalminers, or in 1979 or in 1974. Indeed, there were more lost days during the second world war (13.3m), with its famed all-in-this-together Blitz spirit, than in the 1990s or the 2000s.

In other, less measurable ways current strikes are different too. Disputes in the 1970s often lasted for months; modern ones last for days. British Airways’ cabin crew say they have offered to take pay cuts, a far cry from the inflation-busting rises demanded three decades ago.

The unions’ earlier militancy is the main reason for their relative docility today. Elected after an anti-union campaign in 1979, Margaret Thatcher’s government passed several laws limiting union power. Secret balloting for strikes was made mandatory, secondary strikes made illegal and closed shops restricted. Public revulsion at the violence surrounding the 1984 strike in particular strengthened support for her. These restrictions, combined with the decline in manufacturing during the 1980s, reduced union membership from 53% of the workforce in 1979 to around 27% today, mostly in the public sector.
That is not to say the unions are a spent force: their strong public-sector membership makes strikes particularly disruptive. And they have regained their traditional position as paymasters of the Labour Party, after a decade during which their contributions were eclipsed by those of businessmen. The Conservatives (who have their own funding troubles) make much of the fact that four of the five biggest donors to Labour are unions, hinting darkly about buying influence.

It would be naive to assume that the unions are not getting something for their money. But if Labour and the unions are working hand-in-glove, it is difficult to explain the timing of this latest round of walkouts. A series of strikes just before a general election is the last thing this government needs.
WHEN ministers face a vexed problem, a convenient way to sidestep it is to establish a royal commission. Few are more vexed in ageing Britain than how to pay for long-term care for the elderly. Months after Labour came to power it named a group of worthies, who duly reported in 1999. Yet it has taken the government more than a decade to come up with a policy on care. And no sooner had Andy Burnham, the health secretary, published a white paper on March 30th than he called for yet another commission to be established.

The sick are treated free of charge by the National Health Service, which is funded by general taxation. The disabled receive money to help with everyday tasks. Those who are merely frail, however, cannot be given free help with washing, dressing and cooking unless they are also poor. That strikes many people—but not all—as unfair.

When granny has become so infirm that she can no longer make a cup of tea, she may be nudged into a care home. Unless she is particularly poor, with assets worth less than around £23,000 ($35,000), she must pay for it, first by running down her savings, then, so long as no husband or dependent children live there, by selling her house. This penalises responsible folk who have saved and invested, say those who think care should be provided free of charge.

Not everyone agrees. Old people are usually wealthier than the young, since they have had time to accumulate cash and property. True, they may plan to hand these on to their children. But other people’s children should not have to pay for their care, say dissenters.

Some early ideas for funding care—including mandatory levies on workers, retired folk or dead people’s estates—proved controversial. With a general election looming, the government ducked the issue, leaving it to a proposed new commission to be convened after the election. A bill in the House of Commons would give the neediest old people care in their homes free of charge, if it passes before Parliament is dissolved.

Yet the white paper makes some sensible proposals, such as charging only for the first two years in a care home. Many do not last that long and others do not have assets greater than the fees but, for those who
do, it would bring a certainty now denied to all but the poorest.
THE buzz among Green activists in Brighton, a southern seaside town famed for its pier and political conferences, is contagious. Brighton Pavilion is their party’s best chance of winning their first parliamentary seat in the coming general election, and their candidate, Caroline Lucas, an MEP, is also their leader. With the help of nearly 50 volunteers, Matt Follett, the national policy co-ordinator, and Simon Williams, the local campaign manager, are leafleting at least half of the constituency each Saturday. "Ask Eric Pickles if he can do that," says Mr Follett. (Mr Pickles is chairman of the Conservative Party.)

On paper, Brighton Pavilion should be a stroll for Labour. It won last time with 35% of the votes cast, while the Tories got less than 24% and the Greens under 22% (twice their previous result). But the incumbent is standing down, and polls suggest a fight between the Tories and the Greens.

Ms Lucas’s party takes comfort from two polls. In the first, for PoliticsHome, a website, more than 34,000 people in 238 marginal seats were interviewed last September. The pollsters found that seaside towns showed milder swings to the Conservatives than other marginals and the strongest shift towards minor parties (up from 8% in 2005 to 19% in 2009). The Greens would win Brighton Pavilion, they concluded. This finding was reinforced by an ICM poll in the constituency in December for the Green Party. Some 35% of those intending to vote supported the Greens, 27% the Conservatives, 25% Labour, 11% the Liberal Democrats and 1% the United Kingdom Independence Party.

The Greens infuriate the Tory candidate, Charlotte Vere, a businesswoman and self-styled "social entrepreneur". She believes she can marshal votes in the wealthier northern wards, but says, glumly, that
the fight is "unfair" because the Greens, whom she describes as hard-left "eco-fascists", don’t face the kind of political scrutiny endured by mainstream parties. But she has taken a leaf from their book: her election literature makes great play of her “passion” for the environment.

Such rhetorical flourishes demonstrate the power of the Green vote in Brighton. There are a number of reasons why the party can win there, supporters say. Unlike the other candidates, Ms Lucas is a national figure. The party has strong roots in Brighton, a raffish, leftish town of tattoo salons and health-food shops, where undertakers offer “green funerals”. It holds more seats in the council wards in the constituency than the Tories or Labour do. The party received donations totalling a modest £352,163 last year, which it is concentrating on its three target seats (the others are Lewisham Deptford and Norwich South). And the Greens always have lots of willing hands to help. Widespread fear of climate change boosts their chances too, of course.

But the party has also grown up. Andrew Dobson, a professor of politics at Keele University, wrote the Green Party’s election manifesto. He says that there is now a clear distinction between a professionally run party and the wider, more chaotic environmental movement. The change in how policy is presented demonstrates this, he claims: the manifesto focuses on fully costed economic policies, not on inspirational environmental slogans.

Ms Lucas was elected as the Greens’ first leader two years ago, and she has made the most of her media opportunities. The party has developed, she says, “a much clearer focus on electoral politics”, taking heart from its victories in local and European elections. To improve its chances, it appointed a new advertising agency, Glue London, last year.

The Greens’ PR boss, Tracy Dighton-Brown, recalls arriving for her first meeting with the agency and being greeted by its chief executive. They both had certain stereotypical expectations, she says. “He was wearing a cardigan and offered us herbal tea. I was wearing a suit.” The agency does focus-group research for the party. It also draws inspiration from Barack Obama’s use of friendship networks to mobilise voters (and donors).

Tony Travers, of the London School of Economics, reckons the party has a chance of winning a seat or two this time, pointing out that the Greens are seen as a “gentle and harmless safe alternative for disillusioned voters”, mostly on the left. He predicts a growing presence in southern university towns—Oxford, Cambridge and Norwich in particular. But the first-past-the-post voting system for MPs is a huge obstacle for any small party. Greens may be moaning about that man-made, artificial construct for some time.
A prosperous town with growing pains

LESS than half an hour by train from central London, Reading is a town that wants to be a city. Its ruined abbey lends weight to that claim. So does its magnetic effect on multinational companies seeking cheaper locations for skilled workers, firms such as Oracle, Microsoft, Cisco, Prudential and ING Direct. It is one of the nodal points on the westward motorway out of London, the M4 corridor, also known as Britain’s Silicon Valley. According to a recent study by the Centre for Cities, a think-tank, Reading is the place with the highest percentage of job opportunities in the top-20 export sectors, second only to London in economic prosperity.

But how does that square with the visitor’s first impression on leaving the railway station? Flyblown office blocks in every direction advertise plenty of space to let. Estate agents say there are 2.2m square feet (204,000 square metres) of office space available in Reading. Only 122,000 square feet was let last year, compared with 760,000 in 2007. Yet the agents are astonishingly upbeat. A quarter of that space is high-grade, they say, and demand is bouncing back.

It probably will. The anomaly of Reading is that prosperous, high-tech businesses, and their well-paid, well-educated employees, live cheek by jowl with poverty, poor housing, indifferent schools and a barely managed crime and drug culture. About 15% of the population were born outside Britain, according to the 2001 census, and the percentage has surely risen since then. There are big communities from Ukraine, Poland and Bangladesh, and the biggest cluster of Barbadians outside Barbados. Unemployment has continued to grow in Reading despite the recent fall in national figures.

In some ways the town is hollowed out by its own demographics. Traditionally about 40% of parents choose to educate their children outside the borough or at private schools, says Rob Wilson, the Conservative MP for Reading East, one of the town’s two constituencies. Meanwhile those local schools with excellent reputations, such as the grammar schools, are largely populated by children from outside the area. So the poorer schools and disadvantaged families are left with each other.

The situation is improving though, says Anneliese Dodds, the new Labour candidate for Reading East. The John Madejski Academy (named after the biggest local benefactor, a publishing millionaire who owns Reading Football Club) has replaced one failing school. Prospect School, too, specialising in sport and information technology, has been winning accolades.

This patchwork makes Reading West and Reading East a fascinating pair of constituencies. Each, on past showing, and after small boundary changes, could fall to either Labour or the Conservatives. In 2005 Labour had a majority of 4,682 in Reading West. Now it is 107th on the list of Tories’ most winnable seats, according to UKpollingreport, an election-tracking website, which calculates that the party would need a swing of 5.8% from Labour to win it. Naz Sarkar (Labour) and Alok Sharma (Conservative) are both new candidates, and both of Indian descent.

The fate of Reading East is more precarious. Mr Wilson won the seat by 475 votes in 2005, after some local own-goals by Labour. Ms Dodds believes she is ahead, judging by her door-to-door canvassing. Each champions education, though that issue may not be uppermost in constituents’ minds. Plans for new housing and better traffic management are more topical for many. Local residents and the council have vainly opposed two Whitehall-inspired housing projects—plans for 10,000 homes in Reading West and 490 in Reading East. Many locals, meanwhile, lament the transformation of Reading from market town to urban shopping experience. Tony Vicars, a butcher in West Street since 1972 (his forebear opened the shop in 1866) sees only “shoe shops and mobile-phone stores” around him. His old customers can no longer drive into the pedestrian zone.

But there is little room for nimbyism in Reading. Earlier this month the council unveiled plans for a £500m transformation of the town into a rail hub, accompanied by yet more offices, shops and houses. Visitors
and residents have perennially been rude about Reading, mainly because of its former industrial outskirts and brutal inner ring road, but “it has a lot more going for it than Aldershot or Slough nearby,” says Ms Dodds defiantly.
Training young people

Another brick in the wall
Mar 31st 2010
From The Economist print edition

The growing popularity of apprenticeships

THE Acacia Hair and Beauty Salon in Worcester Park, a suburb in south-west London, is looking for an apprentice. The owner wants someone hardworking, reliable and honest to wash hair, launder towels and gowns, mix hair dyes and make cups of coffee for her well-coiffed clientele. After two years’ training, her apprentice will qualify as a hair stylist, with a certificate to boot.

The economic downturn has seen a revival in the fortunes of the apprenticeship. As apprentices, young people learn a trade or craft directly from an employer, sometimes spending a day a week or so at college. The National Apprenticeship Service, which now has responsibility for trainee hairdressers, aspiring bricklayers and the like, reports that the number of apprentices more than doubled over the decade to 2007 and has risen sharply in the months since then for which data are available. In 2002 barely a quarter of those who started an apprenticeship completed it; by 2008 the figure had risen to 64%. It is possible now to begin one of more than 190 different careers as an apprentice, including accountancy, business administration, textiles and veterinary nursing.

In the good times, such opportunities were overlooked by ambitious youngsters who aspired to a university place. Now they are grateful for what they can get. Unfortunately that isn’t very much. Politicians wring their hands at the number of young people not in education, employment or training, and Labour has promised every school-leaver some sort of job or training or place at college. Yet the number of apprenticeships advertised through the national service is painfully low.

A recent search for vacancies in "retail and commercial enterprise"—a category spanning careers from logistics to manicure, for example—turned up just over 1,000 opportunities across England. Another for
apprenticeships in “engineering and manufacturing technologies” garnered fewer than 2,000 vacancies.

Firms need encouragement to offer more places. A survey of English employers by IFF Research, published last month by the Commission for Employment and Skills, a quango, found that more than 90% of them were aware of apprenticeships but just 8% offered them, and typically only 4% at any given time.

Then there is the tricky question of who gets to say whether an apprentice has learned his stuff. Those who attend colleges must pass basic exams; others whose learning has taken place entirely on the job are visited by inspectors.

Alison Wolf of King’s College London argues that the government is wasting cash paying external observers to issue certificates that “workplace learning” has occurred; it used to be taken for granted that completing an apprenticeship meant that something had been learned. And assessing skills does not come cheap: the state pays £6,500 for an outside body to provide a certificate saying that an apprentice hairdresser is qualified to do the job, and £9,000 to certify an engineer’s training.

Despite all this, the government wants 20% of school leavers to become apprentices by 2020. That will be tough without incentives to encourage employers to provide the opportunities. These days they are required to pay their apprentices the minimum wage, along with teaching them. Yet apprenticeships—even with the certificates that signify their completion—may be the best way forward for young people keener on a job than a degree.
Gordon Brown faces disaster and David Cameron triumph—or is it the other way around?

THERE has been heated debate in Conservative circles over whether, in office, David Cameron will prove a Heath or a Thatcher—ie, will he be buffeted by events like Ted Heath, Tory prime minister from 1970 to 1974, or shape them like The Lady? Yet now another, prior question seems more pressing: is Mr Cameron a Blair or a Kinnock? In other words, will he take his reconstituted party into government like Tony Blair, whose 1997 electoral strategy Mr Cameron's cabal studied and emulated? Or, as Neil Kinnock did when he led Labour in 1992, will he stutter at the last?

The answer will be supplied by the general-election campaign that formally (and finally) begins with Gordon Brown's imminent visit to the queen. This campaign matters: its outcome, which once seemed preordained, is in genuine doubt.

Mr Cameron says in our interview with him (see article) that, for him, only securing an outright majority in the House of Commons will count as a win. Most Tories agree. Yet that prospect has receded since the start of 2010. And worryingly for Mr Cameron, the causes seem to be partly beyond his control. They include the political dividend Labour has enjoyed from the economic recovery (weak though it is), and a generalised loathing of politicians in the wake of the parliamentary-expenses scandal, which has blunted his message of renewal.

But there is something else. Even as the Tory poll lead has narrowed (though it has picked up a little this week), large majorities of voters consistently say they want change. The explanation for this apparent contradiction lies in an impressively resilient distrust of Tory motives, dating from folkloric events of 20 years ago and more. These two reflexes—disillusionment with Labour, but a visceral dislike of the Tories—crop up in conversations about politics across the country. If the latter predominates over the former, Mr Cameron may (soon) be remembered as a leader who strove to detoxify his party, but didn’t quite manage it: like Mr Kinnock, who began the work of modernising Labour that Mr Blair completed, and who lost the 1992 election to an unloved prime minister, during a recession.

On the other hand, Mr Cameron may yet rally to win his majority and end Labour’s long rule. If he does, defeat may be only the beginning of Labour’s woe.
Sensible Labour people recognise that dividing colleagues and policies into the old categories of Blairite and Brownite has become redundant. All the same, if Labour loses, that anachronistic thinking and the concomitant grudges may dominate debate about the party’s future. A noisy wing will blame the debacle on the Iraq- and lucre-tainted “Blairite” faction. Their case will be boosted by the perception, widespread in the party, that the financial crisis has made a more interventionist, redistributive stance viable. The weaker Labour becomes after the election, the greater the sway its trade-union backers will enjoy. Put all that together, and it is possible that Labour will soon consign itself to another long spell of unelectability.

Alternatively, it and Mr Brown may just pull off the most staggering political comeback in living memory.

For Labour, success is more generously defined. A draw is often a moral victory for one of the combatants; at this election, a hung parliament, particularly one in which Labour was the biggest party, might count as a win for the incumbent, considering all the reasons to expect a Labour meltdown. The party has been in office for 13 years; it has presided over a protracted, deep recession; it is led by a prime minister who for much of his tenure has been the most unpopular on record, and about whom half the cabinet can scarcely find a nice word to say when his job is in peril; and so on. In these circumstances, if Mr Brown were somehow to cling on in Downing Street—no longer unthinkable—he will have morphed from Mr Bean to triumphant Lazarus.

Finally Nick Clegg, who has long prophesied the break-up of the duopoly that has dominated British politics for almost a century. He and his Liberal Democrats may be scythed back down to inconsequential size. Or, if the parliamentary arithmetic is kind to him, in a little over a month Mr Clegg could be in the cabinet.

**Lights, camera, redaction**

What will determine which of these versions of the near future comes to pass? Turnout on polling day will be a factor: one big Labour fear is that lots of their erstwhile supporters will stay at home. Tactical voting—likely to be directed against both Labour and the Tories in different constituencies—will be another. A third will be the varying strength of Mr Cameron’s personal appeal in different regions of the country. Most important, perhaps, will be the extent to which marginal seats swing more enthusiastically to the Tories than safer ones. (The impact of Mr Blair’s return to British politics, to help his old adversary Mr Brown see off his imitator Mr Cameron, is another unknown. Labour is hoping that voters have forgotten what it was about him they had come to find so nauseating by the time he left office.)

The next few weeks will probably have many of the traditional features of British election campaigns: the fanfared launch of manifestos that few people read; the nobbling of a leader by some implacable member of the public during a walkabout; a violent row over an allegedly neglected hospital patient. But there will also be a new focus: the televised debates between the three leaders. Analysis of them will dominate campaign coverage; for all the talk about the galvanising power of new media, this old one will be more important than ever. And because they are a novelty, the debates may actively shift opinion, rather than merely congealing it as they tend to in America.

This election will be more competitive and exciting than once seemed possible. Bagehot still predicts a narrow Tory win.

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Economist.com/blogs/bagehot

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WHEN Barack Obama promised, in Prague a year ago, to “seek the peace and security of a world without nuclear weapons” and won a Nobel peace prize for it, even he felt that the accolade was a bit premature. His Prague to-do list was long: reduce the role of nuclear weapons in America’s defences; cut the number of nukes, too, in a bold new treaty with Russia; win Senate ratification of the test-ban treaty; seek a United Nations ban (or “cut-off”) on making fissile material for bombs; and meanwhile secure all nuclear materials from terrorist reach.

The real prize Mr Obama was after was international support for a stronger Nuclear Non-Proliferation Treaty (NPT) at its upcoming five-yearly review in May. For North Korea, Iran and others have battered its anti-nuclear foundations.

Mr Obama will be back in Prague on April 8th to sign the promised new strategic-arms reduction treaty with Russia’s Dmitry Medvedev. Even as he lifted the spirits of would-be disarmers a year ago, Mr Obama acknowledged that a world without the bomb would probably not come in his lifetime. Since then he has found that ticking off items on his “getting to zero” list is considerably harder than he imagined.

In principle, the new treaty with Russia should have been easy to bag. Both sides want the new verification rules it would bring. But negotiations dragged on. Nor is this quite the bold document Mr Obama talked of. Over ten years it will cut each side’s deployed strategic warheads to 1,550 (a reduction of a third below the maximum 2,200 to be allowed by 2012 under a previous accord) and the number of deployed missiles and bombers to 700 apiece. By contrast, a joint commission backed by the Australian and Japanese governments recently called for far deeper cuts: to 2,000 warheads worldwide by 2025, with no more than 500 each, of any sort, for America and Russia.

Mr Obama will shortly make public his nuclear posture review. It may not contain the clear pledge some have lobbied for: that America will never use its nuclear weapons first in a crisis. But it will constrain thinking about such use to the direst of circumstances facing America or its allies. Contrary to his predecessor’s efforts to replace older American warheads with fewer ones of simpler, safer but more modern design, Mr Obama insists there will be no new bombs on his watch.
According to the original NPT bargain, the five recognised powers, America, Russia, Britain, France and China, were to take steps towards nuclear disarmament, while other treaty members vowed not to seek nuclear weapons and to confine themselves to peaceful uses of nuclear power. Whoever leads the effort to strengthen the treaty, therefore, will need others to follow. But the mood going into next month’s review is not overly optimistic. Two items high on everyone’s NPT-support list, negotiation of a verifiable fissile-material cut-off treaty (FMCT, for short) and entry into force of the test-ban treaty, both seem as far away as ever.

In 2009, after years of stalemate, the UN’s 65-member Conference on Disarmament was poised to start inking in a fissile-material treaty, when Pakistan balked. It was miffed at a nuclear deal that the Bush administration had struck with its rival, India. This exempted India from global restrictions on civilian nuclear trade that are meant to apply to countries outside the NPT and, like both India and Pakistan, with nuclear arsenals outside its rules. But allowing nuclear imports for civilian use also eases the bottlenecks for India’s military programme. Pakistan therefore wants a similar deal.

There ought to be a chance of that after the proliferation activities of a former top nuclear scientist, Abdul Qadeer Khan. So Pakistan has turned to China for help in making enriched uranium and plutonium to keep up with India. Neither country is keen on an FMCT, but India is happy to let Pakistan take the flak.

So Mr Obama is hoping that a special nuclear-security summit in Washington, DC, on April 12th and 13th will provide some needed momentum going into the NPT review. The idea is to bring together disparate efforts to prevent illicit trade in nuclear technologies and materials, as part of parallel efforts to encourage countries to buy in nuclear-fuel services from reputable suppliers, rather than make it themselves with technologies that can also be abused for weapons.

But will this be enough? Mr Obama wants to strengthen the NPT’s rules, by getting everyone to sign up to an Additional Protocol of tougher inspections and by making it harder for a cheat simply to shrug off the treaty when caught, as North Korea did. Yet even those obvious steps run into opposition.

Iran is still a treaty member—in good standing, it claims, though others suspect a hidden military programme—and will resist moves that could cramp its nuclear style. Egypt has long refused to accept more intrusive inspections until there is progress on making the Middle East a zone free of weapons of mass destruction. This is a dig at Israel’s arsenal, though others are suspected of having chemical and biological weapons too, and Syria is suspected of having been planning to produce plutonium at a secret nuclear reactor built with North Korean help, and possibly Iranian finance, that was bombed by Israel in 2007 shortly before its completion.

But the achievement that would most symbolise America’s commitment to its end of the NPT bargain, and re-enthuse others about theirs, is Senate ratification of the Comprehensive Test-Ban Treaty (CTBT). The last time it considered the treaty, in 1999, it threw it out on a partisan vote, with Republicans calling the treaty unverifiable; they said that to ensure the safety and effectiveness of its arsenal America should keep testing options open. The same partisans on the Republican side are gunning for the ctbt again. If it is shot down a second time, with it would go whatever remaining goodwill there was for non-weapons states to accept tougher checks on their own nuclear activities.

The first task, however, will be to get the new strategic arms treaty passed by the Senate and by Russia’s Duma. The cuts envisaged may not be ambitious, but the treaty does other useful things. By setting a single ceiling for warheads and delivery systems, it allows each country to configure its forces to suit its own needs. This simpler sort of treaty allows the burden of inspection to be reduced, while setting out principles for more precise checks that will make possible deeper cuts in future.

Indeed, both countries seem keen to press on with cutting once this treaty is ratified. America and its NATO allies worry about Russia’s far larger arsenal of tactical nuclear weapons; Russia frets about the larger number of strategic weapons America keeps stored away for a rainy day. But a warhead is a warhead, whatever the range for firing it. An obvious next treaty could cut both sorts down to size, though monitoring weapons dismantling would require more transparency than Russia has so far been ready to accept. Meanwhile, no treaty would be required for Russia to pick up the proposals Mr Obama has made to discuss co-operation on missile defences.

Despite all this, Mr Obama has yet to earn that peace prize—though he has made a start. Weapons cuts are steadily mounting. Will other governments at next month’s review conference do their bit and strengthen the anti-nuclear rules that are the other part of the NPT bargain?
The Vatican

When words fail, again
Mar 31st 2010 | ROME
From The Economist print edition

Why ire over child abuse is unabated

A shadow over Palm Sunday

THE way the Roman Catholic church responds to the global scandal over clerical sex abuse, said Pope Benedict’s spokesman on March 27th, would be “crucial for its moral credibility”.

The next day, Benedict had a perfect chance to respond, as he addressed the faithful at the start of Easter week. He made no specific mention of the scandal, but did say that faith helped believers not to be intimidated by the “chatter of dominant opinion”. Inevitably, he was assumed to be referring to the scandal, and an impression was left that Benedict thought accusations of paedophilia were mere tittle-tattle. It was a slip the Vatican could ill afford, amid a crisis that threatens the loyalty of many Catholics.

In recent weeks a wave of new accusations has swept the church’s European heartland, whose re-Christianisation Benedict regards as central to his papacy. Claims have been voiced in Ireland, the Netherlands, Germany, Austria, France and even Italy where, for the first time, television airtime has been given to victims to describe their sufferings.

Recently, the focus has switched to Benedict’s own record. The New York Times reported that, in the 1990s when he headed a Vatican department, the then Cardinal Joseph Ratzinger had refused to try under church law a priest accused of molesting up to 200 deaf boys. But it has not been proved that he intervened personally, and anyhow the priest was dying when the Vatican, a long time after the alleged crimes, became involved.

An even more serious question hangs over Benedict’s term as archbishop of Munich. A paedophile priest was taken into the diocese and swiftly reassigned to duties that would put him in contact with children. Another Times report said his office was copied on the memo ordering the reassignment. The diocese does not deny the copying, but says he probably did not know of the reassignment.

Church leaders protest it is unfair to pillory Benedict, who has acted far more vigorously than Pope John Paul II to stamp out sex abuse. True. But there is evidence he was not always as uncompromising, and for now in this affair the past counts more than the present.
Opponents of a bid by Muslim states to “protect religion” claim a small success

IT DOES not happen often: Christian lobbyists, the sort who favour prayer in American classrooms and crucifixes in Italian ones, lining up on the same side as secularists who battle to curb religion’s role in the public square. But in both those camps there has been some quiet satisfaction after a recent vote at the United Nations. Not over the outcome, but over the slim margin of defeat.

On March 25th the Human Rights Council (HRC), a Geneva-based UN agency which often exasperates its Western members, voted by 20 votes to 17, with eight abstentions, for a text that lists the “defamation of religion” as an infringement of liberty. Nothing amazing there: the Organisation of the Islamic Conference (OIC), which groups 56 mainly Muslim states (plus Palestine), has been working to push resolutions of that kind through the General Assembly and other UN bodies since 2005. But the margin was the smallest ever, and opponents think there could be a good chance of defeating a “defamation” motion next time one comes around.

The OIC’s idea is to establish the principle that faiths need protection, just as individuals do. It denies any sinister intention (see article). And to some ears, the OIC’s effort sounds like harmless UN-speak, but nothing more. (The United States Commission on International Religious Freedom, a congressionally mandated body, has noted a logical flaw: defamation means harming the reputation of a living person or entity: that implies that one can’t defame an idea or a religious founder who is no longer, at least physically, alive on earth.)

But critics of the OIC campaign, who include atheists, Christians and indeed some Muslims, say the “defamation” idea is worse than hot air: far from protecting human rights, it emboldens countries that use blasphemy laws to criminalise dissent. What encourages these critics is that more countries seem to be coming around to their view. Mexico, Uruguay, Argentina, Zambia and South Korea voted against the latest resolution. Brazil criticised the text but abstained.

Deeper still inside the UN’s bureaucracy, another battle over religion rages—and the stakes could be even higher. An “ad hoc committee” is mulling ways to amend or extend the UN convention on racial
discrimination. Certain states want language that would fuse the categories of race and faith; some want a new convention, or a protocol to the existing one.

For secularists (in the broad sense of people, including believers, who oppose the idea of faith having privileged access to power), all this is alarming. Non-binding resolutions against defamation are bad enough; a UN treaty on race-plus-religion would have legal force, at least for its signatories, and give heart to theocrats.

At the HRC's latest discussion of this effort in March, the Algerian who oversees the project was keen to plough ahead. But countries like Switzerland, Japan, Mexico, Argentina and France retorted that it would be better to enforce the existing UN norms than dream up new ones. Efforts to widen the racism accord will resume, with a new chairman, late this year—but critics are relieved to have stalled it. Still, would-be theocrats may now focus harder on adding to the racism charter, because they face a real risk of being defeated over defamation, in the view of Roy Brown, Geneva spokesman for the International Humanist and Ethical Union.

Meanwhile a Christian-inspired NGO, the European Centre for Law and Justice, has been denouncing the abuse of blasphemy laws in many OIC member states. How fair is their point? It is an easy case to make, for example, over Pakistan.

Some 41 complaints of blasphemy were registered by police in Pakistan last year, says that country's independent Human Rights Commission. In theory, blasphemy is punishable by death—a penalty that has been handed down but never carried out. Worst-hit by the law are minorities like Christians and Ahmadis, a group whose claim to be Muslim is rejected by the Pakistani state. Although abuse of the law is less rife now than in the 1980s, when an Islamist general tightened up the rules, the law is still invoked in disputes (over property, say) that have nothing to do with faith.

"The most vulnerable people, that is religious minorities, continue to be charged with blasphemy," said Ali Dayan Hasan, a researcher at Human Rights Watch, a campaign group. "But are people convicted? No. Rarely. It is used as an instrument of political and social coercion."

When convictions occur, they lead to long jail terms; and pre-trial detention can last for years. Pakistan's parliament is revising the constitution but it has left intact the religious bits, despite a vow by the ruling party to review the blasphemy laws. (Indonesia too has stepped back from a move to liberalise its blasphemy regime.)

On Pakistani streets, the law has dire effects. In January 2009, in a village in Punjab province, five Ahmadis, a labourer and four children, were charged with blasphemy. They had supposedly written "Prophet Muhammad" on the wall of a mosque toilet. The children were behind bars for nearly six months till the charge was quashed.

And last September a young Pakistani Christian was accused of throwing part of the Koran down a drain. It seems that his real crime, however, was affection for a Muslim woman. A mob torched a church, and many Christians had to flee. He was taken to jail, where he died a few days later. His family alleged torture; the authorities claimed suicide. There was mayhem at the funeral and the country's Christians (see picture) were appalled. In some places, it is not the "defamation" of faith that threatens rights but measures that supposedly defend it.
The Islamic Conference

A cautious gentleman
Mar 31st 2010 | ISTANBUL
From The Economist print edition

The OIC’s definition of civilised debate

AS SECRETARY-GENERAL of the world’s second-largest international body (his description), Ekmeleddin Ihsanoglu walks a tightrope. Born in Cairo in 1943, this scholar and calligraphy expert has the style of an Ottoman gentleman. But he is a citizen of the Turkish republic (whose system is secular, despite the pious tone of the present government) and it was at the republic’s behest that he assumed the reins of the Organisation of the Islamic Conference.

Predictably, then, he presents the OIC’s bid to stop the defamation of religion in emollient terms, rejecting the idea that it validates cruel laws. “We are not against freedom of expression, freedom of the press or civilised criticism,” he insists. “The target is to invite everybody to respect Islam,” he adds, arguing that the faith’s past is replete with “enlightened critique”, with many interpretations of the founding texts.

What the resolutions aimed to stop was the “demonising” of Islam which had become rife in Europe—after the Swiss vote to ban minarets, calls for a similar ban in Germany, and the rise of Geert Wilders, a Dutch politician who has denounced the Koran.

He contrasted the lack of high-level concern over “Islamophobia” in Europe with the recent stance of the Obama administration, which has named a young Muslim lawyer as envoy to the OIC and worked with Egypt to produce a delicately worded free-speech resolution last autumn. As for the risk of endorsing harsh punishments for blasphemy, Mr Ihsanoglu says he “doesn’t see any connection”, given that the latest OIC-backed resolution, in his reading, was simply an appeal for common sense and mutual respect. Far from backing repression, the OIC’s focus these days was on improving the status of women—“their position in some OIC countries is not as it should be”—and on helping in trouble-spots like Iraq and Afghanistan.

His words may not convince critics of the OIC, who feel America has been too ready to give the body the benefit of the doubt, or libertarians who say “uncivilised” criticism (so long as it does incite violence) needs protecting as much as the softer kind. But when asked about one of the OIC’s more controversial aims—to move its office from Jeddah to Jerusalem—he carefully replies that is “not at the top of our agenda” for now.
Time to rebalance
Mar 31st 2010
From The Economist print edition

America's economy is set to shift away from consumption and debt and towards exports and saving. It will be its biggest transformation in decades, says Greg Ip (interviewed here)

STEVE HILTON remembers months of despair after the collapse of Lehman Brothers in 2008. Customers rushed to the sales offices of Meritage Homes, the property firm Mr Hilton runs, not to buy houses but to cancel contracts they had already signed. “I thought for a moment the world was coming to an end,” he recalls.

In the following months Mr Hilton stepped up efforts to save his company. He gave up options to buy thousands of lots that the firm had snapped up across Arizona, Florida, Nevada and California during the boom, taking massive losses. He eventually laid off three-quarters of its 2,300 employees. He also had its houses completely redesigned to cut construction cost almost in half: simpler roofs, standardised window sizes, fewer options. Gone were the 12-foot ceilings, sweeping staircases and granite countertops everyone wanted when money was free. Meritage is now catering to the only customers able to get credit: first-time buyers with federally guaranteed loans. It is clawing its way back to health as a leaner, humbler company.

The same could be said for America. Virtually every industry has shed jobs in the past two years, but those that cater mostly to consumers have suffered most. Employment in residential construction and carmaking is down by almost a third, in retailing and banking by 8%. As the economy recovers, some of those jobs will come back, but many of them will not, because this was no ordinary recession. The bubbly asset prices, ever easier credit and cheap oil that fuelled America’s age of consumerism are not about to return.

Instead, America’s economy will undergo one of its biggest transformations in decades. This macroeconomic shift from debt and consumption to saving and exports will bring microeconomic changes too: different lifestyles, and different jobs in different places. This special report will describe that transformation, and explain why it will be tricky.

The crisis and then the recession put an abrupt end to the old economic model. Despite a small rebound recently, house prices have fallen by 29% and share prices by a similar amount since their peak. Households’ wealth has shrunk by $12 trillion, or 18%, since 2007. As a share of disposable income it is back to its level in 1995. And if consumers feel less rich, they are less inclined to spend. Banks are also
less willing to lend: they have tightened loan standards, with a push from regulators who now wish they had taken a dimmer view of exotic mortgages and lax lending during the boom.

Consumer debt rose from an average of less than 80% of disposable income 20 years ago to 129% in 2007. If other crises of the past half-century are any guide, America’s consumers will spend the next six or seven years reducing their debt to more manageable levels, reckons the McKinsey Global Institute. This is already changing the composition of economic activity. Consumer spending and housing rose from 70% of GDP in 1991 to 76% in 2005 (see chart 1). By last year it had fallen back to 73%, still high by international standards.

![Chart 1: What goes up may come down](chart)

The effect on the economy of deflated assets, tighter credit and costlier energy are already apparent. Fewer people are buying homes, and the ones they buy tend to be smaller and less opulent. In 2008 the median size of a new home shrank for the first time in 13 years. The number of credit cards in circulation has declined by almost a fifth. American Express is pulling back from credit cards and is now telling customers how to use their charge cards (which are paid off in full every month) to control their spending.

Normally, deep recessions are followed by strong recoveries as pent-up demand reasserts itself. In the recent recession GDP shrank by 3.8%, the worst drop since the second world war. In the recovery the economy might therefore be expected to grow by 6-8% and unemployment to fall steadily, as happened after two earlier recessions of comparable depth, in 1973-75 and 1981-82.

**No bounce-back**

But this particular recession was triggered by a financial crisis that damaged the financial system’s ability to channel savings to productive investment and left consumers and businesses struggling with surplus buildings, equipment and debt accumulated in the boom. Recovery after that kind of crisis is often slow and weak, and indeed some nine months into the upturn GDP has probably grown at an annual rate of less than 4%. Unemployment is well up throughout the country (see map), though it declined slightly in February.
So if America is to avoid the stagnation that afflicted Japan after its bubbles burst, where is the demand going to come from? In the short term the federal government has stepped up its borrowing—to 10% of GDP this year—to counteract the drop in private consumption and investment. Over the next few years this stimulus will be withdrawn. Barack Obama wants the deficit to come down to around 3% of GDP by the middle of this decade, though it is not clear how that will be achieved. Indeed, if the rest of the economy remains moribund, the government may be reluctant to withdraw the stimulus for fear of pushing the economy back into recession.

Tighter credit and lower consumer borrowing are not the only drivers of economic restructuring. A less noticed but significant push comes from higher energy prices. A strengthening dollar and ample supply kept oil cheap for most of the 1990s, feeding America’s addiction to imports. That began to change a few years before the crisis as the dollar fell and emerging markets’ growing appetite put pressure on global production capacity.

A fourfold increase in oil prices since the 1990s has rearranged both consumer and producer incentives. Sport-utility vehicles are losing popularity, policies to boost conservation and renewable energy have become bolder, and producers have found a lot more oil below America’s soil and coastal seabed. Imports of the stuff have dropped by 10% since 2006 and are likely to come down further. When natural-gas prices followed the rise in oil earlier this decade, exploration companies used new methods to get at gas trapped in shale formations from Texas to Pennsylvania. Abundant domestic shale gas should radically reduce America’s gas imports.

America’s economic geography will change too. Cheap petrol and ample credit encouraged millions of Americans to flock to southern states and to distant suburbs (“exurbs”) in search of big houses with lots of land. Now the housing bust has tied them to homes they cannot sell. Population growth in the suburbs has slowed. For the present the rise of knowledge-intensive global industries favours centres rich in infrastructure and specialised skills. Some are traditional urban cores such as New York and some are suburban edge cities that offer jobs along with affordable houses and short commutes.

A burst of productivity could lift incomes and profits. That would enable consumers to repay some of their debt yet continue to spend. The change in the mix of growth should help: productivity in construction remains low, whereas in exports the most productive companies often do best. But the hobbled financial system will make it hard for cash-hungry start-ups to get financing, so innovation will suffer.

The outlook for business investment depends on whether it is for equipment or buildings. Spending on equipment is expected to be fairly strong, having largely avoided excess in the boom period, and indeed in the fourth quarter of 2009 it raced ahead at an annual rate of 19%. In February John Chambers, the boss of Cisco Systems, a maker of networking gear, called it “one of the most robust, positive turnarounds I’ve seen in my career”. Demand for new buildings is far lower: empty shops and offices attest to ample unused capacity. And business investment typically accounts for only 10-12% of GDP, so it will never be a full substitute for consumer spending.

The road to salvation
As consumers rebuild their savings, American firms must increasingly look abroad for sales. They have a lot of ground to make up. Competition from low-wage countries, mostly China, has increasingly taken over the markets of domestic industries such as furniture, clothing or consumer electronics. Yet shifts in the pattern of global growth and the dollar are laying the groundwork for a boom in exports. “There’s a world view that the United States is the consumer of the world and emerging markets are the producer,” says Bruce Kasman, chief economist at JPMorgan Chase. “That has changed.” He reckons that America will account for just 27% of global consumption this year against emerging markets’ 34%, roughly the reverse of their shares eight years ago.

The cheaper dollar will resuscitate some industries in commoditised markets, but the main beneficiaries of the export boom will be companies that are already formidable exporters. These companies reflect America’s strengths in high-end services and highly skilled manufacturing such as medical devices, pharmaceuticals, software and engineering, as well as creative services like film, architecture and advertising. Thanks to cheap digital technology, South Korea and India now knock out the sort of low-budget films that compete with standard American fare. But only Hollywood combines the creativity, expertise and market savvy to make something like “Avatar” which has earned $2.6 billion so far, some 70% of which came from abroad. That adds up to several jumbo jets.

Exports are a classic route to recovery after a crisis. Sweden and Finland in the early 1990s and Thailand, Malaysia and South Korea in the late 1990s bounced back from recession by moving from trade deficit to surplus or expanding their surplus. But given its size and the sickly state of most other rich countries’ economies, America will find it much harder. It has been exporting more to emerging markets than to developed ones for several years, but if other countries, particularly China, do not sufficiently boost domestic demand, “the unwinding of the global imbalances could reverse quite quickly in 2010,” says an IMF staff paper.

America’s current-account deficit, the broadest measure of its trade and payments with the rest of the world, shrunk from 6% of GDP in 2006 to 3% last year (see chart 2). Could it come down to zero? It nearly did in 1991 after five years of booming exports. This time the deficit started out a lot larger and the rest of the world is weaker. Still, even stabilisation around 3% would be a blessed relief because it would slow the growth in America’s indebtedness to foreigners.

![Less cavernous](chart)

America’s imbalances were years in the making and will not be undone overnight. But the elements of a rebalanced economy are already visible a 40-minute drive to the south of Mr Hilton’s offices in Scottsdale, Arizona. Around the same time that Mr Hilton was watching sales of his homes dry up, Brian Krzanich, head of global manufacturing at Intel, was finalising plans to spend $3 billion retooling his company’s massive semiconductor factories in nearby Chandler. Mr Krzanich knew perfectly well there was a recession going on. Intel’s sales were down and 3% of the staff at the factories had been laid off. But he also knew that once global demand rebounded, Intel would have to be ready to produce a new generation of cheaper, smaller and more efficient chips. “Unless you think your business is going to shrink for an extended period, like seven years, it always pays to make that investment,” he says. In the last quarter of 2009 Intel, helped by resurgent demand for technology, enjoyed record profit margins, and Mr Krzanich was approving overtime.

Mr Hilton, for his part, runs his company on the assumption that the days of easy money and exuberant
consumers are gone for ever. In his office he has a yellowed copy of the *Wall Street Journal* from September 18th 2008, the week when Lehman failed and American International Group was bailed out. “Worst crisis since the 30s with no end in sight”, reads one headline. “I wish I’d had that article in 2005,” says Mr Hilton. He keeps it around as an antidote any time he is “feeling all happy and slappy”.
The consumer boom defied fundamentals. Now economic rules are reasserting themselves

IT WASN'T supposed to happen. An academic study in 1991 predicted that as the baby-boomers aged, America’s saving rate would rise by one or two percentage points by the mid-2000s. Instead it fell. Between 1995 and 2000 the share of American households owning their home should have dropped by a percentage point as boomers passed their home-buying years. Instead it rose by 4.6 percentage points, with the sharpest increases among those under 45, according to Harvard University’s Joint Centre for Housing Studies.

The economic behaviour of Americans born in 1935-44 turned out to be a poor guide to their children’s conduct. According to a study by the McKinsey Global Institute, when the parents’ generation reached the age of 45 their saving rates rose sharply, to about 30% of disposable income. Yet when their children’s generation, born in 1955-64, reached the same age, their saving rates remained unchanged, at about 10% of disposable income.

This divergence is explained by two events, both dating back to the early 1980s. First, the Federal Reserve’s success in taming inflation resulted in two decades of falling real interest rates and rising share and property prices. As people’s assets rose in value, they felt less need to save for college, retirement or rainy days. Pricier homes provided more collateral against which to borrow.

Second, federal ceilings on deposit and loan rates were abolished, launching a period of deregulation that enabled banks and other institutions to offer countless new financial products and allow millions to borrow large sums of money for the first time. Automated underwriting enabled lenders to screen borrowers more efficiently (and also reduced the opportunity for racial discrimination). Securitisation—bundling mortgages, car loans and credit-card debts into securities and selling them on—helped lenders limit their risks. Policymakers smiled on all this because it allowed many more Americans to become homeowners at no cost to the taxpayer. In 1989 only 47% of middle-income households had a mortgage. By 2007 about 60% did.

The Asian financial crisis of 1997-98 accentuated these trends. It sent oil down sharply and the dollar up, raising Americans’ purchasing power and their taste for imports and oil. In its aftermath Asian countries held down their exchange rates and began to accumulate huge trade surpluses, both to bolster growth and as protection against future crises (and the humiliating strictures of the IMF). They ploughed those
surpluses into America’s bond market, holding down interest rates and inflating the housing bubble.

The return to earth began long before the riskiness of all this became obvious. In 2002 the dollar began to fall. In 2004 oil headed upwards. In 2006 the housing market turned down. Hopes that the transition would be gentle evaporated as the crisis erupted, leading to the recession of 2007-09. Many companies realised too late how much they had depended on credit-fuelled profligacy. Ge, for instance, eventually relied on financial services for half its profits. Last year Jeff Immelt, the conglomerate’s chief executive, admitted that “we let it get too big.” Citigroup’s boss, Vikram Pandit, explained in 2008 how his company got into such a mess: “We had a large, long US consumer position.” Unfortunately, he added, so did the entire world.

Where consumers rule

Consumers have always dominated the American economy. Since 1950 their share of spending (including housing) has ranged from 66% to 76%. What was different about the pre-crisis era was the role of credit: in myriad new forms it made it possible for consumers to spend well beyond their income.

Consumption will recover, but it will no longer grow faster than income, as it did persistently for the two decades before the crisis; indeed, it should grow more slowly. With their shares and homes worth far less than they were, baby-boomers must now save harder for retirement. Lenders demand higher credit scores, bigger deposits and more stringent proof of income. Policymakers, who had cheered looser lending standards on the way up, are now tightening them further on the way down. True, Barack Obama has pleaded for banks to do more lending and put a government guarantee behind much of the mortgage market. But he is also bent on establishing a powerful Consumer Financial Protection Agency to scrutinise lenders’ offerings. Regulators are planning to hold banks to stiffer capital and liquidity rules.

The more that an industry depended on consumers’ access to credit, the harder it has been hit. As home ownership drops, developers are building smaller, simpler homes (see chart 3). Steve Hilton, the boss of Meritage Homes, is keeping the price of his houses down to at most 15% more than comparable existing ones to compete with the flood of foreclosures. On the garage doors of his company’s show homes hang garish banners advertising the “no-tricks” monthly mortgage payment: $1,480 for the three-bedroom, two-bathroom Harrison, for example. “It used to be taboo to talk about the payment,” says Mr Hilton. But nowadays buyers are looking for a place to live, not an investment, and knowing what the monthly repayment will be lets them compare the cost of owning and renting more easily.

Cars, like houses, are usually bought on credit, with either a loan or a lease. During the credit boom the terms of such deals were exceptionally attractive, but not any more, thanks to tight credit generally and the woes of GMAC, the financing arm of General Motors and Chrysler, which has been laid low by bad mortgage lending. In most years since 1960 some 7-8% of driving-age Americans bought a car. Last year only 4% did, according to IHS Global Insight, a consultancy. It forecasts that when the market has recovered the figure will settle at about 6% in any given year.
The recession also marked a “coda” to the credit-card industry’s first 50 years, says David Robertson of the Nilson Report, an industry newsletter. The popularity of credit cards was bound to wane as baby-boomers moved on from their highest-spending years, he says: “Instead of gliding to a manageable end, it wound up blowing up.” The number of holders of Visa, MasterCard, American Express and Discover cards shrank by 32m, or 11%, last year, according to Nilson. Outstanding revolving credit (mostly credit cards and personal lines of credit) fell by $92 billion, or 10%, the largest such drop since records began in 1968. That will have an effect on consumer spending more generally.

Credit-card companies attracted their share of the anger directed at Wall Street. With effect from February, the Federal Reserve and Congress banned a wide range of card-company practices, such as raising a borrower’s interest rate when he defaults on a loan extended by another organisation. Parents must now give their consent before their children under 21 can get a card. “At a time when our economy is in a crisis and consumers are struggling financially, credit-card companies are gouging them,” said Chris Dodd, chairman of the Senate Banking Committee.

Noxious as some of the card-companies’ practices were, they did allow many more people to hold credit cards. Bankers say the new restrictions may cut the number of credit-card holders by up to 45m. That is almost certainly an exaggeration, but there is bound to be a drop.

The changed economic and regulatory environment has certainly affected card companies’ strategy. American Express, for instance, had long favoured charge cards over credit cards, but in 1999 it launched its “Blue” credit card with a charity concert in New York’s Central Park featuring Sheryl Crow, Eric Clapton and Sarah McLachlan. The card was aimed at technologically savvy young consumers and contained a microchip to deter identity theft and encourage internet shopping. In subsequent years Amex followed up with a series of cards aimed at niche borrowers, from newlyweds to young Chicago professionals.

But the push into credit cards cost Amex dear as delinquencies mounted during the recession. Under new accounting rules it will have to hold additional capital for the off-balance-sheet vehicles used to securitise credit-card debts. Having agreed in 2008 to be regulated by the Federal Reserve, in part to qualify for bail-out funds (which it has since repaid), it may face stiffer liquidity and capital requirements than it would have done otherwise.

It has now ditched many of its new credit cards except Blue and returned to its roots in charge cards and services such as electronic payments. “There are going to be segments, not just subprime but [of] the middle class, that are not going to have access to credit, and when they get credit it’s going to be a lot more expensive,” Ken Chenault, Amex’s boss, said last summer. “The charge card is even more a product for these times than…three years ago.” The company is now offering features that help cardholders control spending. It lets them pay for groceries with reward points and impose spending limits on kids with supplemental cards. If consumers espouse frugality instead of ostentatious spending, Amex wants to be there.
Look after the cents
Mar 31st 2010
From The Economist print edition

Are Americans naturally spendthrift?

IN 1867 Horace Greeley, a legendary American newspaper editor, described his compatriots thus: “We are energetic, we are audacious; we are confident in our own capacities and in our national destiny; but we are not a systematic, a frugal, economical people.”

The global imbalances that led to the financial crisis are often blamed on Americans’ high-living optimism. The crisis has brought about a “new creed of thrift”, as the Pew Research Centre, a polling organisation, put it in April 2009. From the early 1970s to 2006 the proportion of Americans who considered air conditioning or dishwashers a “necessity” rose steadily, but in 2009 it dropped sharply, Pew found. Between 1950 and 1980 personal saving averaged 9% of disposable income. By 2007 it had dropped below 2%, but last year it went up to 4%.

Is it true that Americans are prodigal? David Blankenhorn, in his book “Thrift: A Cyclopedia”, argues otherwise. “In this sweet land of liberty, one part of our inheritance...is thrift. [It] is more than anything else a restatement, in secular terms, of the Judaeo-Christian concept of stewardship.” GfK Roper, a consultancy specialising in consumer behaviour, notes that in every recession since 1981 American consumers cut back on going out to eat and play and on holidays.

Economists think they can explain changes in saving behaviour over time and across countries without reference to cultural norms. An IMF staff paper ascribes the enormous differences in saving rates between Americans, Germans and Japanese to demography, wealth and economic volatility. Germans and Japanese used to save more because they were older, had suffered more economic setbacks and were less wealthy, though Japanese saving rates have since come down as more people retire and draw down their savings. A model developed by Barack Obama’s Council of Economic Advisers explains the American saving rate in terms of wealth, credit availability and unemployment. It predicts that it will eventually settle between 4% and 7%.

Yet such exercises do not fully exonerate a culture that can influence people’s saving habits through political choices. In 1950 President Truman refused to run a deficit to pay for the Korean war. Instead he raised taxes and slashed spending, for which he enjoyed the public’s overwhelming support. In 2001, in the wake of the terrorist attacks that year, shopping was presented as a patriotic activity, a way for Americans to “stick their thumb in the eye of the terrorists”, as Dick Cheney, George Bush’s vice-president, put it. Mr Bush did not even consider raising taxes to pay for the wars in Afghanistan and Iraq; he cut them instead.

Institutions also influence saving behaviour. George Akerlof and Robert Shiller, in their book “Animal Spirits”, note that Singapore’s sky-high saving rate can be traced to employers’ and employees’ compulsory contributions to the Central Provident Fund, created by the government in 1955.

Mr Blankenhorn blames the decline in thrift in America on the rise of “anti-thrift” institutions such as rent-to-own stores, cheque-cashing and chain pawn shops, indulgent credit-card companies and proliferating payday lenders. They flourished in America because voters and policymakers did not object. Belatedly, that has changed. Regulators and rulemakers now insist that lenders hold more capital and scrutinise borrowers more carefully. Whether Americans want to save more may be beside the point: they won’t have much choice.
Export or die
Mar 31st 2010
From The Economist print edition

With demand at home at rock bottom, American firms are looking abroad

CLAUDIA CUSUMANO works for a New York firm of architects, Kohn Pedersen Fox (KPF), and has often wondered if she would lose her job in America’s property bust, as many of her professional colleagues already have. In October 2008, when she was working on a huge residential and office complex in northern Virginia, the developer could not get financing. Its e-mail to contractors and consultants said: “It appears to be a good time to stop.” Her boss switched her to another project in northern Virginia but last autumn that, too, went on hold.

Just as things were beginning to look desperate, her firm landed a contract to build an upmarket hotel in the Chinese city of Hangzhou. As design work in America has disappeared, KPF’s growing portfolio of projects in China, South Korea and the Middle East has protected its 550 employees from the worst of the domestic slump. Gene Kohn, the firm’s chairman, explains that “those projects in South Korea and China were big shots in the arm. We didn’t have to let any more people go, we kept the whole New York office
busy and began to hire. Last year turned out better than anyone could have imagined, yet it started out with the doom and gloom of all these jobs stopping.”

About-turn

America’s economic transformation will require businesses to rely less on selling to Americans and more on selling abroad, as KPF has done. The emphasis will be on high-value products and services rather than on labour-intensive items such as furniture and clothing.

When Barack Obama in his state-of-the-union speech called for exports to double in five years, many economists thought he was asking for the impossible. Whenever exports have risen so steeply in the past, it has been thanks to high inflation that lifted nominal values. Yet exports do not have to double for trade to lead economic growth; all they have to do is to grow more rapidly or fall more slowly (in dollar terms) than imports. That has already happened. Between 2008 and 2009 exports dropped by $272 billion whereas imports fell by $589 billion. As a result, the trade deficit narrowed sharply, to $379 billion from $696 billion. As a share of GDP, that was the lowest since 1998.

The deficit may widen again in coming months as companies step up imports to build up depleted stocks, but not by much. Martin Baily of the Brookings Institution and Robert Lawrence of Harvard University predict that as a share of GDP the trade deficit this year, excluding oil, will increase only slightly even if the dollar strengthens.

What about the longer term? A country’s relative trade performance is mainly determined by two (connected) factors: its exchange rate and its growth rate in relation to those of its trading partners. The IMF expects growth globally to average 4.3% a year between now and 2014 but only 2.5% in America. And though the recession hammered overall trade, America’s trade patterns have changed to reflect the shift in global economic gravity. The share of its exports going to emerging markets topped 50% for the first time in late 2007 and has grown further since (see chart 4). All this suggests that the trade deficit will narrow a bit further.

The dollar is more of a wild card. Political or economic upheaval can trigger a flight from or to the dollar (as Greece’s current troubles have done). Other countries, such as China, may continue to hold their currencies down to keep imports in check. That could halt or even reverse the recent narrowing of the deficit.

The notion that exports can lead American growth strikes many, especially on the left, as fanciful. They point out that America’s manufacturing base has been cut down by years of competition from China and other lower-cost countries. Even if the economic climate improves, America may not benefit: it simply does not make the products the rest of the world wants to buy. Flat-screen televisions and mobile phones are made in Asia. “There are just too many products that we no longer make and too many foreign links in the industrial supply chain,” Robert Kuttner recently wrote in the American Prospect.

These prognostications are too gloomy. Experience suggests that export revivals are led by highly
productive industries that already export a lot, rather than less productive industries regaining old markets. Over time a favourable global environment encourages more firms to launch new products or enter new markets abroad. Yet pinpointing those firms in advance is almost impossible.

In a 2001 paper Andrew Bernard of Dartmouth College and Bradford Jensen, now of Georgetown University, analysed the sources of America’s export boom in 1987-92. During that period American exports rose 77% in nominal terms and the trade deficit shrank from 3.2% to 0.6% of GDP. They looked at factories across America and found that only a small portion of the rise in exports came from those that had never exported before; by far the biggest gain was from those that were already exporting. Their research suggested that 90% of the export boom could be explained by the dollar’s depreciation and by relatively stronger growth in America’s trade partners.

A later paper, published in 2009, which Messrs Bernard and Jensen co-wrote with two other scholars, looked at the sources of export growth between 1993 and 2003. The increase in any given year came almost entirely from existing exporters, but over time new ones played an increasing part. For example, in 1993 alone firms exporting existing products to existing markets accounted for 91% of total export growth. But over the entire ten-year period they made up a relatively modest 35% of the total, with new firms contributing 24% and firms with new products or entering new markets as much as 42%.

Mr Bernard says these findings are at odds with the conventional view that export growth is the result of domestic firms becoming more productive. That is true only in the long run. In the short term almost all the growth comes from higher demand for products that existing firms already make. That fills him with optimism: “If you wanted to set the stage for US exporters to do well, you’d like to have rapid income growth in destinations that will be big in GDP terms. We already see that.”

America’s export boom is likely to be led by firms that are already global in scale and by sectors in which America has a clear competitive advantage: sophisticated, knowledge-intensive capital goods like microprocessors, and high-end services like engineering, oil-production services and even (witness KPF) architecture.

Few companies better capture that trend than Intel, a microprocessor giant. It is one of America’s most successful companies, and 80% of its revenue comes from outside its home country. Like almost all big companies it suffered a decline in sales and profits in the recession and had to lay off some staff. Yet it also decided to invest $7 billion in its semiconductor operations to enable them to make chips with circuitry just 32 nanometres (or billionths of a metre) wide, down from 45.

Brian Krzanich, Intel’s vice-president of manufacturing, says labour costs are an important consideration in processes such as assembling and testing systems, which are carried out in Costa Rica, Vietnam, China and Malaysia. But they matter much less in capital-intensive processes such as fabrication where the value of a technician or engineer might depend on how efficiently he or she can operate a $70m tool. If a more productive engineer can get 2% more use out of that tool, “that’s worth a lot of employees.” The difference in pay between a $50,000 engineer in China and a $150,000 engineer in America is a “nit” in that equation, he says. Thus the bulk of Intel’s investment is going into American factories in New Mexico, Oregon and Arizona. By the fourth quarter of last year Intel started shipping the new, smaller generation of chips from its Oregon plant, which helped the company achieve its highest ever gross margin.

Still, over the medium term Intel cannot correct America’s trade deficit by itself. More American companies will have to look abroad. They are the least likely to export out of 15 big economies, according to the National Association of Manufacturers, a trade group. Matthew Slaughter of Dartmouth College notes that only 4% of all American firms and 15% of American manufacturers do any exporting at all. And 80% of America’s total trade is conducted by just 1% of firms that export or import.

This does not mean there is something wrong with American firms. Rather, it reflects the fact that America’s domestic market is large enough for most firms. Exports as a share of GDP last year were estimated at 10.9%, much lower than in most of its big trading partners (see chart 5). Smaller companies are deterred by the investment in market research, distribution and product design needed to sell abroad. To succeed in foreign markets, they first have to do well at home.
The definition of exports has also become less clear-cut over the years. These days much of what America exports is buried deep inside products put together elsewhere. Apple’s iPod, for instance, is assembled in China, but a study by the Personal Computing Industry Centre at the University of California, Irvine, estimated that China accounts for only 2% of the wages involved in its manufacture, whereas America makes up around 70%, in areas such as engineering, software and distribution.

Service with a smile

Services are playing an increasingly important part in America’s exports. Their share of the total has gradually increased, to nearly 33% last year. Within that category, the private side, which covers things like business, professional and financial services, has been growing fastest. Before the recession optimists routinely cited America’s pre-eminence in financial services as a driver of future export growth. Since then the rest of the world has become much more sceptical about the real value of America’s financial engineers.

Yet America leads in many other kinds of services, from software and film to engineering and oil drilling. And as technology advances, more businesses are likely to turn global. A survey by the American Institute of Architects found that in 2008 some 7% of its members’ billings came from international work, against only 2.8% a decade earlier. That increase came almost entirely from firms that were already doing international work but had stepped up their efforts.

Building up such work can take time. KPF, for example, though founded in 1976, did not land its first foreign job until the late 1980s. Getting a toehold in Asia was particularly time-consuming, but the firm now has an office with 40 people in Shanghai that helps with local project oversight, models, presentations to clients and the notoriously opaque building regulations in Chinese cities.

The ease of exchanging information around the world has fuelled fears that even service jobs will be outsourced away from America. But those information flows also make it easier for firms like KPF to do business overseas. Once a week Ms Cusumano and her colleagues in Shanghai log into a teleconference to discuss the Hangzhou hotel and look at drawings with the aid of web-based conference software. And some nights when Ms Cusumano cannot sleep, she exchanges e-mails with her partners in Shanghai.
Energetic progress
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From The Economist print edition

There is every chance that in future energy will contribute less to America’s trade deficit

JUST off the freeway in south-western Pennsylvania a quiet country road leads past picturesque barns and horses in snow-covered fields. Turn right near the top of a hill, and a dirt road seems to take you straight to Texas. An orange drilling rig the size of a block of flats hulks over the countryside, slowly chewing its way a mile below the ground. The roar of portable generators fills the air. The roughnecks in blue overalls here have chased gas from Alaska to Nigeria. Nowadays, Pennsylvania is “the hottest area in the United States, if not the world” for gas, says one.

Range Resources is drilling for gas that is trapped in shale, a dense, non-porous rock formation. For more than a century shale gas has gone largely unexploited because of the high cost of recovering it. But a fivefold increase in the price of gas a few years ago prompted companies like Range to return to two well-tried technologies: drilling horizontally instead of vertically, and releasing the gas by injecting water at high pressure into the rock.

The Barnett Shale around Fort Worth, Texas, was the first to be commercially exploited on a large scale. The Marcellus Shale, which spans West Virginia, Pennsylvania and southern New York state, is the latest (see map). Thanks to these efforts, estimates of America’s “technically recoverable” gas (a broader definition than reserves) has risen by about 500 trillion cubic feet, or a third, in the past two years.

Barely a week goes by without Barack Obama promoting new measures to spur investment in renewable energy such as wind, solar and biofuels to wean America off imported oil and to reduce greenhouse gases. The marketplace has, quietly, accomplished a lot more. After a generation of decline, America’s domestic production of oil and gas is rising again and oil consumption is dropping. If sustained, these trends could play a big role in rebalancing the American economy. In 2008 America’s net imports of oil and gas came to $416 billion, or 60% of the deficit.

The drive to import less

The oil shocks of 1973 and 1979 galvanised America’s politicians into trying to reduce the country’s dependence on imported oil. In 1975 Congress introduced the first corporate average fuel economy (CAFE) standards for cars. Electric utilities cut their use of oil and domestic production rose. But after prices crashed in 1986 conservation efforts petered out. Average car fuel economy declined, and imports began an almost continuous two-decade climb.

The latest oil shock was far more drawn out than its predecessors, but the effects may be just as far-
reaching. As oil rose from $20 per barrel in 2002 to $147 in 2008, oil companies found they could profitably extract more oil from ageing fields with techniques such as gas and steam injection. The oil industry had largely pulled out of the Great Plains when independent prospectors earlier this decade found promising new deposits in the Bakken Formation, below North Dakota and Montana. It is now thought to contain up to 4 billion barrels of technically recoverable oil, the largest continuous oil formation in the lower 48 states. And BP announced last autumn that its Tiber oilfield in the Gulf of Mexico could hold 4 billion-6 billion barrels.

The rise in the price of natural gas from $2 to $11 per thousand cubic feet had a similar effect. The price is now under $5, but Range began drilling in the Marcellus in 2004 and reckons it can profitably extract gas even below $4.

The demand-side response to higher prices has been just as comprehensive. Americans’ consumption of petrol and the number of miles driven peaked in 2007, and the use of public transport is up sharply. Some of this stems from the recession and will blow over. As unemployment drops, people will get back into their cars. Some is due to petrol topping $4 a gallon in 2008. With oil now back to $80, petrol has dropped below $3.

But IHS CERA, an energy consultancy, sees evidence of a more durable change in consumer behaviour. Since the mid-1980s car manufacturers had been using increased engine efficiency for extra power rather than fuel economy. Between the early 1980s and early 2000s the average new vehicle gained about 800lbs in weight and the time it took to reach 60mph dropped by about five seconds. Now the average vehicle is getting lighter and IHS CERA predicts that future advances in efficiency will go towards mileage, not power. California often leads national trends, and in 2008 its petrol consumption was the lowest since 2001. Despite increased air travel, jet-fuel consumption peaked in 2000, thanks to more efficient aircraft and better practices.

Richard Newell, who runs the federal Energy Information Administration (EIA), thinks that with oil at current levels the behavioural changes will stick, helped by new policies. The federal Renewable Fuel Standard, passed in 2005 and updated in 2007, requires that by 2022 refiners blend 36 billion gallons of renewable fuel such as ethanol and biodiesel into motor fuel. If the target were met, that would be about 17% of consumption. CAFE standards were tightened in 2007 for the first time. Last year Mr Obama brought forward their implementation date to the 2012 car-model year. Tony Hayward, BP’s chief executive, told Dow Jones last November that “we will never sell more gasoline in the US than we sold in 2007.”

Increased supply and decreased consumption have radically altered the outlook for imports. Five years ago the EIA forecast that by 2025 America would be importing 16m barrels of oil a day, or 68% of its needs (see chart 6). Now that forecast has come down to less than 9m. Disappointingly, the total bill will still be higher because prices have gone up so much. But at least the American economy will be less dependent on imported oil.

The outlook for natural gas has changed even more. Five years ago the EIA thought that by 2025 America would be importing 28% of its natural-gas supply, much of that through newly constructed liquefied-natural-gas terminals. That forecast has now come down to 9% of its supply. Construction of a number of
LNG terminals approved years ago is on hold.

The exploration boom has produced windfalls in some surprising places. Pennsylvania was home to the first commercial oil well drilled in America, in 1859, but production had long ago tailed off. One industry-backed study thinks shale gas will boost employment in the state by 98,000.

It is already making an impression on Washington county, a mostly rural area south of Pittsburgh first settled before the American revolution. “Two years ago the infrastructure was non-existent,” says Sam Robinson, a consultant overseeing one of Range’s drilling rigs. “You had to lease everything from Oklahoma or Texas.” Now Range estimates that more than 40 suppliers have set up shop locally. Several farmers have become millionaires from leases and royalties. Gas workers are a common sight in diners and churches.

Inevitably the industry has brought controversy too: some locals fear that the drilling will contaminate the groundwater (though there is little hard evidence so far), and New York state has put a hold on drilling in the watershed that supplies New York City’s drinking water.

In the past gas and oil prices have moved together, so there was little incentive for consumers to shift between the two types of fuel. The surge in domestic gas production has broken that link and could encourage a shift away from oil and towards gas in the future, although the supply and storage of liquefied natural gas for vehicles remain fraught with problems.

Several big question marks hang over these predictions. The price of oil is notoriously unpredictable. In the face of higher prices the industry has repeatedly shown ingenuity in developing new sources of supply. The price shot up in the 1970s because OPEC and Iran imposed restrictions on supply. Non-OPEC members boosted production and unity within OPEC frayed as conservation measures slowed consumption growth. In 1986 prices collapsed.

Still, this decade’s increase in oil prices is qualitatively different from that of the 1970s. It is due less to supply restrictions than to demand in emerging markets outstripping global production capacity. Although the recession has restored some spare capacity, emerging-market demand is likely to grow steadily. Western oil companies’ access to many low-cost oilfields is restricted by politics. Rich countries nowadays consume a smaller share of the world’s oil than they did in the 1970s, so their conservation efforts are less likely to bring down the world price.

The other unknown is policy. A cap on carbon emissions would raise the price of fossil fuel, increasing the pressure to lower consumption. It would reduce the cost disadvantage of solar, wind and biofuels, which are more expensive and less reliable electricity generators than oil, coal and gas. Although the domestic coal industry would be the biggest loser, oil imports would also drop.

But the prospects of a cap-and-trade deal have faded. The climate-change conference in Copenhagen last December yielded no firm commitments to new caps on emissions. Prospects for passing a cap-and-trade bill in America, already uncertain, have dimmed further since the Democrats lost their supermajority in the Senate. Legislators from coal-producing states, and Republicans in particular, are strongly opposed to cap-and-trade.

**The best solution is out of reach**

There are other ways to achieve the same thing. Many states require utilities to derive a certain share of their electricity from renewable fuels, which helps to explain why wind in recent years has accounted for more than a third of new electric-power capacity. The House of Representatives’ cap-and-trade bill includes a federal standard, although various exemptions reduce its impact. Raising the federal petrol tax (which has remained at just 18.4 cents per gallon since 1993) would spur conservation and reduce imports even if the world oil price dropped. Unfortunately, any politician bold enough to try that is liable to be driven from office. Americans may be getting used to expensive petrol, but that does not mean they are grateful for it.
CHANDLER and Maricopa are typical of the youthful, sprawling cities on the southern edge of Phoenix, Arizona. The thousands of stucco-walled houses with tiled roofs in Chandler’s palm-tree-lined streets could have been stamped out by a machine that then moved on to produce the same sort of houses in Maricopa 17 miles to the south-west.

Yet the two cities’ economic fortunes have followed quite different paths. In 2000 Maricopa was just a dusty crossroads with 329 homes. The housing boom was its making. As in countless “exurbs” across America, lower-income families drove ever farther afield to find a house they could afford. Maricopa soon grew to over 15,000 homes. But when America’s housing market collapsed, so did Maricopa’s. Over a quarter of its houses have received a foreclosure notice, says RealtyTrac, a property consultancy. Howard Weinstein, a local landbroker, waves at a patch of lots in the desert which the bank seized from someone who bought them for $30,000 each: “At current house prices no builder would pay anything for these lots.”

Chandler too has felt its share of pain as Arizona’s housing boom crumbled; home prices are down by half and foreclosures have soared. But its cluster of high-tech employers, anchored by Intel, have weathered the recession better than most firms and are now enjoying a global rebound in business investment in technology. Builders are snapping up scraps of empty land near the city’s centre.

Chandler’s and Maricopa’s divergent fates reflect the fact that as the crisis and recession reshape America’s economic activity, they will also redraw its economic map. For most of the post-war period the South has been catching up with the rest of the country. Land there is cheaper and land-use regulation more permissive, making it a magnet for families seeking a house with a yard, even if it means long commutes from sprawling suburbs. In the sand states—Florida, Arizona, Nevada and California—these trends went into overdrive in the years leading up to the crisis.

The rush for both sun and sprawl has now reversed, at least temporarily. Population growth has slowed in the suburbs and picked up in cities. During the recession four of the five states with the biggest job losses were in the sunbelt, led by Arizona (see table 7), according to Moody’s Economy.com. For the first time since the end of the second world war more people left Florida than moved in.
Exactly the opposite happened in North Dakota. For only the second time since the 1970s more people are moving in than out and the population is now its highest since 1998. Enrolment at the high school in tiny Tioga is rising as locals who moved away years ago return with their children, and the principal frets that he now has to compete with the oil industry to hire janitors.

Internal migration has been slowed sharply by the fact that a quarter of homeowners with mortgages owe more than their home is worth, according to First American CoreLogic, making it difficult to move. Moreover, an economy shifting away from consumption and housing and towards exports of high-value goods and services will tend to benefit industries that cluster in metropolitan centres, in part because such firms draw on a common pool of intellectual talent. Software publishing, sound recording, film production and securities and commodities trading all form such clusters, note Bradford Jensen and Lori Kletzer in a report for the Peterson Institute. Seattle’s share of employment in America’s software industry, for example, is 18 times its share of population. By contrast, non-tradable services like retail banking and video rental do not show much clustering at all. New York City is reeling from the devastation visited on financial services but retains a leading role in other services, from media to architecture.

Some even predict that cities will regain economic leadership from suburbs. Richard Florida, an expert on urban planning at the University of Toronto, wrote in the *Atlantic* last year that the economy “no longer revolves around simply making and moving things. Instead, it depends on generating and transporting ideas. The places that thrive today are those with the highest velocity of ideas, the highest density of talented and creative people, the highest rate of metabolism,” which are found in cities.

**Let’s hear it for the suburbs**

But that may be going too far. Powerful economic logic underpins the suburbs and car culture. The median commute by car, at 24 minutes, is half the median commute by public transport. Nathaniel Baum-Snow of Brown University has found that since 1960 residents and jobs have been moving to the suburbs at about the same rate. Cutbacks on highway construction will slow that trend but not reverse it.

Short-term trends seem as likely to benefit a city like Chandler as New York: it combines a suburb’s ease of commuting and affordable housing with a city’s clustering of workers with similar skills. Since Intel arrived in 1980, an infrastructure of suppliers and supporting industries has grown up around it. Air Products set up shop to deliver ultra-pure nitrogen, vital to chipmaking, to Intel down a two-foot-wide pipe. That pipe, in turn, attracted other semiconductor companies. Those companies and their suppliers have nurtured a pool of highly trained technical workers fed by two large state universities. Qualastat, which builds flexible circuits, recently announced it would move its headquarters to Chandler from Pennsylvania to be closer to a supply of engineers.

Chandler has all the things Intel looks for when deciding where to put a factory, says Brian Krzanich, Intel’s general manager of manufacturing and operations: space, infrastructure, the transport links that enable it to ship completed wafers to other facilities in the country around the clock and, most important of all, a “pool of talent that’s been here a long time”.

It doesn’t hurt, he adds, that a recent college graduate can more easily afford a home in Chandler than in the San Francisco bay area, where Intel is based. Still, Mr Krzanich gives warning that neither Chandler nor America can take Intel’s presence for granted: “Other countries like China are climbing up the skillset.
They’re fighting fiercely for the same investment.” Intel is now building its first fabrication plant outside the rich world—in China.

As long as Americans want to own homes, the South and suburban sprawl will retain a certain appeal. Eventually those foreclosed homes in Maricopa will be reoccupied. As Mr Weinstein, the landbroker, puts it, “in the 1990s Chandler felt like Maricopa does today. The only difference is the zip code and the decade.”
Can higher productivity fill the gap?

LAST year Christina Romer, chairman of Mr Obama’s Council of Economic Advisers, noted that one of the costs of a bubble is that “some of our brightest minds make small fortunes arranging the deals, rather than pursuing potentially more socially valuable careers in such fields as science, medicine and education.” By that measure the collapse of the bubble may have its compensations. The share of new Harvard graduates entering finance or consulting, which in 2007 reached 47%, plunged to a mere 20% last year, according to the Harvard Crimson.

Whether those graduates who chose a career other than finance are about to launch the next technological revolution matters for the whole country. Innovation drives productivity, and productivity drives real incomes. A burst of productivity growth would make the years ahead a lot less painful. With bigger pay packets workers could reduce their debt and still spend more.

Innovation and productivity, however, are notoriously difficult to predict. They depend not just on inventors and entrepreneurs serendipitously stumbling upon a game-changing product, but on how quickly and widely firms incorporate that product into their operations. Between 1996 and 2009 productivity grew by a robust 2.7% a year as technologies that had been developed in previous decades, from personal computers to fibre optics, found their way into the mainstream.

Dale Jorgenson of Harvard University says technology is advancing more slowly than in the decade before the crisis, so productivity will too, by about 1.5% a year. Martin Baily of the Brookings Institution is more optimistic. He thinks productivity could grow by an average of 2.25% in the next few years, which would yield potential growth for the economy as a whole of about 2.6%—not spectacular, but a lot better than Japan’s during its lost decade. He cites several reasons. Growth is likely to be led by business investment and exports, both of which benefit firms with higher-than-average productivity. Conversely construction, an industry with low productivity, will make a much smaller contribution to GDP than it has done recently.

The combination of shrinking employment and rising GDP in the second half of 2009 has already translated into an impressive 7.4% advance in productivity at an annual rate. In part that reflects firms’ reluctance to hire when they are uncertain if growth is here to stay; the same thing happened after the 2001 recession. But it may also mean that the wave of technology adoption that fuelled productivity growth between 1996 and 2008 may still have further to run. Certainly the rebound in sales at firms such as Intel and Cisco Systems suggests so.

A dearth of talent

A recurrent complaint by such firms is that they cannot get enough college graduates with the right skills to staff up for such growth. Yet an extensive study found that between the early 1970s and late 1990s American colleges produced more than enough graduates in science, technology, engineering and maths to meet demand. The problem was that a growing proportion of them did not pursue careers in their field of study. It is not clear why not. Some may have been lured by the siren song of Wall Street, but others may simply have concluded that it did not offer a stable career, says Hal Salzman of Rutgers University, one of the authors.

The bigger risk to innovation is not a lack of skilled workers but a lack of finance. Recoveries after a financial crisis tend to be weak because of the damage done to the financial system. Firms that depend on external funds, such as bank loans or equity sales, are particularly vulnerable. A recent IMF study of Canadian and American manufacturers estimates that a one-percentage-point increase in corporate bond rates knocks a quarter-percentage point off the productivity growth of firms dependent on outside funding.

The withdrawal of credit in the past two years has been indiscriminate, hitting speculative residential developments and creative business start-ups alike. Small businesses moan that banks will lend to them
only on draconian terms, if at all (though they also say weaker sales are a bigger problem). Robert Kiener, of the Precision Machined Products Association, cites the case of one Ohio manufacturer whose bank asked for his life-insurance policy as collateral.

V Venture-capital finance has also contracted sharply. In part that reflects big losses sustained by charitable and university endowment funds on hedge funds, private equity and shares. Such endowment funds are strong backers of venture capital. Joshua Lerner of Harvard University has documented that although venture capital pays for only a small portion of total research and development, such R&D as it supports produces three to four times as many patents per dollar as regular corporate R&D. He also found that in the 1970s firms trying to commercialise personal computing and network technologies were held back for years by the venture-capital drought then prevailing. Last year venture-capital funds raised just $15 billion, half the average of the preceding four years (see chart 8).

The damage done by tighter finance can be overstated. Venture investment during recessions may actually be more productive, per dollar spent, than during booms, when money is showered on many variants of the same business plan. Research sponsored by the Ewing Marion Kauffman Foundation has found that entrepreneurship is surprisingly resilient to the business cycle, in part because many entrepreneurs turn to self-employment when they are laid off. Some 45% of firms in the Fortune 500 were born in recessions. But it would be safer not to bet on such resilience.
Until the financial crisis hit, America’s mounting imbalances drew scant attention from presidents. George Bush’s advisers would routinely portray the gaping current-account deficit as good news: since it was matched by incoming foreign capital, it simply proved that America was a great place to invest. By contrast, imbalances have been a recurrent theme of Barack Obama’s. His speeches often sermonised about the evils of bubbles, easy credit and borrowing from China. He insisted that America had to live within its means. “As we rebuild we must also rebalance,” he said in the introduction to February’s Economic Report of the President.

Although Mr Obama diagnosed the problem correctly, he has yet to come up with a solution. Indeed, circumstances have forced him to pursue policies that actually slow the rebalancing. A wider federal deficit offsets private retrenchment (see chart 9) but prolongs America’s dependence on foreign savings. Tax credits and mortgage guarantees keep the housing market alive yet compound distortions that contributed significantly to the debt mountain in the first place.
Mr Obama’s supporters on the left want him to attack imbalances by supporting domestic manufacturers (an activity delicately termed “industrial policy”) and punishing other countries, particularly China, that they say trade unfairly. Mr Obama initially shared those instincts. But in the White House he is surrounded by orthodox economists who are sceptical of industrial policy and protectionism. These differences have produced a schizophrenic mix of policies. The president slapped tariffs on cheap tyres from China, proposed making it harder for multinationals to defer taxes on profits from abroad, earmarked stimulus money for green-technology investment and agreed to impose “buy American” provisions on anything bought with stimulus funds. On the other hand he insisted that those provisions must not run foul of World Trade Organisation rules and refrained from telling bailed-out banks and carmakers how to run their businesses.

These tensions are coming to a head. Mr Obama may formally declare China a currency manipulator soon. Some in Congress want to make it easier to impose duties on Chinese imports to compensate. Protectionism and industrial policy are tempting and might, at the margin, hasten rebalancing. But they would inflame relations with trading partners, provoke retaliation and ultimately slow the restructuring of the economy towards more productive, export-oriented businesses. Import protection generally shelters the least productive industries and therefore the ones least likely to export.

The argument for protecting or subsidising “infant industries” until they have become strong enough to compete abroad is complicated. Sometimes it has worked: defence spending, for example, was critical to the early development of computers, semiconductors and the internet. But how can it be made to fit in with world trade rules? New findings on the nature of exporting reveal a potentially productive role for government.

It starts with the insight that exporting is a bit like films: failures far outnumber successes, but the successes are often spectacular. Marc Melitz of Harvard University notes that making just one foreign sale entails big fixed costs: finding a buyer, setting up distribution and learning to deal with regulations that might be tilted in favour of local companies. Many companies that export once never do so again. But those that do so regularly often grow at a remarkable speed. Eventually, exports come to be dominated by firms and products that survive this winnowing process.

Reach for the watering can

This suggests that the right role for government is not to shower money on a handful of putative winners but to take a portfolio approach: finding companies on the margin of exporting and helping as many as possible overcome the fixed costs of entry. Eventually some should become big, productive exporters. Consular services that guide companies through foreign markets are one form of support; trade finance is another, particularly since the seizure in financial markets impaired private trade financing. The Export-Import Bank has authorised record volumes of trade credit, but Fred Hochberg, its president, says America still spends less on such efforts than China or Canada do, even though its economy is much larger.

Further trade liberalisation would encourage firms to export by offering certainty of continued market access. Mr Obama’s free-trade agenda, however, has focused on the enforcement of existing trade laws.
Though he has recently shown renewed interest in free-trade agreements with Panama, Colombia and South Korea, only the first seems likely to be ready for a Senate vote this year.

A similar approach should be applied to innovation. In the 1970s and 1980s the federal government poured billions of dollars into the Synthetic Fuels Corporation to develop liquid and gas fuel from coal, and into the fast-breeder nuclear reactor. Both failed because of political interference and a collapse in the price of conventional energy. Ignoring those lessons, Mr Obama has pledged $1 billion to FutureGen, a joint government-industry project to generate electricity and hydrogen from coal and sequester the carbon dioxide. Both the federal government and private partners have periodically pulled their support. Because its electricity would be costly, commercial success is far from assured.

One study found that federal energy-research spending became more productive when it switched from large-scale demonstration projects to lots of smaller-scale technologies. Many failed, but the handful that succeeded, such as advanced refrigerator and freezer compressors, generated outsize returns.

Supply-side incentives go only so far. When Rebecca Henderson of Harvard University and Richard Newell of Duke University (now head of the federal Energy Information Administration) reviewed the history of federal innovation policy, they concluded that one of the state’s most effective roles was “stimulating or providing demand”. Simply put, if policymakers get the price signals right, firms and consumers will of their own accord reorient their efforts away from consumption and towards exports and cleaner energy.

**Trust the dollar**

In exports the most important price signal is the dollar. “The best attainable of industrial policies for sustained development is an undervalued exchange rate,” write Stephen Cohen and Brad DeLong in “The End of Influence”. It is “better, more automatic, less manipulable and less easily distorted by corruption and rent-seeking” than subsidising domestic industries. In this instance they were writing about China and other emerging markets, but the same is broadly true of rich countries.

America explicitly sought to drive the dollar down to help its trade balance in 1985, and again in 1989-90. A repeat is not on the cards. It would risk panic among the foreign investors who still finance much of America’s public debt, and anger trade partners whose own currencies would appreciate, hurting their exports. Nor is the dollar as obviously overvalued as it was in 1985 (see chart 10).

A more benign route to the same destination would be a combination of tight fiscal and loose monetary policy. Standard economic models predict that when interest rates are low and governments borrow less, foreign capital inflows dry up, dragging the exchange rate down and shifting growth from domestic demand to exports. That is how smaller countries such as Canada in the 1990s and Ireland in the 1980s rebalanced their economies.

For America it will be tougher. The private sector remains so weak that an early and sustained attack on the budget deficit could push the economy back into recession. The Federal Reserve at present has little scope to compensate because interest rates are already at zero. Ms Romer of the Council of Economic
Advisers notes that whereas in theory tight fiscal and loose monetary policy should get an economy back to full strength, the interest rate needed to achieve that might sometimes be negative, which is beyond the scope of conventional monetary policy. That may be why Japan has been unable to wean itself off government spending. Still, the Fed can play a part, either through unconventional policies, such as bond purchases, or by simply keeping its rate near zero for longer.

In energy the necessary price signal is also obvious: raise the price of carbon. That is Mr Obama’s stated aim, but the prospects for a comprehensive cap-and-trade bill look poor. An alternative would be to raise the tax on petrol. At a stroke, that would narrow the budget deficit, encourage conservation, reduce oil imports, make renewable energy more competitive and reduce carbon emissions. It would not substitute for cap-and-trade, but would leave less work for it to do. Yet it will not happen, because a higher petrol tax is politically even more unacceptable to Mr Obama and Congress than cap-and-trade.

The process of rebalancing America’s economy has begun. Consumers are spending less, borrowing less and driving less. The trade deficit has narrowed and exports are rebounding. Encouraging though all this is, there are still plenty of ways that the rebalancing could be halted.
There are still plenty of things that could go wrong with the recovery

AMERICAN consumers showed signs of life in the first quarter, with retail sales and car-buying picking up a bit. But housing is still struggling and consumer spirits remain low. A bit depressing—but proof that the country is learning to live within its means.

Americans will not return to their profligate ways soon. Consumer spending will recover as employment grows, but it will no longer outpace incomes the way it did when credit was easy and home prices bubbly. Many households will not be able to borrow against their homes for years because they have become worth less than the mortgages on them. The torrent of credit-card solicitations flowing through the letter box has slowed to a trickle and millions of Americans are cancelling their credit cards or are having them withdrawn. Regulators who once nodded approvingly as financial companies flogged negative-amortisation and "pick-a-payment" mortgages are now shutting banks weekly and second-guessing the decisions of those that survive.

Higher oil prices are part of this rebalancing process. With a lag, they are changing the behaviour of American firms and consumers. For example, the share of light trucks in total vehicle sales has been falling since 2004. General Motors is winding down its Hummer brand, launched when petrol was less than half today’s price, after a sale to a Chinese company fell through. Pricey petrol has also aggravated foreclosures in the exurbs.

This special report has argued that America’s economy has begun to rebalance away from consumption and debt towards exports and saving. But it is not yet clear whether this transition will bring strong, steady growth and declining unemployment or sluggish growth and stubbornly high unemployment. Much could still go wrong.

Even if Mr Obama’s policies for the recovery were flawlessly crafted, a lot is out of his hands. Heading the list of potential spoilers is the rest of the world. Americans could not have run up so much debt without foreigners lending them the money. The rest of the world has to consume more and rely less on exports to America, or the imbalances could return. “Stopping in midstream is dangerous,” wrote Olivier Blanchard, the IMF’s chief economist, and Gian Maria Milesi-Ferretti last December.
We’d love to help, but…

If a country has suffered a crisis, the normal script for recovery is for the rest of the world to help restore it to health. But what if the rest of the world is unable to do so? This is not a theoretical question. In the fourth quarter of last year only one of the euro area’s four largest economies, France, saw any growth. Were Greece to default, a new crisis would rip through thinly capitalised European banks which hold plenty of debt of the region’s weaker economies.

Emerging economies such as China, India and Brazil are growing faster, yet they, too, could inhibit America’s rebalancing if they rely too heavily on exports instead of domestic demand. Between 1998 and 2007 consumption in emerging markets shrank from 60% to 53% of GDP, according to JPMorgan Chase, and their current accounts swung from deficit to surplus. There is a risk that every country will look to exports to lead its recovery. Clearly that cannot work for all of them.

China has gone some way to reducing its reliance on exports by launching one of the bigger fiscal-stimulus programmes in the G20. As a share of GDP its current-account surplus has shrunk by half between 2007 and 2009. Its fiscal stimulus, however, has mostly boosted investment. A far more effective way to shift China’s growth from exports to consumers would be to let its currency, the yuan, appreciate. But so far its officials are still talking about the benefits of exchange-rate stability.

If the rest of the world does not help America grow, some grim scenarios await, according to Messrs Blanchard and Milesi-Ferretti. The country might try to prop up growth by extending its fiscal stimulus. But that would mean its persistent budget deficits would push up its debt even higher—and perpetuate its dependence on foreign savings. The current-account deficit, having halved to 3% of GDP since 2006, would widen again. Alternatively America might withdraw the stimulus, which could make its economy stall.

Another source of risk is the dollar. Its steady decline since 2002 has played an important role in reducing the deficit, and in theory a relatively slower recovery in American demand should continue to nudge it down. But the dollar often refuses to do as told. During the crisis it rose sharply as borrowers were forced to repay dollar loans. This year feels like a re-run, with investors who doubt the euro’s future flocking to the dollar.

A further question mark hangs over the price of oil. A big increase would pummel consumers and sharply increase the trade deficit, slowing growth and making the imbalances worse. A big drop would help in the short term, but in the longer run it would dissuade consumers from cutting down, sap political support for conservation and alternatives and discourage the industry from looking for more.

Rebalancing may be highly desirable, but that does not mean it is inevitable. It took a long time for America to reach the debt-laden state that brought on the crisis. It will take time, and lots of luck, for it to recover in full.
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The iPad and its kind are both a boon and a bane for book publishers

JOHN GRISHAM, a prolific author of legal thrillers, long refused to allow his books to be sold in electronic form. In a television interview last year, he lamented that e-books and heavy discounting of printed books by big retailers were “a disaster in the long term” for the publishing industry. But last month Mr Grisham’s publisher announced that the author had had a change of heart: henceforth all of his books will be available in virtual form. His timing was impeccable. On April 3rd Apple is due to start shipping the first of its iPad tablet computers, which are expected to give a big boost to e-book sales.

The iPad’s impending arrival has created commercial intrigue worthy of a Grisham yarn. A group of big publishers, including Macmillan and HarperCollins, have been using Apple’s interest in e-books to persuade Amazon, which currently dominates sales of digital books, to renegotiate its pricing model. At one point in January an angry Amazon briefly removed many of Macmillan’s books from its own virtual shelves before reinstating them after some authors kicked up a fuss.

Like many other parts of the media industry, publishing is being radically reshaped by the growth of the internet. Online retailers are already among the biggest distributors of books. Now e-books threaten to undermine sales of the old-fashioned kind. In response, publishers are trying to shore up their conventional business while preparing for a future in which e-books will represent a much bigger chunk of sales.
Quite how big is the subject of much debate. PricewaterhouseCoopers, a consultancy, reckons e-books will represent about 6% of consumer book sales in North America by 2013, up from 1.5% last year (see chart). Carolyn Reidy, the boss of Simon & Schuster, another big publisher, thinks they could account for 25% of the industry’s sales in America within three to five years. She may well be right if the iPad and other tablet computers take off, the prices of dedicated e-readers such as Amazon’s Kindle keep falling and more consumers start reading books on smart-phones. Mobclix, an advertising outfit, reckons the number of programmes, or apps, for books on Apple’s iPhone recently surpassed that for games, previously the largest category.

Alert to such shifts, publishers are trying to undo a mess that is largely of their own making. For some time they have operated a “wholesale” pricing model with Amazon under which the online retailer pays publishers for books and then decides what it charges the public for them. This has enabled it to set the price of many new e-book titles and bestsellers at $9.99, which is often less than it has paid for them. Amazon has kept prices low in order to boost demand for its Kindle, which dominates the e-reader market but faces stiff competition from Sony and others.

Publishers fret that this has conditioned consumers to expect lower prices for all kinds of books. And they worry that the downward spiral will further erode their already thin margins—some have had to close imprints and lay off staff in recent years—as well as bring further dismay to struggling bricks-and-mortar booksellers (see article). Unless things change, some in the industry predict that publishers will suffer a similar fate to that of music companies, whose fortunes faded when Apple turned the industry upside down by selling individual songs cheaply online.

Ironically, publishers have turned to Apple to help them twist Amazon’s arm. Keen to line up lots of titles for new iPad owners, the company has agreed to an “agency model” under which publishers get to set the price at which their e-books are sold, with Apple taking 30% of the revenue generated. Faced with these deals, Amazon has reportedly agreed similar terms with several big publishers. As a result, the price of some popular e-books is expected to rise to $12.99 or $14.99.

Once Apple and Amazon have taken their cut, publishers are likely to make less money on e-books under this new arrangement than under the wholesale one—a price they seem willing to pay in order to limit Amazon’s influence and bolster print sales. Yet there are good reasons to doubt whether this and other strategies, such as delaying the release of electronic versions of new books for several months after the print launch, will halt the creeping commoditisation of books.

Apple, for instance, is rumoured to have kept the option of charging much less for popular e-books if they are being heavily discounted elsewhere. Other firms, including the mighty Google, are likely to enter the fray soon, which will only increase the competitive pressure.

This is particularly alarming for publishers because digital margins are almost as slender as print ones. True, e-books do not need to be printed and shipped to retailers. But these costs typically represent only a tenth of a printed book’s retail price, estimates Credit Suisse, an investment bank. Meanwhile, as David Young, the boss of Hachette Book Group, points out, publishers are incurring new costs in the form of investment in systems to store and distribute digital texts, as well as to protect them from piracy.
Publishers are investing in the internet in other ways too. A few are starting to build their own online groups of readers. For instance Tor.com, a publisher-run website for science-fiction and fantasy enthusiasts, highlights content relevant to its members, even if some of it comes from rival publishers. “This is a rare sign that the light’s finally gone on in publishing,” says Mike Shatzkin of Idea Logical, a consultancy. Sourcebooks, a medium-sized publisher that has developed an online group focused on poetry, found that sales of its books rose by more than 50% in the six weeks after poems from them had featured on the site.

Publishers are also pumping plenty of money into what Hachette’s Mr Young calls “enriched e-books”, which combine the printed word with audio, video and other media to create content that can command a premium price. The launch of the iPad will speed up this experimentation, but it is not the only device to catch publishers’ attention. HarperCollins, for instance, has sold hundreds of thousands of cartridges in Britain that let users read electronic versions of classic texts on Nintendo DS portable game consoles. Charlie Redmayne, the “chief digital officer” of one of its units, reckons many of the buyers would not have splashed out on print editions, so the move to a new platform has created fresh demand for books.

Indeed, many publishing executives like to argue that the digital revolution could usher in a golden age of reading in which many more people will be exposed to digital texts. They also point out that new technologies such as print on demand, which makes printing short runs of physical books more economical, should help them squeeze more money out of the old-fashioned format. And they insist that the shift away from printed books will be slow, giving them more time to adapt to the brave new digital world.

Perhaps. But there are still plenty of inefficiencies in the supply chain for conventional books that firms such as Amazon and Apple can exploit. Many publishers, for example, still take far too long to get books to market in print or electronic form, missing valuable opportunities. Ms Reidy at Simon & Schuster says she has brought functions such as typesetting in-house to boost efficiency. At Sourcebooks responsibility for making books has even been shifted from the editorial team to the firm’s head of technology, underlining the need to think digitally right from the start of the commissioning process.

The publishing firms that survive what promises to be a wrenching transition will be those whose bosses and employees can learn quickly to think like multimedia impresarios rather than purveyors of perfect prose. Not all of them will be able to turn that particular page successfully.
The endangered bookstore

Edited out
Mar 31st 2010 | NEW YORK
From The Economist print edition

The sickliest part of the books business is the shops that sell them

These are not easy times for booksellers. Borders, a big American one, ditched its boss in January and has closed stores, but is still at risk of collapse, some analysts say. The British chain of the same name, which it once owned, failed last year. Barnes & Noble, the world’s biggest bookseller, appointed a new boss last month to help it confront the triple threat of the recession, increased competition and e-books.

The struggles of booksellers can be explained in part by a surge in competition. More than half of book sales in America take place not in bookshops but at big retailers such as Wal-Mart and Target, which compete to peddle bestsellers at ever steeper discounts. Online retailers, too, are wreaking havoc. In 2009 Amazon sold 19% of printed books in North America, reckons Credit Suisse, compared with Barnes & Noble’s 17% and Borders’ 10%. By 2015, the bank estimates, Amazon will sell 28%.

Booksellers are labouring to raise their profile online and win back the customers they have lost. Barnes & Noble’s online sales rose by 32% to $210m in the quarter ending in January, compared with a year earlier. It has started selling its own e-reader, called the “Nook”, and digital books to go with it.

Will bookshops disappear completely, as music shops seem to be doing? Most are pinning their hopes on giving people more reasons to come inside. “Consumers will need some entity to help them make sense of the morass,” says William Lynch, the new boss of Barnes & Noble, which plans to put a renewed emphasis on service, including advice on e-books. Many shops have started to offer free internet access to keep customers there longer and to enable them to download e-books. Other survival strategies include hosting book clubs or other community groups and selling a wider variety of goods, such as wrapping paper, jewellery, cards and toys.

Independent bookshops face a particularly grave threat, because they are unable to match bigger rivals’ prices. Many are branching out by offering new services, such as creative-writing classes. BookPeople, a bookshop in Austin, Texas, runs a literary summer camp for around 450 children. Steve Bercu, the shop’s co-owner, says that independent booksellers can still thrive, provided they “reinvent themselves”.

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Geely buys Volvo

Status symbol
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An obscure Chinese carmaker buys a famous but ailing Swedish one

IF OPPOSITES attract, Ford’s sale of Volvo to a Chinese upstart, Geely, for $1.8 billion ought to be a marriage made in heaven. Sweden’s Volvo is the epitome of good middle-class taste; its slightly dull but hugely safe and practical cars were, in better days, the default choice on many a suburban driveway in America and Europe. Geely, on the other hand, is barely known outside China, partly because its range of mainly cheap, small cars is not yet capable of meeting the rich world’s more stringent safety and environmental regulations. But it is ambitious.

The deal, which was signed on March 28th, brings to an end protracted negotiations by Ford to sell the last of the European premium brands it acquired in a spell of expansionary hubris starting at the end of the 1980s. Having disposed of Aston Martin and Jaguar Land Rover, Alan Mulally, the chief executive brought in from Boeing in 2006, was determined to offload Volvo too, which lost $1.3 billion last year and sold only 335,000 cars. Although Volvo this year appears to have turned a corner and is operating at “sustainable levels”, Mr Mulally’s thus far successful “One Ford” strategy involves concentrating all the firm’s financial and managerial resources on reviving the Blue Oval.

For Geely, acquiring Volvo is both an extraordinary statement of intent and a huge gamble. The deal could help Geely realise the dream of its founder, Li Shufu, the self-styled Henry Ford of China, to become a big international carmaker. Even though Ford has done its best to ring-fence its intellectual property, Volvo has plenty of its own, especially in the critical area of safety, to which Geely will have access and which will lend credibility to its cars as its range expands in both scope and scale. It will also learn from Volvo about how to run a global supply chain and an international dealer network.

But Mr Li believes that Volvo too will benefit. Most important, it will realise its potential in China, the world’s biggest and fastest-growing vehicle market. Fifteen years ago Volvo outsold Audi in China, but these days the German premium brand’s sales in the country dwarf Volvo’s, which were only 22,000 cars last year. He also thinks that away from Ford and the Premier Automotive Group that used to house its upmarket brands, Volvo will have freedom to go into market segments that were previously closed to it because they were occupied by models from Jaguar, Land Rover or Ford itself.

Volvo may still struggle to become a genuine competitor for Audi, BMW and Mercedes, which define and dominate the premium end of the market, but Geely should give it a big presence in China. Volvo’s main production sites will continue to be in Sweden and Belgium, but Geely has plans for two factories and an engine assembly plant in China. These, combined with Geely’s clout in distribution, could help Volvo nearly double its sales to 600,000 by 2015, Mr Li believes.

But what should really ensure Volvo’s future success in China is the government’s commitment to it. Although Geely is that rare thing, a privately owned Chinese carmaker, it could not have raised the money needed to buy Volvo (along with the $900m it is planning to inject in working capital) without the support of state-owned banks and provincial governments’ investment funds. The presence at the signing ceremony in Gothenburg of Li Yizhong, the minister of industry and technology, was significant: Geely is buying Volvo, but so too is China.

Nonetheless, doubts linger. The record of cross-border carmaking mergers is atrocious. Geely intends to allow Volvo to operate with a high degree of autonomy, but cultural clashes are almost certain. Within China, there are worries that Geely lacks the expertise to take on the management of a famous but ailing foreign company—a concern of which Mr Li is well aware. Ford, for its part, insists that Geely has what it takes to be a worthy steward of Volvo. Lewis Booth, Ford’s chief financial officer, is said to have taken a shine to Mr Li, seeing in him a real passion for the car business. At a time when relationships between China and other international companies are under severe strain (see Schumpeter), the future of a small Swedish car firm is not the only thing at stake.
Extended producer responsibility spreads

Junk bond
Mar 31st 2010 | NEW YORK
From The Economist print edition

Governments oblige manufacturers to take back used goods for disposal

FOR seasoned shoppers, “buyer’s remorse” is a familiar feeling. “Seller’s remorse” may also become common soon, as ever more governments order manufacturers to assume the cost of disposing of their products after consumers are done with them. Until recently, most laws on “extended producer responsibility” (EPR) or “product stewardship” applied only to specific types of goods, such as car tyres or electronics. But in late March Maine, following the lead of several Canadian provinces, became the first American state to enact a blanket EPR law, which could in principle cover any product.

Governments are eager to unload some responsibility for waste management onto manufacturers, especially for products that are hard to recycle or may be toxic, such as electronics, batteries, paint, car parts and pesticide containers. It helps them cut costs, for one thing—handy for local authorities short of cash in the recession. In Maine, which has had an EPR law for electronic waste since 2004, municipalities save $1.5m-3m annually because manufacturers have picked up the cost of collection, according to the Natural Resources Council of Maine. Governments also hope that EPR laws will encourage firms to rethink the way they make products, designing them for longevity and recyclability rather than for the landfill.

Thirty-one of America’s 50 states have product-specific EPR laws. The European Union requires manufacturers to dispose of packaging, electronics and vehicles. Canada and Japan also have EPR laws. Other countries, such as Australia, have flirted with the idea.

Maine’s new “framework” law makes it much easier to expand the scope of EPR schemes, by establishing a process for adding products to the list of those covered without requiring a new law each time. The state government, which already enforces five product-specific EPR laws, is now said to have carpet-makers and drugs firms in its sights.

This worries businesses, few of which are eager to pick up the bill for waste disposal. Some business associations, such as the California Chamber of Commerce, have denounced EPR bills as “job killers”. They point out that the increased costs are ultimately borne by consumers. But that does not worry supporters of EPR, who argue that the price of a product should reflect its full “life-cycle” costs, including disposal, rather than simply leaving taxpayers to make up the difference. Moreover, unless manufacturers are
forced to bear the costs, they will have no incentive to make their wares easy to dispose of.

Scott Cassel, executive director of the Product Stewardship Institute, a non-profit organisation, says he has noticed different “stages of grief for companies” coping with the reality of EPR, starting with denial and moving to begrudging acceptance. Not all companies are mourning, however. Some manufacturers and retailers have voluntarily rolled out collection programmes in states that do not require them. Hewlett-Packard, a technology firm, claims to design its products with ease of recycling in mind—cradle-to-cradle, as the jargon has it. Staples, which sells office supplies, and Home Depot, a home-improvement retailer, both offer national take-back programmes in their stores for such items as computer monitors, compact fluorescent light bulbs and batteries. Such programmes may enhance customer loyalty, particularly among environmentally conscious consumers.

Some companies may also be hoping that starting their own collection programmes could help them pre-empt legislation. “We thought we could get out in front of this and set up a system to collect our products, and the exact opposite happened,” says Doug Smith of Sony, an electronics giant. He does not believe EPR laws have much impact on product design.

Companies’ biggest gripe about EPR laws is not their cost but their inconsistency. Few states have the same requirements, making compliance complicated for manufacturers. Many businesses would favour a national policy rather than a patchwork of local laws. EPR laws, it seems, are set to win extended responsibility themselves.
Mining in Ghana

Carats and sticks
Mar 31st 2010 | ACCRA
From The Economist print edition

A resource-rich government takes on foreign mining firms

BRITISH colonialists called Ghana the Gold Coast. To this day it remains Africa’s second-biggest producer of the metal, after South Africa, and the world’s ninth-biggest. Five foreign mining firms are digging huge open pits to get at the gold, encouraged by recent record prices. But the country, once seen as one of Africa’s most welcoming jurisdictions for mining firms, is now becoming more exacting.

Ghana’s parliament has voted to increase royalties from 3% to 5%, although the president has yet to sign the bill. In February the country’s environmental regulator suspended production at AngloGold Ashanti’s Iduapriem mine because the mine’s tailings dam, which stores cyanide-laced waste, was almost full. Last year the agency prevented Golden Star Resources, a Canadian firm, from expanding a mine where it had failed to fill an abandoned pit. Most notably, earlier this year it fined Newmont, the world’s second-biggest goldmining firm, $4.9m over a cyanide spill at its Ahafo mine.

The immediate cause of the increase in royalties is a budget deficit of almost 10% of GDP. But underlying it and the increasingly strict enforcement of environmental rules is a sense that Ghana is not getting much benefit from its mineral wealth. Gold accounted for 40% of exports in 2008, with a value of $2.2 billion. But the government received only $116m in taxes and royalties from mining firms—less than 4% of the country’s total tax take. “When you come here as an investor,” says Sherry Ayittey, the minister of the environment, “don’t come to mine and pollute the water bodies, repatriate your profits and leave our people suffering.”

Mining firms, predictably, are unenthusiastic. They say a new royalty regime could deter future investment and, in some cases, violate existing agreements. The government, in turn, is trying to renegotiate those agreements. Billy Mawasha, who runs Iduapriem, says his firm is not dogmatic, but had hoped that “the investment agreement would stay in place as it is.”

In rich and poor countries alike, taxes and royalties tend to gyrate with commodity prices, as governments seek to cream off a greater share of profits in good years and stimulate investment in lean ones. Several other African countries, including Tanzania and Zambia, have gone backwards and forwards on royalties in recent years. But Ghana’s new tack is noteworthy since the country is in the midst of an oil boom. Several Western oil firms are developing fields off the country’s coast. Production is likely to start next year, and to bring in far more money than mining. The government hopes to capture more than a third of the proceeds in one way or another. It is even arguing over a big investment by Exxon Mobil—a sure sign of resolve.

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Candle-making in Italy

Guttering
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From The Economist print edition

A once revered trade struggles in godless times

FOR centuries Christian congregations have lit tall paschal candles at Easter. Some stand a metre and a half from base to wick, their white paraffin wax decorated with religious symbols. In addition to these, the grandest of liturgical candles, Italian producers have long profited from the brisk trade in altar candles, votive candles and memorial candles to be placed on graves. But as churchgoing dwindles, their business is melting away—prompting some firms to look for new customers.

Being based in Rome and for decades official candle-supplier to the pope gives no special edge to Cereria Di Giorgio. With 45 employees and annual sales of about €10m ($13m), it is the biggest of the 100-odd firms in the candle-making business in Italy. But even it is struggling. “Margins are slim in the religious segment,” says Alessia Di Giorgio, the founder’s great-granddaughter.

With paschal candles costing around €100, some parsimonious priests have taken to economising by changing the year shown on them so that they can be reused. In addition to the problem of fading devotion, electric lamps have replaced votive candles in many churches and memorial candles in many cemeteries. Gianflavio Filippetti, owner of Cereria Umbra, an Umbrian candle-maker, says that the market for the votive products that generate 70% of his firm’s turnover of €3m is in crisis. Competition within Italy is fierce and Asian producers have conquered foreign markets.

Like most of its rivals, Cereria Ronca of Trent began by producing candles exclusively for the church, but now only half of its output is devotional. Throughout Italy, declining religious demand has pushed candle-makers to diversify into decorative candles for the home, which are mainly sold in winter, and outdoor candles to ward off insects, which keep production lines working during spring and summer.

Scented, coloured and marbled, in the form of spirals, tapers, pillars, cubes, balls, eggs and hearts, hundreds of products now fill candle-makers’ catalogues. “But it’s hard to see what the future offers as the...”
market is mature and innovation far from easy,” says Mauro Deanesi, head of sales at Cereria Ronca. The makers of a famous symbol of hope, it seems, see nothing but doom and gloom.
The panda has two faces
Mar 31st 2010
From The Economist print edition

Doing business in China is no stroll in the people’s park—and never will be

GOOGLE and Rio Tinto are the chalk and cheese of the business world: the former a bits-and-bites wunderkind born in 1998, the latter a grizzled mining company that has been around since 1873. But over the past few months they have both found themselves in trouble with the Chinese authorities.

To avoid censorship, Google has closed its Chinese search engine and diverted traffic from the country to its site in Hong Kong. Rio Tinto has seen four of its employees sentenced to lengthy prison terms for taking bribes from Chinese firms. Google and Rio are only the most recent of a long line of Western companies to have been bruised by China. Unilever suffered for years because it was forced into shotgun marriages with unsatisfactory Chinese partners. The government has prevented Coca-Cola from buying a local juice-maker out of seemingly spurious concerns about competition. A recent survey by the American Chamber of Commerce in China found that a high proportion of American firms doing business in the country feel that they are the victims of discriminatory or inconsistent treatment.

The most obvious reason for this is that the ruling Communist Party is a nightmare to deal with—all smiles one moment and snarls the next. The party has been wooing foreign investors for decades with access to cheap labour and a huge market, not to mention fancy office parks and world-class infrastructure: since the mid-1990s Shanghai has built a second international airport, a new subway, inner and outer ring roads, two elevated freeways and a light-rail system.

But at the same time the Chinese want their pound of flesh. The party regards foreign investment as a mechanism for acquiring foreign know-how rather than just jobs and capital; hence the insistence on joint ventures. It also regards economic growth as a tool for entrenching its own power; hence the application of the iron fist whenever business threatens to get out of control.

These political difficulties are piled on top of cultural difficulties. The Chinese emphasis on personal connections (guanxi) makes it hard to distinguish between business-as-usual and corruption. And the weakness of the legal system means that companies operate in a confusing half-light. Transparency International’s most recent Corruption Perceptions Index ranks China 79th out of 180 countries.
Corruption, legal caprice and the government’s determination to control and exploit foreign firms all seem to have played a part in Rio’s troubles. Although the trial of Rio’s employees hinged on the bribes they confessed to taking, the government’s decision to arrest them in the first place came hot on the heels of Rio’s decision to pull out of a deal with one Chinese state-controlled firm, and amid tense negotiations over the price of iron ore with others. The government has done nothing to bring the Chinese bribe-payers to book. In the case of Google, the government not only insisted on censoring search results, but was also thought to be behind attempts to hack into dissidents’ correspondence on the company’s webmail service.

All very messy. Yet the only thing more dangerous than dealing with China is not dealing with it. China is already well on the way to becoming the world’s biggest market for anything you can think of. It has 400m internet-users compared with America’s 240m and India’s 80m. Last year car sales in China surpassed those in the United States. And the Chinese market is only going to get bigger. China’s economy is growing at 10% a year at a time when the developed world looks set for a period of prolonged lethargy. No wonder more than 300,000 foreign firms have invested in the Middle Kingdom.

How can these companies boost their chances of riding the Chinese wave rather than being dragged down by the undertow? The fact that some of the world’s best companies have struggled in China suggests that there are no easy answers. But several decades of corporate agonies suggest two clear rules for doing business in the country.

**Just add butter**

The first is that companies need to show an almost exaggerated respect for China’s traditions: the Chinese are simultaneously immensely proud of their history and highly suspicious of foreigners who, in their view, have repeatedly mistreated them. This means making a long-term bet on the country. P&G took three years to become profitable in China. L’Oreal took nine. KFC spent ten years perfecting its business model before becoming the powerhouse that it now is, with restaurants in 450 cities. It also means investing heavily in politicking. Stanley Wong, head of Standard Chartered’s Chinese operations, reckons that multinationals’ senior representatives in China must spend 30-40% of their time buttering up officials and regulators.

The second rule is that companies should never abandon their principles for short-term gains. Freedom of information is so central to Google’s identity that it was right to declare it sacrosanct and repudiate its previous willingness to negotiate it away for commercial advantage. Although the Chinese government may not accept such intransigence, as in Google’s case, the odds are better if firms slavishly follow the first rule.

That is a price worth paying. There is growing evidence that the Chinese market is living up to its promise. The American Chamber reported in 2008 that three-quarters of the companies that it surveyed were finally making money in China, and almost half were enjoying margins that are higher than the global average, up from 13% a decade before. But there is equally no doubt that the Chinese will remain tough customers. They have profited mightily from their ability to squeeze concessions from Western firms. And the financial crisis has boosted their confidence in their way of doing things. There will be plenty more cases like Google and Rio Tinto in the years to come.
Lee Kun-hee is a man of few words. So when the 68-year-old decided to come out of court-induced purgatory this month to retake the helm of Samsung Electronics, now the world’s biggest technology company, it was appropriate that he chose Twitter, a keep-it-brief social-networking site, to spread the news.

Mr Lee’s message was not just for employees of Samsung Electronics, by far the biggest part of his empire, but also those of the other 64 firms within the conglomerate that he controls. It was delivered with the sort of attention-grabbing hyperbole that any tweeter would be proud of: “It’s a real crisis now. First-class global companies are collapsing. No one knows what will become of Samsung. Most of Samsung’s flagship businesses and products will become obsolete within ten years. We must begin anew. We must only look forward.”

It did not quite have the pithiness of Mr Lee’s rhetoric in 1993 when he said Samsung was a second-rate company and that its employees should “change everything except your wife and children.” But his words had the same urgent ring of truth about them.

How can that be? It is a question that could be asked by anyone who has recently turned on a flat-screen television, bought a mobile phone, stored masses of data on a flash memory or watched Chelsea’s footballers in shirts sporting Samsung’s name. Far from being a disaster in the making, Samsung Electronics has become one of the world’s strongest brands, known for sleek design, razor-sharp technology and good value.

Think of anything with a screen, from a few centimetres square on a mobile phone, to a laptop, a wide liquid-crystal display or a giant 3D television, and Samsung Electronics will be one of the top two firms in the world making it—or at least the memory chips inside it (see chart). The company’s global market shares are staggering: more than 40% of the flash memory used in sophisticated electronics like the Apple iPhone, almost one in five of the world’s mobile phones and one in six of its television sets. It even makes screens for Sony’s TVs.
Having invested aggressively in new products in 2008, Samsung Electronics sailed through the global financial crisis, almost doubling its operating profit in 2009. This year analysts expect it to generate record profits of over $10 billion. Sales are forecast to be about $130 billion, which is likely to confirm its lead over America’s Hewlett-Packard as the world’s biggest technology company by revenue. Not to be outdone, other parts of the Samsung group have notched up successes. The construction division recently completed the tallest building in the world in Dubai and Samsung Heavy Industries is flush with shipbuilding orders.

In a way that General Motors can only have dreamed of, what has been good for Samsung has been good for South Korea. The group’s products account for about 20% of the country’s GDP, making it huge even by the standards of an economy top-heavy with big firms. When the won tumbled in 2008, raising fleeting fears of a currency crisis, exporting champions like Samsung, Hyundai and LG quickly took advantage, betting that their customers would be willing to buy newer, better models if the price was right.

South Korea’s conglomerates were also well diversified globally—only one-tenth of the country’s exports go to America. That meant sales lost in America were partly made up for by those gained in fast-growing emerging markets like China. Thanks to generous promises of government stimulus, South Korea, one of the rich world’s most export-dependent countries, pulled off the surprising feat of surviving the worst slump in global trade since the second world war with only a fleeting dip into recession.

For that, South Koreans give much of the credit to their industrial conglomerates, or chaebol as they are known, and the rich, inscrutable families who control them and live like royalty in South Korea. Yet Mr Lee’s comeback causes nervous speculation. If Samsung really does face a crisis, what does that mean for South Korea? If Mr Lee believes he is the only person who can avert disaster, what does that say about the business acumen of his potential successors? And if he can walk back into the corner office without even having board approval, can it really be argued that the country is progressing to Western-style standards of corporate governance? Business people have watched, with a mixture of suppressed glee and dread, former role-models such as Toyota and General Motors struggle with huge financial and technical problems. Could this be the fate that Mr Lee fears for his firm?

Get out of jail free

These are pertinent questions for Korea Inc, the business model that has so recently undergone a remarkable rehabilitation. Just over a decade ago, when the South Korean economy was reeling from its near collapse in the Asian financial crisis of 1997-98, it was the chaebol that were widely blamed by the public, the centre-left government of the time and the IMF.

The extent of the mismanagement was shocking. In the 1960s and 1970s, under the dictatorial regime of Park Chung-hee, the chaebol soaked up cheap government financing and relied on official protection from foreign competition. Loosely, the models were the zaibatsu conglomerates that had helped turned Japan into an imperial—and militaristic—power before the second world war.
The chaebol, some of which were started by war racketeers, had the same vast ambitions, albeit for industrial conquest—and they had public money to back them. Samsung expanded from sugar and wool into electrical goods, chemicals and engineering. Hyundai’s founder, Chung Ju-yung, started building roads and then decided to build the cars to drive on them. But many chaebol overburdened themselves with debt as they tried to move up the technological ladder in the 1980s. As they borrowed lavishly to buy capital equipment, South Korea’s current-account deficit soared. Some thought the chaebol had become so big the government could not let them fail. They were spectacularly wrong.

The conglomerates failed in droves. The collapse of Daewoo in 1999 was followed by the bankruptcy of more than half of the then top 30 conglomerates. Four of the country’s five carmakers (even Samsung had ventured into the market) went bust. South Koreans, many of whom had flocked to hand over their gold jewellery in a patriotic gesture to help pay off the foreign debt, were appalled at the level of government and business collusion that came to light.

Under two consecutive left-of-centre governments, many of the chaebol bosses—some now being run by the children of their founders—were prosecuted. Suspended sentences were handed out to the boss of SK in 2003, the former chairman of Doosan group in 2006, and the owner of Hanwa group in 2007. But this was justice for the rich—quite different from justice for the rest. Chung Mong-koo, chairman of Hyundai Motor (which also owns Kia, the country’s second-biggest carmaker) was convicted of embezzlement in 2006. But his prison term was reduced to community service and a $1 billion donation to charity because of his economic importance to the republic. Then in 2008 Mr Lee was convicted on tax-evasion charges, but also spared prison after paying a fine.

Partly chastened, both business and government have embarked on reform. Balance-sheets have improved, as has corporate governance, increasing the rights of minority shareholders and the responsibilities of company directors. Since then, some—though by no means all—of the cross-shareholdings used to disguise the weakness of subsidiaries and protect them from hostile takeovers have been rooted out and replaced with more transparent holding-company structures.
A friend in the Blue House

The reputations of the chaebol—especially in the eyes of South Koreans—recovered further during the 2008-09 global slump. So much so that when you ask experts in Seoul how their conglomerates fared during the crisis, some ask: what crisis? It was not just Samsung Electronics that sparkled. Hyundai increased market share in America every month last year, as its small, well-equipped cars with long warranties benefited disproportionately from the cash-for-clunkers programme.

For the first time in many years the chaebol have a political wind behind them. Lee Myung-bak, who became president in 2008, is a former chief executive from within the Hyundai extended family of firms. In December he pardoned Mr Lee, freeing the way for his return to Samsung. The same month he championed a successful bid by a chaebol-heavy consortium under the aegis of the Korean Electric Power Company to provide nuclear power to Abu Dhabi, pulling the rug from under industry leaders in France and Japan. This year, his government is pushing to relax holding-company laws that would make it easier for the chaebol to own financial firms. “The business community has not seen a political environment this accommodative in the past decade,” CLSA, a broker, said in a recent report.

Japan looks on aghast as the chaebol catch up with more of its large firms. “Of all their competitors on the global stage, the Japanese fear the South Koreans most,” writes Mark Anderson, author of Strategic News Service, a technology newsletter. Some Japanese industrialists acknowledge this publicly. “Korea is much more full of vitality than Japan,” Osama Suzuki, head of Suzuki Motor, lamented in a recent talk to foreign journalists in Tokyo. “Japan is coasting.”

All of which makes Mr Lee’s strident warning, as the head of South Korea’s most successful company, more puzzling. The charitable view is that it may have been just a rhetorical device to soften up opponents to his rehabilitation—and to the eventual transfer of power to his son, Lee Jae-yong, Samsung Electronics’ chief operating officer. But it may also reflect deeper fears that the days of relying on manufacturing as a growth strategy, for all its technical sophistication, are numbered. The most obvious cause for concern is China. The acquisition on March 28th of Volvo by Geely, a Chinese carmaker, is the latest example of low-cost Chinese producers’ determination to build global brands.

In computer chips, Samsung Electronics is comfortably ahead of China for now. But the skills needed in that business are described by one Samsung expert as like running a “digital sashimi shop”—the trick is to get products so swiftly to market that they do not lose their freshness. There is no inherent reason why Chinese firms cannot eventually catch up. What is more, as Mr Anderson points out, China is more open to imports and foreign direct investment than South Korea, which helps China’s quest for intellectual property.

An even bigger threat comes from America. Late last year Apple finally got permission from South Korea’s telecoms authorities to waive a rule prohibiting the domestic sale of iPhones. Demand for the iPhone has since exploded, leaving Samsung and its domestic rival LG (which together have sold seven out of ten phones in South Korea), looking uncharacteristically leaden. Smart-phones accounted for just 1% of the market, but Apple has been selling some 4,000 iPhones a day, making South Korea one of the gadget’s hottest markets. Even the finance ministry has launched an iPhone application—the Glossary of Current Affairs in the Economy—to unexpected popular appeal.

For Samsung and LG this problem is magnified at the global level, and not just against Apple but also against firms like Google and Research In Motion, maker of the BlackBerry. For all its success in mobile phones, Samsung is an also-ran in the global smart-phone market. The South Korean company has rushed to remedy that with its own smart-phone platform, Bada, and by producing mobile phones that use Google’s low-cost Android operating system. As a result, Samsung hopes to sell more smart-phones in America than any other firm this year.

To win, however, Samsung needs more than sleek hardware. It is also outgunned by the iPhone’s 140,000 applications, which means it needs more creative input into its products. That will mean encouraging a less hierarchical, more inventive, corporate culture. The fluid ecosystem surrounding mobile technology may mean Samsung will need to engage more openly in partnerships with other firms, as it already has with DreamWorks Animation, creator of films such as “Shrek”, to help in the launch of 3D television. But such team efforts are not naturally in the DNA of a company that likes to keep its suppliers in the corporate family.

To their credit, Samsung executives did not appear to be complacent, even before Mr Lee’s call to action. They do not want to abandon what Samsung does best—making cutting-edge hardware—just because
China is on the warpath or to chase Apple. They greatly value the Samsung brand, which has been painstakingly built through good design over many years.

But they do speak of change, albeit in an evolutionary way. They intend to offer affordable smart-phones to the masses, not just to the top of the market. To improve content, they are concentrating on hiring software engineers rather than hardware experts. And to help stimulate ideas they have offered flexible hours to their notoriously hard-working employees, as well as hiring more young people and women. Nor have they stopped benchmarking against their competitors.

But there is still the bottom line to worry about. “Samsung Electronics may be the largest technology company in the world by sales, but it’s far from global number one by profit,” Lee Keon-hyok of the Samsung Economic Research Institute acknowledges. Profit margins leave something to be desired. In the quarter ending on December 31st, Samsung Electronics reported operating-profit margins of 9%. Apple’s were 36%. Moreover, the South Korean firm can hardly dispute that its market-share gains—especially against Japanese rivals such as Sony—were helped by a cheap won. But in a country where being number one is almost an obsession, these are elements that are likely to make Samsung strive harder.

**No leeway**

Arguably the most difficult challenge Samsung Electronics faces is internal, and as in most things at the company that ultimately comes back to the patriarch. As Steve Jobs has proved at Apple, nothing beats having a visionary leader—and Mr Lee is one of those. It was his decision, back in 1993, to concentrate the sprawling empire on certain world-class technologies, like chips, mobile phones and display screens. He is credited with instilling the mantra of first-class product design among his staff.

But the manner of Mr Lee’s return may raise as many problems as it solves. When he stepped down in 1998, the hope was it would usher in a reform in Samsung Electronics’ corporate governance so that investors outside his sphere of influence—about half are foreigners—would have a clearer view of the way the company was run. His son was given different managerial posts, which groomed him for the top job better than many other “chaebol princes”. A murky Strategic Planning Office that sat atop the Samsung family of companies and allocated resources was disbanded. No one doubted that Mr Lee continued to pull strings from behind the scenes. But the first traces of Western-style corporate governance were apparent.

His return, without a board meeting to approve it, appears to have put that process into reverse. Already there is speculation that he will revive the “control tower” system of group-wide oversight. His comeback may make it even less likely that Samsung will embrace a more transparent holding-company structure as, say, LG has.

Most troubling, argues Jang Hasung, dean of the University of Seoul’s Business School, is that the “emperor-management” approach suggests Mr Lee is not confident enough in the company’s numerous other executives around the world—including his son—to lead the company into the future. This problem is true of the chaebol in general; succession issues loom everywhere. What’s more, it appears to ignore the lesson so recently exposed by Toyota that family ownership can be a huge weakness as well as a strength.

“His decision to come back gives the impression that he’s the only one who can fix whatever crisis it is he’s talking about,” Mr Jang says. With so much of South Korea’s future at stake, maybe it is the next generation of leadership that Mr Lee should be tweeting about.
ACROSS much of the rich world an era of budget austerity beckons. Government debt is rising faster than at any time since the second world war. By 2014 the public debt of big rich countries will reach an average of 110% of GDP, up by almost 40 percentage points from 2007, according to the IMF (see chart). On current policies it will continue rising.

How to alter this bleak trajectory will be policymakers’ most difficult task over the next decade. Financial markets are already forcing some into drastic action. Greece plans to cut its deficit from 12.7% of GDP in 2009 to 3% by 2013, using spending cuts, tax hikes and heroic growth projections. Portugal has rushed out plans to cut its deficit from 9.3% last year to 3% by 2013. Britain’s election will be fought over the contours of future austerity.
But so far less than half of the OECD’s member countries have detailed medium-term plans to reduce their deficits. Their choices will have huge implications for the growth and structure of their economies. Worryingly given the stakes, economics offers surprisingly little certainty about either the optimal goal or the best way of getting there.

Begin with the goal. Today’s deficits, which are leading to ever-higher debt burdens, are plainly unsustainable. But what level of public debt should governments aim for? A popular rule of thumb for a “safe” level of government debt in a rich economy is 60% of GDP. That is the limit enshrined in the Maastricht Treaty, which governs membership of the euro. It was the average debt-to-GDP ratio among big rich economies before the financial crisis. And it is the figure to which the IMF reckons rich countries should aspire.

Reducing debt burdens to pre-crisis levels may make some sense. It would ensure the costs of the crisis were not passed on to future generations. It would leave governments with more fiscal room to deal with recessions to come. And it would ensure that higher government debt did not crowd out private investment, which could lower future growth. The fund reckons that the 35-percentage-point increase in rich countries’ debt could raise borrowing costs by two percentage points.

Unfortunately, there is little rigorous evidence in support of a target of 60%, let alone for reaching it quickly. In the past some countries’ public-debt ratios have been higher than they are today and they have often fallen slowly. Andrew Scott of the London Business School points out that Britain’s debt burden rose from 121% of GNP in 1918 to 191% in 1932 and did not return to its 1918 level until 1960. In a recent study Carmen Reinhart and Ken Rogoff find that public-debt burdens of less than 90% of GDP have scant impact on growth, but they do see a significant effect at higher ratios. That argues against a single number for all. With the world’s biggest sovereign-bond market and trusted institutions, America will be able to carry a higher public-debt burden than Greece.

In principle, countries can cut their debts in several ways. They can default, either outright or, if they have their own currencies, through inflation. For most countries, these paths are unappealing (see article). They can try to boost growth, which reduces the burden of public debt and makes it easier to cut deficits by bringing in more tax revenue. But the size of today’s deficits—on top of the future cost of existing pension and health-care promises—means growth alone will not be enough. Budgets also have to be tightened.

By how much depends on governments’ debt goals. The IMF’s calculations, for instance, suggest that to reduce their ratios of public debt to GDP to 60% by 2030, the rich world’s governments need to improve their budget balances by an average of 8% of GDP by 2020. The average structural deficit (ie, before interest payments) must swing from 4.3% of GDP in 2010 to a surplus of 3.7%. They must then maintain that surplus. A fifth of the rich world’s economies (including America and Britain) would need adjustments of around 10% of GDP or more. Stabilising debt ratios at 2012 levels would demand, on average, an adjustment only half as big.

The appropriate debt-to-GDP goal will depend on the means used to get there. Balancing a budget by raising taxes, for instance, may harm growth more than living with a higher debt ratio. Here, the academic evidence is clearer. Fiscal adjustments that rely on spending cuts are more sustainable and friendlier to growth than those that rely on tax hikes. Studies show that cutting public-sector wages and transfers is better than cutting public investment. Many cuts, from raising pension ages to slashing farm subsidies, have a double benefit: they boost growth both by improving public finances and by encouraging people to work harder or promoting more efficient allocation of resources.

Austerity can even be expansionary. A number of budget adjustments based on spending cuts in the 1980s and 1990s were accompanied by faster growth, presumably because the effect on confidence and interest rates outweighed the loss of government demand. That may not happen again, not least because consumers are weighed down with debt and interest rates are already so low. But the superiority of spending cuts still holds. The problem, however, is that the scale of adjustment may be too big to achieve by cuts alone. The IMF’s analysts, for instance, reckon that three percentage points of the 8% of GDP fiscal swing they deem necessary will have to come from higher tax revenue.

The taxes that do least harm to growth are those on consumption or on immobile assets such as property. Given the pressures of global warming, green taxes also make sense. European governments already rely more on consumption taxes than other rich countries do, and some are raising their rates of value-added tax. But politics often points elsewhere, towards making rich people pay to clean up the fiscal mess: the highest marginal rates of income tax are set to rise in America and Britain. That may please populists but
it will not boost growth.
Government-bond markets enter the twilight zone

WHAT is going on in government-bond markets? Longer-dated bond yields have risen in recent weeks and the gap between long- and short-term rates (known as the “yield curve”) is much higher than normal. Potential explanations range from the benign (the economy is returning to normal) to the apocalyptic (investors have lost their appetite for government debt).

An upward-sloping yield curve, in which long-term interest rates are above short-term rates, is normal. You would expect creditors to demand a higher return for tying up their money for extended periods. An “inverted” curve, with short rates above long ones, is usually seen as a herald of recession, as it turned out to be before the credit crunch.

So what does a very steep yield curve tell us? One possibility is that the economy is heading for a vigorous recovery. For one thing, long rates are a forecast of future short rates. So the markets are essentially predicting that the Federal Reserve will eventually increase rates because the economy has been restored to health. In addition a steep yield curve creates profitable opportunities for banks, which can borrow short-term at a low rate and lend to companies at a higher one. The Fed engineered a steep yield curve in the early 1990s to boost bank profits after the savings-and-loan crisis.

This time, however, a steep yield curve is hardly stimulating bank lending. Bank credit has contracted over the past 12 months. Big companies are turning away from the banks to the bond market as a result: high-yield bond issuance in March broke the previous monthly record. Smaller companies have found it more difficult to borrow money.

A rise in long-term bond yields could indicate a belief that inflation is set to soar. But inflation expectations, derived from the gap between yields on index-linked and conventional bonds, hardly suggest fears of a Zimbabwe-style debasement. American inflation is expected to average just 2.4% between now and 2028.

There are other possibilities. One current technical oddity in the markets is the “negative swap spread”. In the interest-rate swap market borrowers exchange fixed-rate streams of payments for floating ones (or
vice versa). The floating rate is often based on LIBOR, the rate at which banks borrow from one another. The fixed-rate element normally carries a higher yield than that of Treasury bonds with the same maturity. After all, the other counterparty in the swap will usually be a bank, which is less creditworthy than the American government. But on March 30th the fixed-rate element of a ten-year swap was paying 3.82%, while the equivalent Treasury bond was yielding 3.87%. Does that really mean the market considers banks a better credit risk than the Treasury? Given the continued use by banks of government-support schemes of various kinds, that seems ridiculous.

A more likely explanation is the sheer volume of bonds being issued. These bond issuers would rather swap their fixed-rate obligations for floating-rate ones. So they have to pay a floating rate and receive a fixed one. The result is an imbalance of supply and demand: those people willing to pay the fixed-rate part of the swap can get away with a lower yield than the American government.

In Britain a similar technical oddity has led to the 30-year swap spread being negative for a considerable period already. Demand from British pension funds, which use the swap market to hedge their long-term liabilities, has forced down fixed-swap rates. What is seen as an unusual situation in the American market may become the norm.

Technicalities aside, the most plausible explanation for the steep yield curve is the interaction of monetary and fiscal policy. On the monetary side the Fed is holding short rates at historically low levels in response to the severity of the crisis. On the fiscal side America’s budget deficit has soared to over 10% of GDP, leading to heavy debt issuance. Recent Treasury-bond auctions have seen fairly weak demand, forcing yields higher.

This still represents a challenge for markets. One reason why equities have rallied is that their potential returns have seemed attractive relative to government-bond yields. Now there will be more competition. And governments have been able to support their economies so generously because their financing costs have been so low. Higher yields will add to the pressure on them to tighten fiscal policy. A market and an economy too dependent on government support will have to learn to live without its crutch.
Japan’s failed postal privatisation

Return to sender
Mar 31st 2010 | TOKYO
From The Economist print edition

Japan Post, the world’s biggest bank, is handed an unfair advantage

THE Japanese cabinet is a contentious lot. When Shizuka Kamei, the minister of financial services and postal reform, unveiled plans in March to halt the planned privatisation of Japan Post, several ministers publicly balked. The finance minister was shouted down on TV by Mr Kamei.

On March 30th the government adopted Mr Kamei’s plans nonetheless. Japan Post, which is not only a post office but also the world’s biggest bank, with assets of more than ¥300 trillion ($3.2 trillion), will be allowed to double the amount of deposits it can take from a customer to ¥20m. Its life-insurance unit, which controls 40% of the market, will be permitted to raise its coverage limit to ¥25m from ¥13m. The government will retain a stake of more than one-third, giving it veto power.

Japanese bankers grumble that increasing the maximum deposit, with its implicit guarantee, gives the postal bank a huge advantage. Japanese savers tend to shift their wealth to the post office for safety. Half of all household assets are in cash or bank deposits, which amount to more than ¥800 trillion. American and European officials are considering going to the World Trade Organisation over access to post offices to sell insurance, among other things.

The policy amounts to "renationalisation", and throws Japan’s financial markets “back to the past”, complains Heizo Takenaka, an economist who shepherded postal privatisation in 2001-06 for the then prime minister, Junichiro Koizumi. Japan Post has long been a tool of the state. Over 80% of its funds are used to buy Japanese government bonds; it holds one-third of the ¥683 trillion market. This, in turn, has allowed the government to finance pork-barrel projects, diverting funds from more productive uses. It was for these reasons that Mr Koizumi outlined plans to privatise Japan Post by degrees between 2007 and 2017. His scheme included a sale of shares to the public as early as this year. That would have helped the government pare its debt (around 200% of GDP) and probably given a pleasant lift to the stockmarket.

But as soon as Mr Kamei took office in September, he signalled a halt to privatisation. His interest was in keeping post offices open in rural areas, where they are considered the heart of the community. He also wants the postal bank to provide loans as a way to revitalise rural regions, further infuriating other Japanese banks.

The saga is a symbol of the government’s reluctance to restructure the economy. After six months in power, the Democratic Party of Japan (DPJ) has shied away from many of its promised reforms, such as spending cuts. On March 24th the government passed a ¥92 trillion budget for the fiscal year starting in April, almost half of it financed by government debt: the decision on Japan Post will help secure continued demand for its bonds.

The imbroglio also raises the question of who runs the country: the prime minister, Yukio Hatoyama, or Mr Kamei, the gadfly leader of a small coalition party, whose six parliamentarians give the DPJ its majority in the upper house of the Diet. The DPJ believes it needs Mr Kamei’s support for upper-house elections this summer. But appeasing him only ends up making the government look hapless.
The government takes a firmer line

STEFAN INGVES, the governor of the Riksbank, Sweden’s central bank and an architect of his country’s bank bail-outs in the 1990s, cut an exasperated figure on the financial regulators’ conference circuit after the crisis. The medicine he administered during the Swedish crisis, and has prescribed ever since, is bitter: an immediate write-down of all bad assets and forced recapitalisation of banks, even if it means nationalising them. Few of today’s patients have been willing to stomach it. Many have chosen more palatable cures in the belief that the prices of banks’ bad assets will recover given time.

Ireland was in this camp at first. Last year the government proposed to buy bad assets—most of them commercial-property loans from the country’s development boom—from Irish banks for about 30% less than their face value, arguing that this reflected their “long-term economic value”. The worry was that the government would overpay, enriching shareholders in the banks at taxpayers’ expense.

On March 30th Ireland sent the homeopaths packing and started taking stiffer medicine. The first pill was a steep cut in the price that Ireland’s newly-formed “bad bank”, the National Asset Management Agency (NAMA), is paying for the assets it will take off the banks. It is paying little more than half the face value for the first €16 billion ($21.5 billion) in bad loans that will be transferred. Analysts are now raising their estimates of the discount, or “haircut”, that will apply to the full €81 billion of loans NAMA will take.
The second pill is an increase in the amount of core capital that banks need to hold against losses. The regulator wants them to have a cushion of 8%, of which 7% needs to be equity, the best form of capital. The authorities also published details of its stress tests on Irish banks, which include assumptions of total losses of 5% on mortgages and losses of up to 60% on loans backed by property developments.

As a result of the stress tests, the new capital requirements and the greater-than-expected haircuts on toxic assets, the regulator reckons that Allied Irish Banks will need to raise as much as €7.4 billion in equity while Bank of Ireland will require €2.7 billion. Anglo Irish Bank, which is already in state hands, may need more than €18 billion. The banks have 30 days to say how they would fill the holes opening up in their balance-sheets, but they are unlikely to manage without additional support from the state. That would probably mean the government taking a majority stake in Allied Irish Banks. Shares in the bank fell by 27% ahead of the announcement (bondholders continue to escape unscathed).

The reasons that the government gave for applying a steeper haircut to the first batch of assets that NAMA has bought are hair-raising. Among them is the finding that the “underlying security” of the assets is of “variable quality”. This is likely to add fuel to talk that some indebted developers did not own the land they had pledged as collateral for loans but that they had merely acquired a right to build on it. Almost as alarming are the revelations that asset prices continued to fall after August, when NAMA first valued them, and that banks’ initial estimates of loan-to-value ratios seem to have been off the mark.

Mr Ingves, meanwhile, seems to be spending more time offering advice to those who appreciate it. In recent months he has been hosting web “chats” with consumers on the Riksbank’s website, providing homespun advice on matters such as whether they should take out fixed- or floating-rate mortgages and why they shouldn’t mortgage their homes to 100% of their value. More counsel that the Irish could usefully have heeded earlier.
WITH America braced for 4m or more foreclosures this year, the government is still searching for an effective way to stop the rot in housing. Under the Home Affordable Mortgage Programme (HAMP), a mere 170,000 borrowers have received permanent loan modifications, well below the target of 3m-4m. Will a revamped HAMP, unveiled on March 26th, mark a turning-point?

Until now the focus has been on lowering mortgage payments as a share of income, mainly through interest-rate reductions and term extensions. New rules put an emphasis on reducing principal (ie, loan balances). A crisis first sparked by subprime-mortgage defaults has since spread to better-heeled borrowers: one in four American households with mortgages owe more than their properties are worth. Forgiving some of this debt makes it less likely that they will throw away the keys.

The new plan aims to help in four main ways. It offers incentives for loan servicers (which collect payments for investors in mortgage-backed securities) to reduce principal for those owing more than 115% of the property’s current value; the write-down will be staged over three years if the borrower keeps up with lower payments. Second, struggling borrowers who have kept up their payments can switch into loans guaranteed by the Federal Housing Administration (FHA), a government agency, as long as their loan is reduced by 10% or more. Third, jobless borrowers will get up to six months of payment assistance while they look for work.
The final element is perhaps the most important. The government hopes to remove a blockage in the
modification process with a bribe to holders of “second lien” mortgages, such as home-equity loans.
CreditSights, a research firm, estimates that the four big banks hold $423 billion of home-equity loans
(see chart), $151 billion of them to borrowers who are either underwater or close to it. These lenders have
resisted modification of first mortgages, fearing knock-on write-downs of their second liens. The
sweetener on offer is a payment of between ten and 21 cents on the dollar for balances they cut.

The new plan is widely seen as having more teeth than the first version of HAMP. But it still has its flaws.
Participation by servicer banks is not assured. The motivation to avoid modifying second liens is likely to
be stronger than a few thousand dollars in incentive payments for investors and servicers. Even so, the
plan appears to treat second-lien holders better than investors in the main mortgage, because the former
are not required to cut principal when first-lien balances drop. This “undermines the priority of claims in
the capital structure” and supports the overvaluation of exposures on banks’ books, says Joshua Rosner of
Graham Fisher, a consultancy.

The taxpayer will still be stuck holding the bill for the FHA. Already, the agency’s reserves have been
heavily eroded by risky loans it took on in 2008-09 to shore up the housing market. Even homeowners
may end up feeling dissatisfied. It is jobs that these households really desire, says Anthony Sanders, a
property-finance professor at George Mason University, not to stay in a house that they cannot afford,
especially when rental properties are so readily available.
Chinese tax breaks

Bankers' heaven
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A lesson in regressive taxation

AS AMERICA and Europe plan new ways to claw back money from high earners in finance, China is going the other way. When the Communist Party decided to transform Shanghai into a financial centre, it gave a great deal of thought to personal-tax incentives. A ruling put out at the end of 2008 by the city’s Pudong district is the most regressive form of taxation imaginable.

Ordinarily, China imposes one of the highest top marginal income-tax rates in the world, 45%. There are few complaints about this from locals: nothing good is likely to come from provoking the authorities’ attention. But it is a turn-off for employees of companies that Shanghai wants to attract to the skyscrapers popping up on the western bank of the Huangpu River.

Chinese law specifically bans local governments from offering personal tax breaks, but there is a way around this constraint. Typically taxes are divided into two pools, with 60% going to the national government in Beijing and the remaining 40% retained locally. The most competitive local governments collect their share and then send it straight back to the lucky taxpayer—technically a reimbursement, but in reality a big tax break.

The ruling by Pudong’s district government—Circular 301, as it is officially called—allows these subsidies to be paid to “qualified financial talents working at qualified financial institutions”. Upon approval by regulators, senior managers can receive a reimbursement of 40% of their taxes, plus a housing subsidy. That pushes their tax rate down to 27%, still higher than Hong Kong’s 15% and Singapore’s 20% but well below what a banker would pay in New York (44%) or London (soon to be 50%) or for that matter Tokyo (50%) or Seoul (35%).

Bankers who are not quite so important get a not-so-grand tax break, roughly half as large. More junior staff get nothing. The same system of targeted personal-tax breaks for senior executives was apparently successfully used in Beijing to entice financial firms to move from one side of the Forbidden City to the other, to an area called Financial Street. Once the leading global firms had moved their offices, the tax rebates were allowed to lapse. The same will probably happen in Shanghai. But for now, if you’re a capitalist-roader, the people’s party is pretty hard to beat.
IN MORE than 30 years of teaching introductory macroeconomics, says Alan Blinder of Princeton University, he has never seen interest as high as it was last year. At Harvard, says David Laibson, students in his undergraduate macroeconomics course are “chomping at the bit”. At elite American universities, where endowments have shrivelled and hiring is down, increased interest in economics is among the most benign of the recession’s effects.

Yet the crisis has also highlighted flaws in the existing macroeconomics curriculum. Greg Mankiw, a Harvard economist and the author of a bestselling textbook, points out that students can hardly be expected to make sense of the crisis if they know virtually nothing about things like the role of financial institutions. Yet if there is a “financial system” in most introductory texts, Mr Blinder observes, it usually focuses on the demand and supply functions for money. “The current curriculum fails to give students even imperfect answers” to their legitimate questions about recent economic events, he says.

Changes are coming. Mr Blinder is one of the authors of another popular undergraduate textbook, which he is now revising. In the process, he is having to think long and hard about how to balance the need for more detail about things like finance with the constraints under which introductory macroeconomic courses are taught. The new edition is likely to have a prominent place for the idea of leverage and how it contributed to the crisis. That is fairly simply explained. But some additional complexity will be unavoidable.

For instance, the convenient fiction of a model of the economy with a single interest rate was defensible as long as different rates moved in concert. This, Mr Blinder says, is no longer something that students can be told “with a straight face”. Some discussion of the role of securitisation and systemic risk is essential, even if it feels like a lot of detail for beginners to grasp. Mr Blinder, with a nod to Albert Einstein, says that economists need to remember that things should be made as simple as possible, but no simpler.

Revised textbooks will soon find their way into bookshops. Charles Jones of Stanford University has put out an update of his textbook with two new chapters designed to help students think through the crisis,
and is now working on incorporating these ideas into the body of the book. A new edition of Mr Mankiw’s book should be out in about a year. And Mr Blinder’s publishers aim to have his revised text on sale by June.

Courses in many leading universities are already being amended. Mr Laibson says he has chosen to teach his course without leaning on any standard texts. Francesco Giavazzi of the Massachusetts Institute of Technology is now devoting about two-fifths of the semester’s classes to talking about how things are different during a crisis, and how the effects of policy differ when the economy hits boundaries like zero interest rates. Discussion of the “liquidity trap”, in which standard easing of monetary policy may cease to have any effect, had fallen out of vogue in undergraduate courses but seems to be back with a vengeance. Asset-price bubbles are also gaining more prominence.

Will these changes in the way macroeconomics is taught really stick? The rewriting of widely used texts should ensure that some of the ideas that have helped explain the crisis become part of the future curriculum. Mr Jones says it will be instructive to compare the bestselling textbook in ten years’ time with the pre-crisis version of Mr Mankiw’s book. He thinks they will differ substantially.
Sovereign defaults do not typically lead to economic catastrophe. How much comfort should that give?

IN DECEMBER 2001 Argentina defaulted on $81.8 billion of sovereign debt, after months of turmoil in the country’s banking system. That led to the abandonment of its exchange-rate regime and a sharp devaluation of the peso. Argentina’s GDP plummeted by 10.9% that year. It has been locked out of international capital markets ever since. In Greece such tales now have a worrying resonance. Despite raising $6.7 billion on bond markets on March 29th, the scale of the country’s financing needs means that an eventual default cannot be ruled out. Both Greece’s 2009 budget deficit, at 12.7% of GDP, and its debt-to-GDP ratio of 113.4% are higher than the corresponding figures for any sovereign defaulter between 1998 and 2001. If the worst were to happen, how much pain might it suffer as a result?

In theory, default should be costly. The damage it causes is the main incentive for debtor countries to honour their promises. Yet there are clearly lots of occasions when governments judge that the benefits of defaulting outweigh the costs. An IMF study by Eduardo Borensztein and Ugo Panizza counts as many as 257 sovereign defaults between 1824 and 2004. Between 1981 and 1990 alone, there were 74 defaults (see chart).

In fact, the evidence suggests that the penalties for default are often less severe than those meted out to Argentina. Its experience of being shunned by international capital markets is not typical, for example. At least in recent years defaulters have been able to re-enter markets once debt restructuring is complete. Argentina’s woes stem partly from the fact that it is only now, more than eight years since it defaulted, nearing a final deal with its creditors (see article).

Defaulting does affect the cost of funds to a country. A study in 2006 by a trio of economists at the Bank of England found that countries which defaulted between 1970 and 2000 had both a higher bond spread and a lower credit rating in 2003-05 than countries with the same debt-to-GDP ratio which did not default. In their study Messrs Borensztein and Panizza show that having defaulted is associated with a credit-rating downgrade of nearly two notches. Using data for 1972-2000, they also find sizeable jumps in bond spreads after a default. In the first year spreads widen on average by four percentage points. This additional cost declines to 2.5 percentage points the year after. These figures may understate the pain, however: as the Greek case shows, worries about default are enough in themselves to lead to an extended period of high spreads.
That said, markets appear to have short memories. Only the most recent defaults matter and the effects on spreads are short-lived. Messrs Borensztein and Panizza find that credit ratings between 1999 and 2002 were affected only by defaults since 1995. They find that defaults have no significant effect on bond spreads after the second year. This tallies with earlier research by Barry Eichengreen and Richard Portes. Studying bonds issued in the 1920s, they also found that recent defaults resulted in higher spreads but more distant ones had no effect.

Attempts to measure the broader economic costs of default reach a similar conclusion. Messrs Borensztein and Panizza find that a defaulting country grows by 1.2 percentage points less per year while its debt is being restructured compared with a similar country that is not in default. This effect, too, is concentrated in the first year after default. Once again, measuring from the point of default will somewhat underestimate the damage: defaults tend to occur during recessions, so GDP is already depressed when a country reneges.

Countries whose debt is not restructured bear a higher and more persistent penalty. The Bank of England study found that output losses were more than three times as large for countries which had failed to reach a deal with creditors than for defaulters whose debt had been restructured. The details of restructuring also matter. Bond spreads were typically larger in countries, such as Ecuador, whose creditors were forced to accept a large loss of principal, than those, such as Pakistan or Ukraine, where “haircuts” were less severe.

Sovereign defaults do not just affect the governments of countries that fail to honour their promises. Another IMF study finds that defaults lead to a 40% decline in external credit to private companies in the defaulting country. Even countries that do not default are sometimes affected by the fallout. In the aftermath of the 1980s debt crisis, for instance, credit to developing countries as a whole (including non-defaulters) dried up. Other rich countries with strained public finances may also have lots to worry about if Greece defaults.

**This time really could be different**

Greece cannot afford to be sanguine. The Argentine example shows that the averages mask considerable variation. And there are several reasons to think that Greece’s experience in the event of a default would be worse than the norm. The academic research focuses on emerging markets because that is where all recent defaults have been. The impact of a Greek default, which would be the first by a rich country since the second world war, may be greater. If Greece defaulted, it would do so when the global economy is still weak, credit is scarce and other sovereign borrowers are raising lots of money. So markets may be less welcoming than other recent defaulters have found them. Greece's use of the euro also means that it cannot devalue: that implies it would have to impose fairly high haircuts on creditors and might face a higher-than-average increase in its cost of borrowing.

Another element to the costs of default may also alarm Greek policymakers. Messrs Borensztein and Panizza find that political leadership changed in the year of default or the year after in half of the 22 cases they study. That is twice the usual probability of such change. These political costs, at least, are unlikely to vary.

The article refers to the following papers:


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Applications are invited for The Economist’s 2010 Marjorie Deane internship. Financed by the Marjorie Deane Financial Journalism Foundation, this award is designed to provide work experience for a promising journalist or would-be journalist, who will spend three months at The Economist writing about finance and economics. Applicants are asked to write a letter introducing themselves, along with an original article of no more than 500 words that they think would be suitable for publication in this section. The deadline is April 23rd 2010. To apply, visit www.marjorie.deane.com
IN 1975 scientists expert in a new and potentially world-changing technology, genetic engineering, gathered at Asilomar, on the Monterey peninsula in California, to ponder the ethics and safety of the course they were embarking on. The year before, they had imposed on themselves a voluntary moratorium on experiments which involved the transfer of genes from one species to another, amid concerns about the risk to human health and to the environment which such “transgenic” creations might pose. That decision gave the wider world confidence that the emerging field of biotechnology was taking its responsibilities seriously, which meant that the Asilomar conference was able to help shape a safety regime that allowed the moratorium to be lifted. That, in turn, paved the way for the subsequent boom in molecular biology and biotechnology.

Another bunch of researchers, accompanied by policy experts, social scientists and journalists, gathered in Asilomar between March 22nd and 26th, hoped for a similar outcome to their deliberations. This time the topic under discussion was not genetic engineering but geoengineering—deliberately rather than accidentally changing the world’s environment.

Geoengineering is an umbrella term for large-scale actions intended to combat the climate-changing effects of greenhouse-gas emissions without actually curbing those emissions. Like genetic engineering was in the 1970s, the very idea of geoengineering is controversial. Most of those who fear climate change would prefer to stop it by reducing greenhouse-gas emissions. Geoengineers argue that this may prove insufficient and that ways of tinkering directly with the atmosphere and the oceans need to be studied. Some would like to carry out preliminary experiments, and wish to do so in a clear regulatory framework so that they know what is allowed and what is not.

Ruled in or ruled out?

Like the biotechnology of the 1970s, geoengineering cannot be treated just as science-as-usual. There are, however, important differences between the subjects. One is that in the 1970s it was clear that the
ability to move genes between creatures was going to bring about a huge change in the practice of science itself, and biologists were eager for that to happen. Modern climate scientists, by contrast, usually see geoengineering research as niche, if not fringe, stuff. Many wish it would go away completely. Another difference is that in the 1970s there was a worry that DNA experiments could in themselves present dangers. With geoengineering the dangers are more likely to be caused by large-scale deployment than by any individual scientific experiment.

There are two broad approaches to geoengineering. One is to reduce the amount of incoming sunlight that the planet absorbs. The other is to suck carbon dioxide out of the atmosphere and put it somewhere else. The second of these approaches is not particularly in need of new regulation. Whether the carbon dioxide is captured by real trees, as some would like, or by artificial devices, environmental problems caused by the process would be local ones at the site of the sucking. Underground storage of the captured carbon would be regulated in the same way that carbon dioxide sequestered from power stations might be—again, for the most part, a local matter. Even the most potentially disturbing suggestion, which involves fertilising the oceans with iron in order to promote the growth of planktonic algae (in the hope that they would sink to the seabed, taking their carbon with them), can be covered by the London Convention on marine pollution, which regulates dumping at sea, and has already addressed itself to research in the area.

Reducing incoming sunlight, by contrast, is fraught with danger. While it is possible to imagine doing so in a way that cancels out the change in average temperature caused by an increase in carbon dioxide, such a reduction would not simply restore the status quo. Local temperatures would still change in some places, as would ocean currents, rainfall patterns, soil moisture and photosynthesis. Sunshine reduction, then, clearly needs to be regulated. (It also needs to be renamed: these techniques are currently referred to as "Solar Radiation Management", a term invented half in jest that has somehow stuck.)

One set of small-scale sunshine-reduction experiments discussed in Asilomar would send plumes of various sulphurous fluids in the stratosphere to find out which would best produce a haze of small particles similar to those that cool the planet after a large volcanic eruption. Another would attempt to whiten clouds over the oceans by wafting tiny salt particles up into them. Thus enriched, the clouds would, in theory, tend to have more, smaller droplets in them. More droplets mean more reflection and less sunshine down below. A team of scientists and engineers that calls itself Silver Lining is working on this idea, with some of its research paid for with money from Bill Gates.

In both cases, the experiments would be tiny compared with what people are already doing. In the week of the Asilomar meeting Science published evidence that more pollutants than previously appreciated, including oxides of sulphur, are getting into the lower stratosphere. Exhaust gases from shipping already brighten clouds over various bits of the ocean, and in so doing are thought to cool the Earth appreciably. As new regulations clean up shipping fuels in order to improve air quality in coastal regions, that brightening effect will be reduced, adding to the world’s warming in a sort of inadvertent reverse geoengineering.

Researchers in the field fear, though, that despite being much smaller than existing, inadvertent changes, their experiments will nevertheless become a focus for strident opposition unless there is a clear and respectable system of regulation. Without that, each experiment, however harmless, would be forced to serve as a proxy for the whole approach—a recipe for strangulation by protest and bureaucracy.

In retrospect, the Asilomar meeting may come to be seen as a step towards that respectable system, but probably only a small one. The participants did not produce clear recommendations, but they generally endorsed a set of five overarching principles for the regulation of the field that were presented recently to the British Parliament by Steve Rayner, a professor at the Saïd Business School, in Oxford.

The "Oxford principles", as they are known, hold that geoengineering should be regulated as a public good, in that, since people cannot opt out, the whole proceeding has to be in a well-defined public interest; that decisions defining the extent of that interest should be made with public participation; that all attempts at geoengineering research should be made public and their results disseminated openly; that there should be an independent assessment of the impacts of any geoengineering research proposal; and that governing arrangements be made clear prior to any actual use of the technologies.

The conference’s organising committee is now working on a further statement of principles, to be released later. Meanwhile Britain’s main scientific academy, the Royal Society, and the Academy of Sciences for the Developing World, which has members from around 90 countries, are planning further discussions that will culminate at a meeting to be held this November.
Producing plausible policies and ways for the public to have a say on them will be hard—harder, perhaps, than the practical problem of coming up with ways to suck up a bit of carbon or reduce incoming sunshine. As Andrew Mathews, an anthropologist at the University of California, Santa Cruz, puts it, it is not just a matter of constructing a switch, it is a matter of constructing a hand you trust to flip it.
WHAT the helicopter was to the Vietnam war, the drone is becoming to the Afghan conflict: both a crucial weapon in the American armoury and a symbol of technological might pitted against stubborn resistance. Pilotless aircraft such as the Predator and the Reaper, armed with Hellfire missiles, can hit targets without placing a pilot in harm’s way. They have proved particularly useful for assassinations. On February 17th, for example, Sheikh Mansoor, an al-Qaeda leader in the Pakistani district of North Waziristan, was killed by a drone-borne Hellfire. In consequence of this and actions like it, America wants to increase drone operations.

Assassinating “high value targets”, such as Mr Mansoor, often involves a moral quandary. A certain amount of collateral damage has always been accepted in the rough-and-tumble of the battlefield, but direct attacks on civilian sites, even if they have been commandeered for military use, causes queasiness in thoughtful soldiers. If they have not been so commandeered, attacks on such sites may constitute war crimes. And drone attacks often kill civilians. On June 23rd 2009, for example, an attack on a funeral in South Waziristan killed 80 non-combatants.

Such errors are not only tragic, but also counterproductive. Sympathetic local politicians will be embarrassed and previously neutral non-combatants may take the enemy’s side. Moreover, the operators of drones, often on the other side of the world, are far removed from the sight, sound and smell of the battlefield. They may make decisions to attack that a commander on the ground might not, treating warfare as a video game.

Ronald Arkin of the Georgia Institute of Technology’s School of Interactive Computing has a suggestion that might ease some of these concerns. He proposes involving the drone itself—or, rather, the software that is used to operate it—in the decision to attack. In effect, he plans to give the machine a conscience.

The software conscience that Dr Arkin and his colleagues have developed is called the Ethical Architecture. Its judgment may be better than a human’s because it operates so fast and knows so much. And—like a human but unlike most machines—it can learn.
The drone would initially be programmed to understand the effects of the blast of the weapon it is armed with. It would also be linked to both the Global Positioning System (which tells it where on the Earth’s surface the target is) and the Pentagon’s Global Information Grid, a vast database that contains, among many other things, the locations of buildings in military theatres and what is known about their current use.

After each strike the drone would be updated with information about the actual destruction caused. It would note any damage to nearby buildings and would subsequently receive information from other sources, such as soldiers in the area, fixed cameras on the ground and other aircraft. Using this information, it could compare the level of destruction it expected with what actually happened. If it did more damage than expected—for example, if a nearby cemetery or mosque was harmed by an attack on a suspected terrorist safe house—then it could use this information to restrict its choice of weapon in future engagements. It could also pass the information to other drones.

No commander is going to give a machine a veto, of course, so the Ethical Architecture’s decisions could be overridden. That, however, would take two humans—both the drone’s operator and his commanding officer. That might not save a target from destruction but it would, at least, provide room for a pause for reflection before the pressing of the “fire” button.
The Large Hadron Collider

Phew!
Mar 31st 2010
From The Economist print edition

The LHC is now operating in earnest

EIGHTEEN months ago CERN, Europe’s particle-physics laboratory, based near Geneva, switched on its latest toy. The toy in question was the Large Hadron Collider (LHC), and it was going to find all sorts of wonderful things, ranging from the Higgs boson (which is needed to explain why mass exists in the first place) via dark matter (which is needed to explain why the universe is as massive as it is) to miniature black holes (the densest concentrations of mass possible, which journalists of a more scaremongering disposition confidently predicted would eat the Earth up as soon as the machine was switched on).

Nine days after the fanfare, however, a leak in the cooling system put things on hold and they did not restart until last November, with a few gentle collisions between low-energy protons.

Since then, the LHC has been cranking up for serious operation and on March 30th it passed a milestone. There was less trumpeting this time, but protons were made to hit each other at energies higher than any accelerator had managed before. The Tevatron, in America, has officially been relegated to second place.

Once, that might have been a signal for a bit of quiet European gloating. Hubris, however, has been followed by nemesis rather too often in this field for anybody to be making a song and dance about things. Though there was cheering and champagne in the control room when the first high-energy beams collided, sighs of relief are more the order of the day.

Assuming there are no further glitches, the energy of the collisions will be cranked up over the next few months and the new subatomic goodies will start pouring out of the machine and into the pages of physics journals. Finding the Higgs boson is as near a racing certainty as exists in science. For the rest, those who fancy pitting their knowledge of physics against the pros can do so. Paddy Power, an online bookmaker, is offering odds of 11 to 10 that dark matter will be found before black holes and 8 to 1 that black holes will be first. Dark energy, a mysterious force thought to drive the expansion of the universe, trails at 12 to 1. And for those who fancy a real outside bet, the firm is also offering 100 to 1 that the machine will discover God.
Clearing space junk

Sweeping the skies
Mar 31st 2010
From The Economist print edition

A satellite that tidies up after itself

ARISTOTLE believed that the heavens were perfect. If they ever were, they are no longer. The skies above Earth are now littered with the debris of dead satellites, bits of old rockets and the odd tool dropped by a spacewalking astronaut. Such is the extent of the detritus that the first accidental collision between two satellites has already taken place. It happened in February 2009, when a defunct Russian *Cosmos* smashed into a functioning American *Iridium*, destroying both and creating even more space junk. To stop this sort of thing happening again Vaiois Lappas of the University of Surrey, in England, has designed a system that will remove satellites from orbit at the end of their useful lives—and as a bonus will scour part of the sky clean as it does so.

Dr Lappas’s satellite-removal system employs a solar sail. As light from the sun hits the sail, it imparts a minuscule but continuous acceleration. When a satellite is first launched, the sail is angled in a way that causes this acceleration to keep the satellite in orbit. (Orbits gradually decay as a result of collisions with the small number of air molecules found even at altitudes normally classified as “outer space”.)

Solar sails have yet to be used widely to propel spacecraft in this way—several earlier versions came unstuck when the sails failed to unfurl properly—but doing so is not a novel idea in principle. The novelty Dr Lappas envisages is to change the angle of the sail when the satellite has become defunct. Instead of keeping the derelict craft in orbit, it will, over the course of a couple of years, drag it into the atmosphere and thus to a fiery end. Not only that, but the sail will also act like a handkerchief, mopping up microscopic orbital detritus such as flecks of paint from previous launches. A fleck of paint may not sound dangerous, but if travelling at 27,000kph (17,000mph), as it would be in orbit, it could easily penetrate an astronaut’s spacesuit.

A prototype of Dr Lappas’s design, called CubeSail, will be launched late next year. It weighs just 3kg (7lb) and, when folded up, measures 30cm (12 inches) by 10cm by 10cm. Once unfurled, however, the sail will have an area of 25 square metres. If this prototype, which is paid for by EADS, a European aerospace company, proves successful, solar sails might be added to many future satellites. That would enable them to be removed rapidly from orbit when they became useless and would restore to the skies some measure of Aristotelian perfection.
An atheist and a Roman Catholic offer a fresh take on an old question

Jesus: A Biography From a Believer. By Paul Johnson. Viking; 242 pages; $24 and £17.99. Buy from Amazon.com, Amazon.co.uk

The Good Man Jesus and the Scoundrel Christ. By Philip Pullman. Canongate; 245 pages; $24 and £14.99. Buy from Amazon.com, Amazon.co.uk

WAS Jesus of Nazareth divine or human, or did he combine both attributes in a unique, mysterious way? On every page of the Gospels there are passages that have been used as evidence on one side or the other of that 2,000-year-old discussion. Traditional Christian theology offers subtle, mind-bending formulas which aim to settle the matter in so far as it can be settled within the limits of human language. But for many ordinary believers, the question is just a paradox that they are forced perpetually to grapple with without ever quite resolving it.

Nowhere is the paradox thrown into sharper relief than in the readings that will be heard by hundreds of millions of people, from Mexico to Vladivostok, on April 4th. (This is a year when the rotating calendars of the Christian West and the Christian East agree on the same date for Easter Sunday.) According to those readings, the resurrected Christ is not a ghost but a flesh-and-blood human being, who breaks bread and consumes fish. But he is not instantly recognisable; it is not his physical attributes but a “burning in their hearts” that tells the world who he is. And when Jesus successfully challenges his sceptical disciple, Thomas, to touch his wounded hand, the gasped response is not simply relief at the return of an old, human friend, but...”My Lord and my God.”

Two new books, one by a British journalist who is a Roman Catholic and the other by an atheist novelist whose cultural reference-points are Christian, offer modern responses to the Jesus paradox.

As a commentator (once on the centre left but now on the traditionalist right) and a writer of big, broad works on history, Paul Johnson has the literary skills to make a compelling narrative out of the Gospels’ disjointed account of the words, deeds, death and resurrection of Jesus. As a Catholic, he is committed to the belief that Christ was both "True God from True God” (in the words of the Nicene creed) and a man...
who experienced sorrow, temptation, loneliness and all the other features of human life. But he explains in the opening pages that he considers it “futile” to delve into divine realities, and will therefore focus on the earthly life of Jesus.

Dedicated to his late mother “who first taught me about Jesus” and with a subtitle that makes his own position crystal-clear, this is a book that some readers—especially non-believers—may find sentimental or cloying. It assumes the Nativity stories are more or less literally true, skirting round the problems posed by differences between the accounts of Luke and Matthew. But there are some good observations about the differences between the Gospels and other contemporary texts; Mr Johnson notes the prominent role played by women and the empathy of Jesus with female dilemmas. He shows how Jesus mixed compassion for children and their parents with insistence that ultimately, obedience to God supersedes family ties.

Philip Pullman addresses the apparent separateness of his subject’s divinity and humanity in a far more provocative way. Brought up by a clerical grandfather, Mr Pullman is a declared adversary of organised Christianity and is best known for his bestselling children’s trilogy, “His Dark Materials”. As he tells the Gospel story, Mary did not have one son but twins—a gifted but pious and humble one called Jesus and his more calculating and sophisticated brother, Christ. Observing his modest sibling, Christ concludes that the story needs to evolve in certain ways if the wandering faith-healer’s work is to become the basis of a world religion. In the end Christ colludes with his brother’s death and helps, directly and indirectly, to construct a new narrative about his resurrection. When the disciples meet their risen master, it is really Christ they are encountering, not his twin, Jesus.

Many Christian readers will recoil in horror at Mr Pullman’s plunge into heresy. But he is wrestling with the same question they are: how divinity and humanity could co-exist in the founder of their religion. Thomas wondered about that, too.
Let Our Fame Be Great: Journeys Among the Defiant People of the Caucasus. By Oliver Bullough. Allen Lane; 496 pages; £25. To be published in America by Basic Books in August. Buy from Amazon.co.uk

WESTERN colonialists have often behaved abominably but they usually repent of it later. Move east, though, and the picture becomes cloudier. Few now remember what happened to Circassia. As the Ottoman empire crumbled in the mid-19th century, Russia conquered the loosely held Turkish domains on the north-east coast of the Black Sea—and huge numbers of the anarchic, steely Circassian tribespeople died in what would today be termed a genocidal colonial war. Many more fled the killing grounds, crossing the Black Sea in leaky and overcrowded ships, many of them to die miserably in now-forgotten refugee camps on the Turkish coast. Around half the Circassian population of 2m perished.

Oliver Bullough’s first book marks him out as a distinguished researcher, observer and narrator. The opening chapters deal with a part of history wholly neglected in Russia. It is as if Americans had never heard of the Sioux, and Wounded Knee had become a tourist resort where the events of 1890 had faded from memory.

That is pretty much how surviving Circassians now see the 2014 Winter Olympics in Sochi, which 150 years ago was the site of their final and greatest defeat and massacre. Mr Bullough tracks down their remnants, determined and despairing by turns, in Russia and in exile. His quest takes him from dirt-poor villages in Kosovo to influential bits of Jordanian officialdom. He paints a haunting portrait of a people blown to the winds by a forgotten storm.

His research is formidable. He unearths long-buried contemporary accounts of the killings, and desperate pleas for help buried in old files in the British Foreign Office. He matches this with accounts of the contemporary diasporas, often both nostalgic for what they have lost and disgusted by what they find when they return.
If the tsarist conquest of the northern Caucasus was savage, what followed under communism was worse, including the Stalin-era deportations of whole nations to the steppes of Central Asia. A particularly harrowing account is of a wartime massacre in the Cherek valley in Balkaria (a Turkic-speaking district next door to the former Circassia). Like the murder of Polish officers at Katyn, this was carried out by Stalin’s secret police, the NKVD—but then cynically blamed on the Germans. But whereas Poles have doggedly defended their history against falsifiers, the Circassians have been all but voiceless. One of Mr Bullough’s most powerful points is how little about the Circassians can be found even in works by specialist historians of the region.

The heirs to this history visit cruel, random destruction in terrorist attacks, bringing botched responses by the authorities. Mr Bullough unpicks the seizure, by terrorists claiming to be Chechen fighters, of the Beslan school in North Ossetia, a neighbouring republic in Russia’s Caucasus, in 2004. And he investigates the background of the women who have become suicide-bombers to avenge their husbands, sons and brothers—a tactic which, early indications suggest, was repeated in two attacks on the Moscow metro this week.

Russian and then Soviet rule brought literacy, electricity and roads to the region, and uprooted feudalism. But by Mr Bullough’s account, it would be a travesty to call that a civilising mission. It has come with a shocking mixture of brutality, incompetence and corruption, entrenching criminality on all sides.

“ILL Fares the Land” is poignant and arresting, both for who wrote it and for what it says. Its author, a British 20th-century historian at New York University, is dying of motor-neurone disease that has robbed him of movement and will soon rob him of speech. He dictated this *cri de coeur* about the need for social democracy to an amanuensis.

Social democracy, which Tony Judt calls “the prose of European politics”, is what Americans call liberalism. Though wounded as a theory, it limps on under assumed names as the practice of government on both sides of the Atlantic for want of credible alternatives. As an idealist, Mr Judt hopes for a revived social democracy that will again speak its name. As a realist, he recognises that it may be grievously, even terminally vulnerable.

He writes, he says, for the young, who have to deal with the mess he believes his own generation has made of Western society. He scolds it for letting inequalities grow. Not everyone will like the tone, although such charges are today harder to brush off than in the boom years. Preaching aside, his key point is sound: neither right nor left has any longer a plausible story to tell about the state.

Whichever label you use, liberalism or social democracy was the bipartisan outlook that underpinned American and European politics for 30 years after 1945. It achieved a balance between market and state. It oversaw a fruitful truce between business and labour that produced a golden period for capitalism with benefits all round. Then came stagflation, taxpayer revolts, fiscal crisis and a triumphant revival of free-market ideas. For the next 30 years, a new shrink-the-state “paradigm” ruled, with its own promise of open horizons and benefits all round. Now weakened and indebted governments are counted on for handouts from every side, banks and businesses included. Nobody is sure what to believe.

Though many will agree with that diagnosis, Mr Judt himself is hesitant about the cure. Ideally he wants another post-1945 social compact. But he is too aware of the internal conditions that made it possible—economic depression, sacrifice in war, the totalitarian shadow—to think it restorable on the earlier terms. The external conditions have changed utterly as well. The West has lost economic eminence. Increasingly social democracy must borrow from foreigners to pay for itself. That cannot last.

The future is not inevitably bleak for the Euro-American way. As the rest of the world grows richer, perhaps it too will see the benefits of a compact that, for those lucky enough to enjoy it, struck a unique balance between economic growth, social equity and personal freedom. Then again, perhaps not, he says. Mr Judt explores neither possibility in depth, ending instead with an eye cast back to the past century. How easily, he reminds readers, stable-looking societies can totter. His final case for social democracy is a “show-me-a-better-foxhole” plea. Nothing else looks more desirable. Without it, much that Western people value may be lost. “If social democracy has a future,” Mr Judt concludes, “it will be as a social democracy of fear.”
"I WAKE up every single night thinking, ‘What could I have done differently? What could I have said? What should I have done.’ And I have searched myself every single night. And I come back to this: at the time I made those decisions, I made those decisions with the information that I had. I can look right at you and say, this is a pain that will stay with me for the rest of my life…”

When Dick Fuld delivered these words to Congress, he was loudly berated for being insufficiently sorry for his role in the demise of Lehman Brothers—America’s biggest bankruptcy—in September 2008, a bankruptcy that triggered the near collapse of the global financial system. Yet Vicky Ward’s history of the last 25 years of the Wall Street investment bank, the final 15 under Mr Fuld’s watch, broadly supports the former chief executive’s assessment of himself. It offers no evidence of the alleged wrongdoing for which many people want to see him in court.

Indeed, writes Ms Ward, a contributor to Vanity Fair magazine, “despite appearances and the endlessly self-perpetuated myth of being a mighty gorilla, Dick Fuld was never truly synonymous with Lehman.” Instead of the domineering king of the Lehman jungle, Mr Fuld was in reality merely a “lieutenant” to two more powerful leaders of the firm who technically served under him, Chris Pettit and then Joe Gregory. Well, maybe.

Ms Ward’s account is engaging enough, though it suffers from the fact that both Mr Fuld and Mr Gregory refused to co-operate with her. She reveals little that is new about either man. Mr Fuld liked his staff, especially his executives, to be married and faithful and clothed in a suit and tie. He is flattered when his new chief of staff, after seeing a wildlife film, addresses him as Ntwadumela, Tswana for “He who greets with fire.” Mr Fuld insists his executives take their wives hiking during an annual retreat at his home in
Sun Valley, which provides the basis for an entertaining chapter entitled “Lehman’s Desperate Housewives”, though to be fair the complaints about husbands being slaves to their company could have been heard just as loudly at any other Wall Street firm.

Mr Gregory, president of Lehman until he was ousted just before the end, should have been focused on the firm’s ballooning balance-sheet. Instead he allowed himself to be distracted by a crusade to turn Lehman into a model of political correctness. Mr Gregory championed a gay, lesbian, bisexual and transgender network at the firm and hired 30 executives to run inclusion and diversity programmes. He was quickly nicknamed “the Oprah Winfrey of Wall Street”.

The reader learns that Pettit, who died in an accident in 1997, is regarded by some as a saintly figure who embodied Lehman’s legendary “One Firm” philosophy that later crumbled under Messrs Fuld and Gregory. Ms Ward received so much help from his family and friends that it unbalances her book. She even interviews Pettit himself, through a psychic, eliciting the scoop that Mr Gregory “deceived” and Mr Fuld “covers his tracks better”.

She provides a moving account of Lehman’s recovery from the September 11th 2001 attacks; it occupied three floors of the North Tower. How much did this survival, following an earlier escape from disaster at the hands of the failed hedge fund, Long-Term Capital Management, fuel Lehman’s sense of invulnerability, that persisted until the stroke of midnight?

Few readers will have the energy to take in more than one or two books on the financial crisis. The last days of Lehman have been described more comprehensively by Andrew Ross Sorkin in “Too Big To Fail” and with greater insider perspective and passion by Larry McDonald and Patrick Robinson in “A Colossal Failure of Common Sense”. As the death throes begin, Ms Ward paints Mr Fuld as increasingly out of touch, uninformed and unable to see how bad things had become: a gorilla in the mist, as it were. For that, at least, his defence team should be grateful.

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ENGLAND’S Lake District was “discovered” in the 18th and 19th centuries by a succession of brilliantly manic visionaries. Since then its blameless fells and lakes have served as a backdrop on which English sensibilities have been fervidly projected. Native idiosyncrasies such as Picturesque and Romantic ideals, the National Trust and National Parks are organically bound to the area. Ian Thompson gently deconstructs the myth that William Wordsworth invented this repository of the English soul, but he attempts only half a debunking: the Lakes still begin and end with the poet.

Mr Thompson’s approach deals summarily with geology, Herdwick sheep, mining and the Celts and Norse-Irish who bequeathed many of the place names to the eight valleys that, according to Wordsworth’s description, radiate “from the nave of a wheel”, a nub of rock formed by volcanoes as powerful as Vesuvius.

The thrust of the narrative, aided with illustrations including Mr Thompson’s pleasant photographs, hangs on a series of introductory and diverting potted histories of the Lake poets, writers, artists, climbers and charlatans who gave a remarkable profile to this relatively low-lying group of mountains in England’s north-west.

From the 18th century onwards outsiders, or “off-comers”, were harbingers of revolutions in taste who shaped the area with their competing views of it as either an Arcadia, a playground or a source of commerce. In 1724 Daniel Defoe recorded only “horrid mountains” in the district. But the chance combination of Georgian England’s fascination with the Alps, a passion fed by paintings by Nicolas Poussin and sightings on the Grand Tour, and the outbreak of the Napoleonic wars, which curtailed Englishmen’s travels to the Continent, spawned a national obsession with the “English Alps”.

In 1769 the first of the timorous poets, Thomas Gray, was on the scene shuddering pleasurably at the mountains’ “dreadful bulk”. A Jesuit priest wrote the first guidebook in 1778. And another cleric, William Gilpin, the father of the Picturesque movement, drew up a list of pedantic instructions on how to view the landscape. He quickly became the subject of satire.

But it is the legacy of Wordsworth, who became a tourist attraction himself, as Romantic, ecologist, guidebook writer, landscape gardener (of particular appeal to Mr Thompson, a landscape architect) and arbiter of taste that continues to inspire and provoke controversy.

Wordsworth’s Arcadia stood on the doorstep of a billowing menace—industrial Manchester. The poet was opposed to hordes of the city’s factory workers arriving at the Lakes by rail. His writings inspired other figures, such as John Ruskin and Beatrix Potter, to take up the role of defender and to protest against reservoirs, afforestation and, more recently, wind farms.

Mr Thompson treads an already crowded field. But he has raked up much engaging historic detail that runs from the mutton suet applied to Samuel Coleridge’s leather walking-boots to descriptions of mock sea-battles staged on the lakes. Moreover, in unstuffly if occasionally plodding style, he conjures the pungent cultural atmosphere with which the English, from elitists to the “proto-socialist” ramblers, have cosseted their most beloved scrap of wilderness.
European porcelain was invented 300 years ago in Germany. Or was it?

DISAGREEMENTS about art history in Europe can be just as heated as political squabbles. Three tiny glazed pots, decorated with cherubs, provide new evidence that European hard-paste porcelain was invented not in Germany, as has been thought for three centuries, but in England. German experts vehemently disagree.

The Chinese were the first to invent white, translucent hard-paste porcelain under the Tang dynasty (618—907AD) when they learned to fire a mixture of china clay and china stone at very high temperatures. The Chinese kept their recipe secret and with that their monopoly on production. In the mid-16th century Chinese porcelain began to be exported to Europe, first by the Portuguese and then also by the Dutch. European grandees quickly developed a craving for this elegant, exotic material. Increased supply only increased demand. Hundreds of thousands of pieces came to be traded in Amsterdam. Porcelain was so expensive that Europeans called it “white gold”. The race to discover how to make it in Europe was won in 1708 by Johann Friederich Böttger, working in the Dresden court of Augustus the Strong. Or so it was believed until the news about the little English pots.

The two slender lidded vases and a plump round bowl (pictured), standing barely three inches (7.5cm) high, were first listed in an English aristocrat’s inventory of luxurious bequests in 1683. A few years later they entered the collections of Burghley House, a stately home in Lincolnshire where they have been ever since. Earlier this year Burghley House issued a press release comparing the recent findings to learning that Russian astronauts had landed on the moon 25 years before the Americans. Ulrich Pietsch, director of Dresden’s famous porcelain collection (where Böttger’s pots are proudly displayed), answered with a press release of his own, refuting the English claims. Böttger’s discovery, Mr Pietsch reaffirmed, “is still to be regarded as the hour of birth of European hard-paste porcelain”.

Transactions, the bible of the small but influential English Ceramic Circle, has included a series of six
papers about the pots in its latest issue. The tone is academic, but the message is clear: the pots are hard paste; a European first.

Tucked inside one of the little vases is a slip of paper that reads "Lord Buckingham’s china". Inside the other, a note that has now gone missing, identified him as the patron of its manufacturer. The second Duke of Buckingham (1628-87) was one of England’s richest men and a keen amateur chemist. Did he really commission the pots? That is one of many questions examined in the first Transactions paper by Morgan Wesley, a young graduate who made the Buckingham pots the subject of his dissertation for his master’s degree. Mr Wesley is hugely excited by them. "In every way this little group is trendsetting and unique,” he says. Two more examples have now been discovered elsewhere. One is at Dunham Massey, another English stately home. A fifth pot was recorded in the royal collection at Windsor Castle but has since been lost.

John Mallet, sometimes called the pope of porcelain, wrote the last article in the Transactions series. He discusses the vexing question of how to define hard-paste porcelain. He points out that the recipe used in the Buckingham pots differs from Böttger’s, and both differ from that used by the Chinese. In his view the little pots are close enough to “represent a clean break” with previous Western experiments. They have a claim to be Europe’s earliest hard-paste porcelain, he concludes.

Böttger will remain important whether or not he is considered the first. The Wright brothers were not the first to fly, but they are still regarded as the fathers of manned flight. Böttger’s discoveries enabled Augustus the Strong to open a factory to produce hard-paste porcelain at Meissen. Its initial goal was to replicate Oriental wares. Soon something entirely new and marvellous occurred. Hard-paste porcelain with a European aesthetic was created.

The early Meissen menagerie of life-size, hard-paste creatures on view in Dresden is a breathtaking example of what the porcelain inventors achieved. Lord Buckingham’s china was a crucial step along the way. The three pots are beauties with a remarkably powerful presence. Spotlit in their own vitrine, they dazzle visitors to “Art in Miniature”, a special exhibition at Burghley House until October 31st. Their maker clearly knew what he had achieved.
Wolfgang Wagner, custodian of the Bayreuth Festival, died on March 21st, aged 90

THE very moment he came into the world, breech-born, at Bayreuth, Wolfgang Wagner’s life was mapped out for him. His aunts Eva and Daniela, leaning over his cradle, could discern already “the Master’s” nose and chin, and imagine his baby lips babbling the prelude to “Die Meistersinger”. Growing up in his grandfather’s house (Wahnfried, or “peace from illusions”), his wrestling-ground was the Master’s grave in the back garden, his dressing-up costume a Nibelung’s cloak and horned helmet, and his playroom the prop-store at Richard Wagner’s own Festspielhaus on the green hill, among the wooden models of gods awaiting their downfall. He was seldom allowed on the top floor at Wahnfried but, when he was, he would daringly tickle the unmoving feet of his grandmother Cosima, lying in black on her huge chaise longue, while his sisters brushed her full grey hair.

But Wolfgang was the second son. This meant that responsibility for the treasure of Bayreuth, the shrine built especially for his grandfather’s compositions and the annual festival devoted to them, was bound to devolve to his elder brother Wieland. Everyone applauded Wieland’s “fabulous brilliance” at interpreting the works. Little brother Wolfgang, on the other hand, was straightforward, practical and plodding. He made a chicken run at Wahnfried, selling the eggs to his mother at market prices. He liked the technicalities of sawing and hammering, pounding his own anvil like the thieving dwarf Alberich of “Das Rheingold”, and no job around the Festspielhaus was too humble for him to do.

Underneath that easygoing surface, though, with its thick Franconian inflections, ambition and resentment burned in Wolfgang’s breast. He went to war in 1939, getting hurt in Poland, while Wieland was given a deferment for his genius. He was not included in Wieland’s “fireside chats” about festival planning, “evidently thinking he could achieve better results by dispensing with my presence”. And yet, from a stint at the Berlin Staatsoper, he knew about staging musical dramas. As American bombs began to pound Bayreuth in 1945, it was he who rescued the busts, pictures and autograph scores from Wahnfried, stuffing them into rucksacks on his bike and pedalling them to safety. And when the festival resumed in 1951, out of the ruins, his commercial flair found, from somewhere, sponsors and money.

So when, in 1966, Wieland died suddenly, there was no doubt in Wolfgang’s mind that he should take over. Nor did he doubt that he should sit there, crouched over the Festspielhaus like the dragon Fafner over his hoard, until he died. No one else was remotely suitable. Certainly not his meddling sister Friedelind, who had turned her back on Germany and skipped off to America; nor Wieland’s pushy wife
Gertrud, who had said “defamatory” things about Wolfgang on television; not Wieland’s son, Wolf-Siegfried, who seemed to think he could drift into Bayreuth’s top job without hard work or training; nor, as the years rolled by, his own children from his first marriage, the sniping Eva and that unspeakable leftist “crackpot”, Gottfried.

**Bedtime with Hitler**

Controlling Bayreuth, in Wolfgang’s terms, was not just a matter of organising directors, conductors, money and, in 1973 and 1986, legal instruments to ensure that the family, meaning him, kept its grip on the festival. He also had to keep the heritage pure. In fact he was not over-pious, refusing to see his grandfather’s sets, even for the sacred “Parsifal”, as holy relics; he ignored letters accusing him of betraying German culture when he allowed a communist salute during “Tannhäuser”, or when a French “Ring” of 1976 put turbines on the Rhine and turned the Rhine-maidens into whores. He liked to think of Wagner’s works as Greek tragedies, of fresh and universal human importance.

Nonetheless, because the Nazis had commandeered them, and because most of the family had been only too happy to go along, there was much purifying to be done. So Wolfgang hid away, in his motor-cycle sidecar in the garage, the film he had shot of Hitler, known as “Uncle Wolf” to him, happily strolling round Wahnfried in the 1930s. Presumably he buried deeper the memories of Hitler telling bedtime stories. His mother’s devotion to “our blessed Adolf” remained acutely embarrassing; but Wolfgang, who had never joined the Nazi party, proclaimed that he himself had nothing to repent of. It was not his fault that Hitler had loved his family.

For himself, he loathed it. As long as his health allowed, he kept them all at bay—save Gudrun, his second wife, who died before him, and his daughter Kati, who now succeeds him. His life was not this squabbling brood, but the ten operas and music dramas his grandfather had left to the world. And though it could be argued that fiery Loge, foolish Wotan and impetuous Siegfried were not much improvement on the Wagners, Wolfgang at least controlled them. As the grasping antagonists sang on, gradually losing out to the tubas and bass trombones, he could make the set yawn open and shut like the giant circle from his 1970 “Ring” until, in the end, it swallowed them whole. The world ended then; silence descended; and the stocky second son, with his grandfather’s profile, would stride onstage and take a bow. 

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The annualised rate of growth of America’s GDP in the fourth quarter of last year was revised down by 0.3 percentage points to 5.6%. The S&P/Case-Shiller index of house prices in ten of the country’s leading cities fell by 0.2% in January, leaving prices unchanged from a year earlier. Only in Los Angeles and San Diego were house prices higher in January than they had been in December. On a seasonally adjusted basis, however, the index rose by 0.4% during January. An index of consumer confidence published by the Conference Board, a research firm, rose to 52.5 in March from 46.4 in February.

Britain’s fourth-quarter GDP growth was revised up by a tenth of a percentage point to 0.4%, leaving the British economy 3.1% smaller than in the fourth quarter of 2008. Britain recorded a current-account deficit of £1.7 billion ($2.8 billion), or 0.5% of GDP, for the last three months of 2009, compared with £5.9 billion, or 1.7% of GDP, in the preceding quarter.

After rising for 11 months in a row, industrial production in Japan fell by 0.9% in February. Output was still 31.3% higher than a year earlier. Consumer prices fell by 1.1% in the year to the same month.

Germany’s annual inflation rate rose to 1.1% in March from 0.6% in February.

Belgium’s inflation rate was 1.7% in March.

Brazil’s unemployment rate rose to 7.4% in February from 7.2% in January.
Output, prices and jobs
Mar 31st 2010
From The Economist print edition
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**MORE COUNTRIES** Data for the countries below are not provided in printed editions of *The Economist*

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% change on previous quarter, annual rate. 1* The Economist poll or Economist Intelligence Unit estimate/forecast. 2National definitions. 3% change on 2007=100. 4* Preliminary.
The Economist commodity-price index
Mar 31st 2010
From The Economist print edition

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<td>$ per oz</td>
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<td>1105.60</td>
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<td>+20.8</td>
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<td>$ per barrel</td>
<td>81.62</td>
<td>82.38</td>
<td>+3.2</td>
<td>+66.8</td>
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*Provisional  †Non-food agriculturals.
Trade, exchange rates, budget balances and interest rates
Mar 31st 2010
From The Economist print edition
<table>
<thead>
<tr>
<th>Country</th>
<th>Trade balance* Latest 12 months, Sbn</th>
<th>Current-account balance Latest 12 months, Sbn</th>
<th>% of GDP 2010</th>
<th>Currency units, per $ Mar 30th</th>
<th>Year ago</th>
<th>% of GDP 2010†</th>
<th>3-month interest rates, latest</th>
<th>10-year government bonds, latest</th>
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<td>19.8 Q3</td>
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<td>-0.8</td>
<td>0.79</td>
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**MORE COUNTRIES**

Data for the countries below are not provided in printed editions of The Economist

- Estonia
- Finland
- Norway
- Latvia
-_critically trade only
-‡The Economist Intelligence Unit estimates
-§Data downloaded from Bureau of Economic Analysis.
<table>
<thead>
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<th>Country</th>
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<th>one week</th>
<th>Dec 31st 2009 in local currency</th>
<th>Dec 31st 2009 in $ terms</th>
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<tr>
<td>Argentina (MERV)</td>
<td>2,404.8</td>
<td>-1.4</td>
<td>+3.6</td>
<td>+1.7</td>
</tr>
<tr>
<td>Brazil (Bovespa)</td>
<td>69,959.0</td>
<td>+0.8</td>
<td>+2.0</td>
<td>-0.9</td>
</tr>
<tr>
<td>Chile (IGPA)</td>
<td>17,646.5</td>
<td>-0.3</td>
<td>+0.1</td>
<td>+2.3</td>
</tr>
<tr>
<td>Colombia (IGBC)</td>
<td>12,042.2</td>
<td>+0.3</td>
<td>+1.8</td>
<td>+0.9</td>
</tr>
<tr>
<td>Mexico (IPC)</td>
<td>43,395.9</td>
<td>+0.1</td>
<td>+4.0</td>
<td>+9.3</td>
</tr>
<tr>
<td>Venezuela (I BC)</td>
<td>38,345.4</td>
<td>+2.6</td>
<td>+5.5</td>
<td>+14.1</td>
</tr>
<tr>
<td>Egypt (Close 30)</td>
<td>6,820.9</td>
<td>+2.4</td>
<td>+0.9</td>
<td>+9.5</td>
</tr>
<tr>
<td>Israel (TA-100)</td>
<td>1,160.9</td>
<td>+0.9</td>
<td>+9.0</td>
<td>+11.6</td>
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<tr>
<td>Saudi Arabia (Tadawul)</td>
<td>6,815.0</td>
<td>+1.1</td>
<td>+11.3</td>
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<tr>
<td>South Africa (JSEAS)</td>
<td>28,735.3</td>
<td>+1.0</td>
<td>+3.9</td>
<td>+3.6</td>
</tr>
<tr>
<td>Europe (FTSEurofirst 300)</td>
<td>1,079.3</td>
<td>+0.6</td>
<td>+3.2</td>
<td>-3.4</td>
</tr>
<tr>
<td>World, dev'd (MSCI)</td>
<td>1,201.1</td>
<td>nil</td>
<td>+2.8</td>
<td>+2.8</td>
</tr>
<tr>
<td>Emerging markets (MSCI)</td>
<td>1,093.1</td>
<td>+1.5</td>
<td>+2.0</td>
<td>+2.0</td>
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<tr>
<td>World, all (MSCI)</td>
<td>207.5</td>
<td>+0.2</td>
<td>+2.7</td>
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<tr>
<td>World bonds (Citigroup)</td>
<td>816.9</td>
<td>-1.4</td>
<td>-1.6</td>
<td>-1.6</td>
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<tr>
<td>EMBI+ (JPMorgan)</td>
<td>550.4</td>
<td>-0.3</td>
<td>+3.5</td>
<td>+3.5</td>
</tr>
<tr>
<td>Hedge funds (HFRX)</td>
<td>1,175.0</td>
<td>+0.4</td>
<td>+1.5</td>
<td>+1.5</td>
</tr>
<tr>
<td>Volatility, US (VIX)</td>
<td>17.1</td>
<td>16.4</td>
<td>21.7 (levels)</td>
<td></td>
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<tr>
<td>CDS5, Eur (Euraxx)</td>
<td>70.2</td>
<td>-2.6</td>
<td>+0.3</td>
<td>-6.2</td>
</tr>
<tr>
<td>CDS, N Am (CXLX)</td>
<td>100.6</td>
<td>-3.2</td>
<td>-7.4</td>
<td>-7.4</td>
</tr>
<tr>
<td>Carbon trading (EU ETS)</td>
<td>€ 12.8</td>
<td>-1.2</td>
<td>+0.9</td>
<td>-5.6</td>
</tr>
</tbody>
</table>
Global commerce was walloped by the global economic crisis. The World Trade Organisation reckons that the value of merchandise exports declined by a staggering 23% in 2009. The value of Japan’s shipments abroad shrank by 26% and that of Germany’s fell by 22%. America’s went down by 18%, China’s declined by 16% and South Korea’s decreased by 14%, the smallest fall among the ten biggest exporters. China’s smaller contraction enabled it to edge past Germany to become the world’s leading exporter. China accounted for 9.6% of the global total in 2009, while Germany’s share was 9% and that of America 8.5%. Six of the ten leading exporters last year were European countries.