The Republicans ride in
The Republicans ride in
Now they must prove that there is more to their cause than blind fury: leader

The world this week
Politics this week
Business this week
KAL’s cartoon

Leaders
America’s elections
The Republicans ride in
Silvio Berlusconi under pressure
A comedy that has gone on too long
Running the world economy
Finally, a talking-shop worth having
Smart systems
Living in a see-through world

Myanmar’s elections
The junta takes one small step back

Letters
On Colombia, Israel, libraries, smart-phones, water, stockmarkets, energy, gays, children, reluctance, spending cuts

Briefing
Myanmar’s election
Slowly, the army eases its grip
Myanmar’s tribal conflicts
Excluded

United States
The mid-terms
The latest thumping
The speaker
Passing the gavel
Barack Obama’s response
That tin ear
Economic policy
Countdown
The governors’ races
In the red
Ballot initiatives
Change we can do without
Lexington
And now on to the White House

The Americas
Brazil’s next president
Stepping into outsize shoes
Spying and corruption in Colombia
The dark side
Foreign investment in Canada
Not so fast

Asia
Rocky relations between China and Japan
Bare anger
A Russo-Japanese tiff
Unsettling territory
Indian corruption
Scam-flat millionaires
Freedom of speech in Singapore
You can cage the singer
Indonesian’s police
Cop killers
China’s ten-yearly census
The world’s biggest headcount

Search
Welcome shiyi18
My account
Manage my newsletters
Log out
Sunday November 7th 2010

Previous print editions
Oct 30th 2010
Oct 23rd 2010
Oct 16th 2010
Oct 9th 2010
Oct 2nd 2010

More print editions and covers »

Subscribe
Subscribe to the print edition
Or buy a Web subscription for full access online
RSS feeds
Receive this page by RSS feed

A special report on smart systems
It’s a smart world
A sea of sensors
Making every drop count
Living on a platform
Augmented business
The IT paydirt
Your own private matrix
Sensors and sensibilities
Horror worlds
Sources and acknowledgments
Offer to readers

Business
Business and bureaucracy
Snipping off the shackles
Bihar’s pro-business reforms
Paper tiger
Japanese bosses
From Walkman to hollow men
The defence industry
War on new fronts
Oracle v SAP
Maintaining fees
Face value: Martin Sorrell
King of the Mad Men
Schumpeter
The other elephant

Briefing
The global monetary system
Beyond Bretton Woods 2

Finance and Economics
The Fed’s big announcement
Down the slippery path
Pay at investment banks
Mutiny over the bounty
The yuan-dollar exchange rate
Nominally cheap or really dear?
Europe’s new regulators
Continental shift
Buttonwood
Accentuate the negative
Ambac’s fall
And then there was one
Microfinance in India
Discredited
Economics focus
Fail safe
Correction: Buttonwood

Science & Technology
Geoengineering
Lift-off

Books & Arts
Street life, street death

Middle East & Africa

The Israeli-Palestinian peace talks
Can Israel now say boo to America?

Elections in Jordan
Judging by turnout

Iraq's insurgency
Another spasm

Zimbabwe
Enough's enough—but what next?

Diplomacy over Western Sahara
Morocco v Algeria

Europe

Italy's beleaguered prime minister
A step too far

Greece's economic troubles
Pasok and its discontents

France's rigid labour laws
Labour pains

Nordic politics
Love in a cold climate

Ukraine's government
Life under Yanukovich

Latvia's new government
And for my next trick

Charismagine
A grim tale of judges and politicians

Britain

The treatment of veterans
The unmourned

Homelessness
Cutting out the middle men

The Anglo-French defence pact
Divided we fall

The Murdocks and Sky
Patience, Rupert

Pay for higher education
The cap fits

Pop-ups
Up, up and away

Strikes and trade unions
Struck out

Bagehot
Terror and dissent

Articles flagged with this icon are printed only in the British edition of The Economist

Yemen's local and global terrorism
No quick fixes

A history of parcel bombs
Going postal

Air freight and counter-terrorism
Turbulence

Bomb-making for beginners
Bangers

The Ambani brothers
A durable yarn

Bringing history to life
Ages of imagination

The rise of Asia
At America's expense

Cancer
With hope, farewell fear

Giuseppe Occhialini
Emporium of wonders

Obituary

Viktor Chernomyrdin

Economic and Financial Indicators

Overview

Output, prices and jobs

The Economist poll of forecasters, November averages

The Economist commodity-price index
Trade, exchange rates, budget balances and interest rates

Markets

Human Development Index

About sponsorship
Politics this week
Nov 4th 2010

America’s mid-term elections turned out much as predicted. The Republicans picked up at least 60 seats in the House of Representatives, giving them control of the chamber; John Boehner will replace Nancy Pelosi as speaker when the new Congress convenes in January. The Republicans also gained at least six Senate races, including Barack Obama’s old seat in Illinois. Although this is not enough to give the party a majority in the Senate, the Democrats will find it ever more difficult to overcome Republican filibusters. See article

There were mixed fortunes for candidates favoured by the conservative tea-party movement. Marco Rubio was elected to the Senate in Florida, as was Rand Paul in Kentucky. But Harry Reid, the Democratic majority leader in the Senate, beat Sharron Angle handily to retain his seat in Nevada, and it looked as if Sarah Palin’s preferred Senate candidate in Alaska had been defeated by Lisa Murkowski, the incumbent Republican who ran an independent bid after losing the primary. See article

California proved to be a bright spot for the Democrats. Barbara Boxer fought off a challenge from Carly Fiorina and kept her Senate seat, and Jerry Brown won the governorship by beating Meg Whitman, who spent $160m on her campaign.

The Republican tide swept the Democrats from power in many other races for governor, however. The Democrats will have to hand over the key to the governor’s mansion in Wyoming, New Mexico, Kansas, Oklahoma, Iowa, Wisconsin, Michigan, Ohio, Pennsylvania, Maine and Tennessee. See article

Dozens of state initiatives were also on the ballot. A proposal to legalise marijuana in California was defeated, but a measure to streamline the state’s dysfunctional budget process passed. Voters in Arizona and Oklahoma approved amendments to their state constitutions stating that people who refuse to take out mandatory health insurance will not be penalised. See article

Terror freight

Two cargo planes bound for the United States were discovered with package-bombs on board. The devices were found while the planes were on the ground in Britain and Dubai, the explosives hidden in printer-ink cartridges and addressed to synagogues in Chicago. Al-Qaeda’s offshoot in Yemen was suspected of being behind the plot, though it remained unclear whether its intention was to bring the aircraft down. See article

At least 117 Iraqi civilians were killed by insurgents during a five-day period, starting on October 29th, when a suicide-bomber killed 25 people in a town north of Baghdad. Two days later at least 52 people, mostly Iraqi Christians, were killed when a church in the capital was occupied by insurgents and stormed by security forces. Two days after that, another 40 people died in a series of bomb attacks, mainly in Shia districts, also in Baghdad. Presumed to have been the work of Sunni jihadists linked to al-Qaeda, it was the highest week’s death toll since American combat troops left Iraq at the end of August. See article

Preliminary results of a presidential election in Côte d’Ivoire, which is divided between north and south, gave the incumbent president, Laurent Gbagbo, a narrow lead over his main rival,
Alassane Ouattara, with a run-off expected in three weeks. Jacob Zuma, South Africa’s president, sacked seven members of his cabinet in one of the most drastic overhauls of government since apartheid ended in 1994.

Islands mentality
A long-simmering row between China and Japan over a group of contested islands in the East China Sea erupted again. The dispute between the two countries flared up when Chinese fishermen were arrested off the Japanese-controlled Senkaku islands (or Diaoyu in Chinese) in September. An offer by Hillary Clinton, the American secretary of state, to mediate was rejected by China. See article

There were also problems for Japan over more troublesome territory, in the Sea of Okhotsk, when Dmitry Medvedev became the first Russian or Soviet leader to visit the disputed southern Kurile islands. Russia seized the islands at the end of the second world war, in what Japan claims is an illegal occupation. Mr Medvedev said of his visit that “there are many beautiful places in Russia”. See article

Dilma does it
Dilma Rousseff, the chosen successor of Luiz Inácio Lula da Silva, won the run-off in Brazil’s presidential election, beating José Serra by 56% to 44%. On January 1st she will formally become Brazil’s first female president. See article

Gordon Campbell resigned as premier of British Columbia in the face of a tax revolt. He harmonised the Canadian province’s sales tax with the federal sales tax in July (as did Ontario), but a backlash saw support for Mr Campbell wilt.

Police in Colombia staged a raid on the office of the government agency that controls assets confiscated from drug-traffickers, in response to concerns that some of its employees were collaborating with organised criminals.

A centuries-old complaint
Mikhail Khodorkovsky, once Russia’s richest man, delivered a stinging speech on the last day of his trial for embezzling oil. The former tycoon, who is already serving an eight-year prison sentence for tax evasion, a conviction many see as politically motivated, lamented the arbitrary exercise of power by Russia’s rulers. See article

Britain and France signed treaties to deepen defence cooperation between the two countries. Aircraft carriers will be shared, a joint expeditionary force of 10,000 troops will be created and there will be co-operation on nuclear technology and testing. The two countries account for around half of all defence spending in the European Union. See article

A suicide-bomber detonated a device in central Istanbul, injuring 32 people. The Kurdistan Workers’ Party, the main Kurdish insurgent group, denied responsibility, although authorities claimed the bomber had links to the group.

Silvio Berlusconi’s private life became news again when it emerged that the Italian prime minister had personally intervened to secure the release from police custody of a 17-year-old
Moroccan showgirl. Displaying what some describe as his customary wit, Mr Berlusconi said it was better to have a fondness for pretty girls than to be gay. See article

The world this week
The Federal Reserve announced that it would buy $600 billion in Treasuries over the next eight months in a second round of “quantitative easing”. The decision to pump more liquidity into the American economy to bring down long-term interest rates and spur growth prompted modest rises in stockmarkets around the world. See article

Yields rose sharply on Irish and Portuguese ten-year government bonds, mostly in reaction to the European Union’s decision to back a Franco-German proposal to rewrite the rules on euro-zone debt. The proposal would shift the burden of rescuing countries that face a sovereign-debt crisis away from richer EU members, such as Germany, and towards bondholders. Jean-Claude Trichet, the president of the European Central Bank, warned that the plan would push up borrowing costs for the heavily indebted nations.

Cautious growth

America’s economy grew by 2% in the third quarter at an annual rate, according to the first official estimate, up from 1.7% in the second quarter. Consumer spending, the biggest component of demand in America, also rose again but still at a much slower rate than after previous deep recessions.

Spain’s Banco Bilbao Vizcaya Argentaria made its first big acquisition outside the Spanish-speaking market by acquiring a 24.9% stake in Garanti, Turkey’s second-biggest bank. BBVA launched a €5 billion ($7 billion) rights issue to help fund the deal.

Ambac, a bond insurer, gave warning that it could soon declare Chapter 11 bankruptcy protection. The company introduced insurance for municipal bonds in the 1970s, enabling thousands of local governments in America to secure their credit ratings, but it has teetered since the beginning of the financial crisis thanks to its exposure to mortgage-based loans. See article

AIA’s share price jumped by 17% on its stockmarket debut in Hong Kong’s biggest initial public offering. American International Group decided to float a 58% stake in its Asian insurance unit after a sale to Britain’s Prudential fell apart. AIG will use proceeds from the sale of shares, part of a series of divestments, to repay some of the bail-out money it has received.

The price of sugar hit a 30-year high amid forecasts of a sharply reduced harvest of the crop in Brazil and elsewhere.

On the road

General Motors commenced a long-awaited public offering of shares, as the American and Canadian governments gradually unwind the stakes they took in GM as part of its bail-out. The company hopes to raise $10.6 billion by offering 365m shares of common stock with an initial price range of between $26 and $29 and 60m shares in preferred stock.

BHP Billiton’s $40 billion bid to buy the world’s largest potash producer, based in Saskatchewan, was dealt a blow when the Canadian government provisionally rejected the deal.
A Hollywood drama

Metro-Goldwyn-Mayer filed for bankruptcy protection. The film studio submitted a restructuring plan pre-arranged with creditors that turns management of the company over to Spyglass Entertainment, which includes “Invictus” among the films it has recently co-produced. MGM was saddled with debt after a leveraged buy-out. It resisted a move by Carl Icahn, who owns a chunk of the debt, to force a merger with Lions Gate, a studio in which Mr Icahn holds a big stake.

British Airways reported its first profit in two years. Pre-tax income for the six months ending in September came in at £158m ($240m). The airline recovered from a loss it incurred between April and June, when cabin crews went on strike and an erupting Icelandic volcano caused disruption to flights. BA’s cargo business did well, with revenue up by 39%.

Net profit at Emirates grew by 351% for its half year, compared with the same period in 2009, to $925m. The ambitious carrier, based in Dubai, said revenue from its traffic in cargo was up by nearly 50%.

BP took an extra $7.7 billion charge related to the cost of its oil spill in the Gulf of Mexico, bringing its total charges so far to $40 billion. However, the energy company managed to make a headline profit of $1.8 billion in the third quarter, compared with a $17 billion loss in the previous quarter.

Britain’s information commissioner found that Google had committed a “significant breach” of the law by collecting data from wireless networks, and will review Google’s privacy-protection procedures. The internet company recently admitted that it had unintentionally gathered e-mail and password data in many countries while mapping its Street View service.

The world this week
KAL's cartoon

Nov 4th 2010

The world this week
America’s elections

The Republicans ride in
Now they must prove that there is more to their cause than blind fury

Nov 4th 2010

ONLY four years after the voters sent them packing, handing both chambers of Congress to the Democrats at the 2006 mid-terms, the Republicans are back. Voters then (and again in 2008) decided that Republican policies had blown up the deficit with unaffordable tax cuts, let the banks run wild, dragged America into two costly wars and produced a wretched harvest of stagnant wages, rising job insecurity and soaring health-care costs. Now they seem to have decided that they like Barack Obama and the Democrats even less.

The mid-term elections on November 2nd saw the biggest swing to the Republicans for 72 years (see article). With a few results still to come, they have picked up over 60 seats in the House of Representatives, for a solid majority of at least 50. In the Senate they gained at least six seats, though they will fall short of control there.

From Barack to Boehner

For Mr Obama, the lesson is simple enough: sharpen up, and prepare for a tough two years. Yes, this was hardly an enthusiastic vote for his opponents, more a howl of rage against incumbents from citizens struggling after the worst slowdown since the 1930s. And he has a string of legislative achievements to his name. But plenty of centrists plainly fear that he has drifted too far to the left, that he dislikes business and that he does not understand middle America. He looks a far less competent figure than he did two years ago. With a hostile House and a gridlocked Senate, the chances of passing any big new laws are remote; and Republican victories in crucial swing states such as Florida, Michigan, Ohio and Pennsylvania will make the president’s re-election battle in 2012 a lot harder. If Mr Obama is to win again, he needs to move back to the pragmatic centre of what is still a pretty conservative country.

But so do the Republicans. If the road ahead for Mr Obama is filled with pot-holes, that in front of John Boehner, the next speaker of the House, is strewn with elephant traps. He has just inherited, along with Nancy Pelosi’s gavel, a trillion-dollar fiscal deficit coupled with a weak recovery that is generating hardly any new jobs. It is a Republican House that must now pass America’s budgets, decide whether to stimulate the stricken economy or tighten the purse strings, and figure out what to do about the government’s debt, which will soon bump up against the $14.3 trillion limit currently set for it by law. Whether Mr Boehner decides to work with Mr Obama or against him, voters will accord him a share of the blame if things continue to be miserable.

And what exactly does Mr Boehner head? It never pays to underestimate the American right. In the past two years of opposition, it has rediscovered one great strength, a belief in small government that George Bush foolishly shed. But this is clouded by three other things: fury, an absence of ideas and more than a little craziness. Much though the leaders of the tea-party movement claim the mantle of Ronald Reagan, they lack both the Gipper’s sunny optimism and his pragmatism.

Take for instance the thing the right affects to care about most: the deficit. To reduce America’s
debt involves cutting spending, increasing taxes, or a combination of both. Tax rises are anathema. But Republicans are strangely silent about what spending they would like to cut, apart from those inadequate old standbys, earmarks and government waste. No red-blooded conservative will touch defence expenditure at a time when America’s troops are in combat and the country faces toner-wielding terrorists and a rising China. Reforming entitlements, which mostly means chopping away at Medicare, the health scheme for the elderly, is the obvious place to start. But tea-partiers, who tend to be elderly themselves, are rather keen on that bit of big government. (Of course, Mr Obama has no credible plan to deal with the deficit either. But at least by backing a stimulus now he has a cogent answer to the immediate problem of the stuttering recovery.)

Mr Boehner is from the more sensible end of his party. He is surely aware that American elections are won in the centre. The tea-partiers, for all their energy, threw away at least two Senate seats, in effect, by imposing unelectable oddballs (including a self-confessed ex-witch) in states where Republican victory had been assured. But he will be under pressure to keep his base happy. And there will be the additional distraction of various Republicans, including perhaps Sarah Palin, jockeying for their party’s presidential nomination.

Who wants to live in a town called Nope?

It is easy to tell Speaker Boehner what not to do. Impeaching Mr Obama, for instance, as some of his newer recruits are keen to do, would be a huge mistake: a pointless distraction from far more serious issues. Blocking everything in sight in the hope of denying Mr Obama re-election may work against the Republicans, just as shutting down the government hurt them in 1995 after their last congressional takeover, and helped Bill Clinton to re-election the next year. Sabotaging Mr Obama’s health-care plans, as Republican leaders say they plan to do, is risky as well: the reforms are unpopular, but creating chaos, which is all the Republicans will be able to manage thanks to Mr Obama’s veto pen, could prove even more so.

In theory, there could be room for some form of useful grand bargain on the economy. Mr Obama could extend more help to small businesses, offer tax reforms that would make commerce simpler and generally do more to show that he understands how wealth is created. The Bush tax cuts, due to expire at the end of this year, could be extended and a short-term stimulus agreed upon. Mr Boehner and Mr Obama could work together on a convincing medium-term plan for bringing down the deficit, one which included entitlement reform.

The danger is that the opposite may happen. A deficit deal will prove impossible. Deadlock over the Bush tax cuts will see them expire, letting taxes rise sharply by default. Without further help from the federal government, cash-strapped states will sack employees and cut benefits next year. It is in everybody’s interest that Sheriff Obama and the Republican posse work together. But a shoot-out seems more likely.
Silvio Berlusconi under pressure

A comedy that has gone on too long

He is a survivor. But if he cares about his country, Italy’s prime minister should head towards the exit quickly

Nov 4th 2010

ANOTHER week, another forecast that Silvio Berlusconi may go. Italy’s 74-year-old prime minister, first elected 16 years ago, is a famously canny fighter. A new sex scandal, more mutinous murmurs by his former allies, the threat of an early election, claims that he abused his position by telephoning the police before they released a teenage girl suspected of theft: none of these may prove enough to lever the obstinate old goat out. But there is now an unmistakable feeling in the Italian air of an era drawing to a close.

Mr Berlusconi’s defenders are blaming the newspapers, the magistrates, the foreigners and his arch-rival (and erstwhile supporter), Gianfranco Fini, for their man’s difficulties. The Milan prosecutor has decided that the police followed proper procedures in releasing the girl. But nobody can disguise the truth that Mr Berlusconi’s approval rating among voters has hit new lows, or that Mr Fini controls enough votes in the lower house to bring down the government. Even some in the prime minister’s camp are starting to wonder if he has become such a liability that he ought now to go (see article).

Oddly some of Mr Berlusconi’s longtime critics are among those fretting that this would be unwise. They support the view he expressed this week that, at a time of new bond-market jitters and jangling economic nerves, Italy would suffer “great harm” if he were ousted, because it would enter a new period of political instability. They note that, thanks partly to the skill of the finance minister, Giulio Tremonti, Italy has steered clear of the credit concerns that have engulfed other countries like Greece, Portugal and Ireland. This may not be the right time, they conclude, to rock the political boat.

It is a tempting argument, but it is wrong. For the stability that Mr Berlusconi’s continuation in office offers is illusory. Every new scandal sucks his authority and exposes him (and, incidentally, his country) to renewed ridicule. With Mr Fini preparing to launch a new party and the Northern League, another party in the coalition, eager for an early election, the threat of a government collapse has become perpetual. The debt markets may not be concerned about Italy right now, because it skipped the banking and property bubbles that burst elsewhere. But in the longer term the colossal size of Italy’s public debt, the pension and health-care burden arising from its ageing population and its continuing loss of competitiveness are bigger worries than the odd bust bank.

Enough of the Burlesqueoni

In truth, what Mr Berlusconi really offers is not stability but stagnation. Far from steering Italy skilfully past the many dangers that confront it, his government has become almost totally paralysed. Mr Berlusconi’s legal and other preoccupations have distracted him and his ministers from the pursuit of any of the hard reforms that are necessary to restore the economy to long-term health. Even the first triumph of his current government, trumpeted so loudly after it was formed in 2008, the clearing up of garbage in and around Naples, has proved ephemeral: the stinking piles of rubbish are back.
This newspaper opposed Mr Berlusconi from the start. Many Italians have disagreed with us, convinced that only an outsider could bring change. Now they have nothing: just an ageing Lothario clinging to power. Radical reform demands a new champion, whether from left, right or centre, to take on entrenched vested interests and push the cause.

At the end of Leoncavallo’s opera “Pagliacci”, Canio the clown steps forward, after stabbing Silvio, to tell the audience “La commedia è finita.” The curtain should now fall on the tragicomic reign of today’s Silvio, too.
Running the world economy

Finally, a talking-shop worth having

The G20 has been a mild success. If it sticks to boring, pragmatic incrementalism, it might just remain one

Nov 4th 2010

ONE of the few winners from the global financial crisis was the G20, a group of the world’s biggest economies. These countries’ leaders have met four times in the past two years to chart a common response to the global recession and find ways to prevent a repeat. With big players from the emerging and rich worlds around the table, the G20 has a legitimacy that is lacking in other economic clubs, such as the rich-country-only G7. In the darkest moments of the crisis the G20 yielded impressive results, from a common commitment to fiscal stimulus to more resources for the IMF. Optimists hoped it could become something all too rare in international economic diplomacy: a talking-shop worth having.

Those hopes can be realised even though there are signs that the G20’s utility has faded as the world economy has recovered. The leaders’ last meeting, in Toronto in June, was a washout. It did nothing to reconcile widening divisions, particularly between Europeans and Americans, over the merits of short-term budget austerity. That feebleness has raised the stakes for the next gathering, in Seoul on November 11th-12th.

Global currency tensions are rising as America’s Federal Reserve embarks on a second round of “quantitative easing” (printing money to buy bonds, see article), as China resists allowing the yuan to strengthen much and as other emerging economies face a surge of capital inflows. If the G20’s leaders manage no more than another mealy-mouthed communiqué, many people will begin to suspect that it—like so many of the Gs—is a waste of time.

That would be a pity. For behind the scenes, under the energetic chairmanship of South Korea, the G20 has notched up a few notable accomplishments in recent weeks. There has at last been some progress in overhauling the IMF. A reform of the “quotas” that determine countries’ heft will increase the clout of emerging economies. Over-represented European countries have been cajoled into giving up two seats on the board. The IMF has also revamped its lending schemes so that well-run countries have access to large amounts of cash if a crisis hits. South Korea argued, rightly, that such a safety net is essential if emerging economies are able to withstand financial crises without piling up ever-larger foreign-exchange reserves. These are small but important improvements. And, thanks to the G20, they were done quite quickly (at least by the glacial standards of international institutions).

If the Seoul summit is to be a success, the G20’s leaders must apply the same approach—call it urgent incrementalism—to today’s main challenge: rebalancing global demand so that it relies less on overindebted America and more on domestic spending in vibrant emerging economies, particularly China. The process will take several years, and is complicated by domestic politics. In America the Republican victory in the mid-term elections reduces the already slim chances of progress either on short-term fiscal stimulus or medium-term deficit reduction. Fiscal gridlock means extra reliance on quantitative easing to boost the economy. That, in turn, will provoke extra capital flows to emerging economies. And since the main emerging economy, China, keeps its capital account closed and its currency pegged, the pressure on others is all the greater.
A Korean lesson for France

The G20 meeting will not magically resolve these tensions. But it can help manage them. It can provide a common analysis of how far countries’ currencies are over- or undervalued and where current-account balances ought to head. America has proposed limiting these imbalances to 4% of GDP. That is too rigid, but there is plenty of scope for the G20 to agree on the ranges countries’ current-account balances should reach.

Incrementalism, however, even of the urgent sort, may not be grand enough for France, which takes over the leadership of the G20 on November 12th. Nicolas Sarkozy, France’s president, has made clear that he wants a debate “without taboos” on the future of the international monetary system. He wants to tackle big subjects, such as the dollar’s role as a reserve asset (see article). Unfortunately, history suggests that big-picture debates on the future of the international monetary system rarely yield results, while diverting attention from smaller, practical goals. France should take note. The G20 will remain worth having only if it sticks to the art of the possible.

Leaders
Smart systems

Living in a see-through world

Clever use of ubiquitous technology will make the world much more efficient—but it has a dark side

Nov 4th 2010

COWS moo if they need to be milked, but otherwise they do not show a great desire to communicate—until now. A Dutch start-up called Sparked has devised a system that keeps track of a cow’s health. A sensor attached to the ear of the animal reads its vital signs and transmits a mass of data wirelessly to a computer, which crunches the numbers and sends a message to the farmer if, for instance, the cow is about to give birth.

Far from being just an anecdote from the animal kingdom, these networked cows are part of an exciting technological trend. As our special report in this issue explains, the physical and the virtual worlds are converging, thanks to the proliferation of sensors, ubiquitous wireless networks and clever analytics software. Increasingly there will be two interconnected worlds: the real one and its digital reflection.

If this sounds like science fiction, it is because “smart systems”, as the trend has come to be called, are still not widely understood. As sensors become ever smaller and more versatile, they find their way into an ever-wider range of things, from aircraft engines and buildings to alarm clocks and farm animals. There they gather huge amounts of data, which can be analysed and acted upon. Infrastructures are also becoming smarter, not least thanks to networked power meters. And “smart cities”, in which more and more systems are monitored and connected, are multiplying.

All this is to be welcomed. The more data there are, the more efficiently resources can be allocated. Smart cities are coming just in time to help cope with the rapidly expanding demands on urban infrastructure: some 350m people are expected to move to cities in China alone by 2025. Smart power meters can vary electricity rates to reduce peak demand. Such tricks make smart systems a crucial tool in tackling global warming. By one calculation, if America’s power grid were only 5% more efficient it would save the equivalent of the greenhouse-gas emissions of 53m cars.

Smart systems will also disrupt one industry after another. Because its pricey aircraft engines are packed with sensors, Rolls-Royce no longer needs to sell them, but can rent them, billing for the time they run. The firm can also offer to diagnose the health of an engine remotely. Across the economy, smart systems will hasten a shift from owning physical goods to running services. Economic value will migrate to data and the algorithms used to analyse them.

As with most new technologies, however, there is a dark side to all of this. Three areas in particular give cause for concern. First, the more connected the world gets, the greater the opportunities for hackers to wreak havoc, as the Stuxnet computer worm (apparently aimed at disrupting Iran’s nuclear programme) has recently shown. Second, smart systems offer autocratic governments Orwellian ways to keep people under control. Yet it is a third worry that will turn out to be more common: more sensors also mean less privacy. Consumers have only started to realise that every single thing they do online leaves a digital trace. Smart systems bring that fear offline too: meters will reveal what you eat; sensors will say how healthy you are; researchers even think they can use such data to show how people’s marriages are faring.
A matter of common sensor

Smart systems will become more and more complex, making it hard to grasp what exactly happens to the data they handle. Facebook, a social network, offers a glimpse of things to come. It now has a decent “dashboard” that allows users to decide how much information about them is made public. But most users struggle to understand what the settings actually mean.

In Western countries existing regulation should be able to deal with many of the privacy issues raised by smart systems. But not all. Governments will need to insist that these systems be as transparent as possible. One starting point is to change the default settings on smart gadgets (and for that matter Facebook) to the most private end of the scale, so consumers have to choose the more public options. Some firms may have to be forced to explain complicated products in the same way that the financial industry is obliged to explain its products to consumers—admittedly with mixed results. And in a few cases, firms should be obliged to lay open their systems’ inner workings (though not the data in them).

In the long run, smart systems will create more transparency but to get accepted they need to be less opaque themselves. Otherwise people are likely to rebel. Even in technophile California people have started to resist smart meters. There is much to be gained from a smarter world, but it will be possible only with the consent of its inhabitants.

Leaders
Myanmar's elections

The junta takes one small step back

However restricted, the first elections in 20 years might just mark the start of something new

Nov 4th 2010

CHINA will heap praise on Myanmar’s elections on November 7th. So long as Aung San Suu Kyi, a Nobel laureate, is released from house arrest on cue, ASEAN, the ten-nation Association of South-East Asian Nations, will attempt to label them a success. But much international opinion will condemn the exercise in “disciplined democracy” as a Burmese farce, scripted by the oppressive ruling junta.

International opinion is right. The poll is as false as the façades in Naypyidaw, the junta’s gaudy new inland capital. For all that, however, the vote might yet lead to an inkling of political, social and economic change in a benighted country. Whether it does will depend upon two shifts in Myanmar and one piece of self-restraint among its neighbours.

Stuff it up your junta

The foundation for change could hardly be less promising. The election is based on a contemptible new constitution that preserves a pre-eminent role for the armed forces in running the country’s affairs (see article). Swathes of insurgent-infested territory will have no vote. Those seats outside the gift of the army are beyond the grasp of many political parties, deterred by high registration fees, an absence of media coverage and a ban on prisoners joining political parties. The last of these limitations ruled out 2,000-odd opposition members banged up in jail. The most notable dissident of all, Miss Suu Kyi, under house arrest for most of the past two decades, has declined to test whether the ban applies to her too.

Even so, change can sometimes come from the bleakest beginnings. In the months leading up to the election the junta has organised a huge sell-off of state monopolies, infrastructure, factories, mines and buildings as people in or close to the army have feathered their nests. The process has stunk. But, as the International Crisis Group suggests, it betrays the fear among today’s holders of power that they will lose control of patronage networks in post-election Myanmar.

After all, the junta’s awful old guard under the cruel eye of Senior General Than Shwe looks as if it will cede much of the country’s running to a perhaps less awful younger guard. It is a veiled admission of the mess the generals have made of Myanmar. Even the main pro-government politicians have attempted to create space between themselves and the junta.
The retirement of the old generals is the first shift to watch in Myanmar. The second is what happens to Miss Suu Kyi. The opposition National League for Democracy (NLD) she leads is the biggest loser from the elections. Many within the party had wanted to contest them. But their leader refused: accepting this election would mean accepting the validity of the NLD’s stolen victory in 1990. A principled stand, but still probably wrong. It has ended up undermining those democrats who are contesting the elections, and the NLD’s non-participation has led to its legal disbandment as a political party. Yet even if the NLD is a spent political force, Miss Suu Kyi is not. She is expected to be released on November 13th. The restrictions the junta imposes on her after that will not mask her huge moral stature and widespread support. She should now press these into the service of national reconciliation, including among the country’s many ethnic groups.

Reconciliation is in everybody’s interests, neighbours included, which is where the self-restraint comes in. Last year China got a shock when floods of refugees crossed into Yunnan province fleeing from a government attack on insurgents. But China’s own business depredations in Myanmar, in everything from minerals to pipelines and ports, increase the risk of a backlash: its support of its cronies in government at the expense of local communities is hardly risk-free. China might not care about democracy, but it does want a stable neighbour.

If the army really does start to step back from the political front-line, there are historical parallels, particularly Thailand. With its recent history of turmoil and military coups, that country is hardly in a happy state at the moment. But by any reasonable measure the Thais are massively richer, freer and happier than the wretched Burmese are.
Letters

On Colombia, Israel, libraries, smart-phones, water, stockmarkets, energy, gays, children, reluctance, spending cuts
Nov 4th 2010

Chronicle of deaths foretold

SIR – Your article on the criminal threat to media freedom in Latin America was incomplete ("Shooting the messenger", October 23rd). The Colombian press has suffered at the hands of the drug lords, but not “especially in remote towns”. Reporters, editors and even publishers of leading national dailies were gunned down in the main streets of Bogotá, Medellín, Cali and other big cities. Such was the case of Guillermo Cano of El Espectador, whose newspaper was blown to pieces and whose assassination in 1986 triggered the first collective reaction of the Colombian press against the drug cartels, a media shutdown that left Colombia without television, radio and press for 24 hours.

This was followed by a series of detailed investigations into the Medellín and Cali cartels that were published and aired simultaneously by newspapers and broadcast on the networks. This was unprecedented in Latin American journalism, a turning point in our fight against the mafia and a message to Pablo Escobar and his henchmen that we would not be silenced.

It has been sad and costly that in all these years our Mexican colleagues refused to see themselves in the same light of our terrible experience. To talk of the “Colombianisation of Mexico” was offensive to their sense of national pride. Now they are avidly studying how the Colombian media dealt 20 years ago with the narco-terrorist threat. Better late than never.

Enrique Santos Calderón
President of the Inter American Press Association, 2008-09
Bogotá

An oath in Israel

SIR – Your article on the mixed Jewish-Arab city of Lod in Israel mentioned the proposed “loyalty oath” for new Israeli citizens, which defines Israel as “Jewish and democratic”. ("Pulled apart", October 16th). The oath is more complicated than it might seem. Whereas abroad the adjective “Jewish” generally pertains to religious affiliation, in Israel it does not: most Israelis are not religious. Here, Jewish is an adjective for the Jewish nationality just as “French” refers to the culture of the French people, or “Estonian” to the culture of Estonians. The wording is problematic in Hebrew as well, which is one reason why one alternative proposal was to refer to Israel as “the homeland for the Jewish people”, something Lord Balfour proclaimed in 1917.

In any case, the issue is still provoking heated debate in Israel. Fortunately, it now looks unlikely that the proposal will pass, rather ironically, because the Ultra-Orthodox minority in the country—less than 10% of the population—objects to the word “democratic”.

Laura Wharton
Councillor
Jerusalem City Council
Jerusalem
Book smart

SIR – I read your article on the efforts of national libraries to preserve material found on the web ("Born digital", October 23rd). With non-virtual collections the archivist’s job is to appraise what will be important in both the short-term and for centuries to come (it is what keeps us awake at night). The web, in many cases, is more equivalent to the millions of attics in homes that over the years have stored a person’s precious history.

Some of the material in the attics has proven invaluable and made it into the special collections of historical societies, universities or libraries. But most of the material that individuals saved has been lost or determined, rightly or wrongly, not to be important enough for preservation.

The libraries that are presently wringing their hands over collecting everything digital have abrogated this basic responsibility of appraising documents for the future. By blindly trying to grab it all they will most likely let some of the important gems disappear. It is a shame that thoughtful decision-making has been replaced by building warehouses for petabytes.

Barbara Haws
Archivist and historian
New York Philharmonic
New York

Google view

SIR – Your article on the patent wars in the smart-phone market left out one key player: the consumer ("The great patent battle", October 23rd). The flourishing competition among mobile platforms, devices and applications directly benefits consumers. In contrast, exploiting vague software patents to try to block open-source innovation neither helps consumers nor promotes the development of new technologies.

Innovation and competition, not litigation, are the keys to providing the new generation of products and services that is changing the lives of billions of people around the world.

Joshua Bloch
Chief Java architect
Google
Mountain View, California

Water plight

* SIR – Your article on dwindling groundwater ("Deep waters, slowly drying up", October 9th) rightly states that a better scientific understanding of freshwater aquifers is urgently needed to manage these life-sustaining resources. You note that the International Atomic Energy Agency is surveying the Nubian Aquifer. Yet our work in preserving and protecting freshwater is much more than a "sideline in environmental monitoring".

As a part of its mandate to promote the peaceful uses of nuclear energy and technology, the IAEA helps developing nations to use isotopes produced by natural radioactivity as tracers to understand rivers, lakes and aquifers. The IAEA’s global data derived from isotope surveys are used to better understand and predict the impact of climate change on the water cycle.

With nations struggling to deal with increased water scarcity, the IAEA is helping to create scientific assessments of aquifers within national borders to support their sustainable use and to strengthen co-operation among neighbours on shared resources.

Pradeep Aggarwal
A flash in the pan?

* SIR – Your description of what occurred in American financial markets during the “flash crash” of May 6th was spot on ("Autopsy", October 9th). The recent report by the staffs of the Commodity Futures Trading Commission and Securities and Exchange Commission was indeed an autopsy of what happened that day. Or, as your source put it using aircraft parlance, it was the “black box.”

Now, we need to learn from the autopsy and put the regulations in place so that another flash crash won’t happen. Already, that’s going on. The industry is reviewing circuit breakers and other “stop and take a deep breath” mechanisms that will pause trading if prices swing too far, too fast. Some futures markets use “price banding” to prevent the entry of orders that are well away from the product’s last transaction price.

Given the interrelatedness of markets, in America and globally, these types of “pause buttons” must be harmonised, to the extent possible, across all exchanges.

These measures, while important, are not enough. What is needed are the types of procedures the new Wall Street reform act will put in place. There will be more transparency and oversight, limits on speculation and appropriate backstops that will help to avoid another meltdown. The rules of the law are being written now and, when complete, will make markets more effective and efficient and devoid of fraud, abuse and manipulation, and hopefully, free of the need for another autopsy.

Bart Chilton
Commissioner
United States Commodity Futures Trading Commission
Washington, DC

High energy

* SIR – Buttonwood’s column fell prey to the (mercifully brief) “energy theory of value” fad of the 1970s (October 23rd). That proposition, picked up by Buttonwood, elevated the relationship between BTUs of energy input and output as one of central importance. But by that reckoning, electricity, for example, would be a clear loser since it takes many more BTUs of steam to produce a BTU of electricity; the point being that the comparatively higher dollar value of electric power trumps the dollar value of coal or other energy inputs. Money talks.

Joel Darmstadter
Senior fellow
Resources for the Future
Washington, DC

Homophobia in America

* SIR – I take exception to Lexington’s assertion (October 16th) that the public mood is not one that should have made Barack Obama’s position on gay rights a political embarrassment to him. America is currently witnessing a mounting surge in atrocious, abject homophobic activity, perhaps in direct correlation to the significant steps forward taken by gays and lesbians of which your columnist details.

Despite opinion polling showing a majority in favour of lifting the ban on don’t-ask-don’t-tell, the
“public mood” over the past month alone has been anything but sanguine towards homosexuals.

To overlook this detail is to overlook the continued condemnation of equal rights for gays by politicians and pastors, multiple incidents of wanton brutality committed in New York City against gay men, and a sick affliction consuming our schools and universities that has driven several bullied young children to take their own lives.

Adam Paul Levine
Los Angeles

Lifestyle choices

* SIR – Robin Schlinkert argued that an individual with children should pay less tax than a childless person on the same income, reflecting more the “ability to pay” (Letters, October 23rd). It is certainly not right, in this increasingly overpopulated world, that an individual who does not place an extra burden on the planet by choosing not to have children should be taxed the same as a person who does choose to have kids.

Clearly the childless individual should receive substantial tax relief in recognition of their selfless contribution to assuring the future sustainability of the planet.

Alan Stedall
Birmingham

A wrong word

SIR – Like the Japanese legal system I am reluctant, or unwilling, to expose your honourable selves to necessary correction. But I will no longer be reticent, or silent, and must point out that a fear of failure among officials would reinforce a reluctance, not “a reticence”, to test weak legal cases (“Prosecutors or persecutors?”, October 16th).

Warwick Ruse
Swanbourne, Australia

Promises, promises

SIR – It was disappointing to see you argue that the British government should have “wriggled out of” its commitment to maintain funding for the National Health Service when it unveiled its austerity programme (“Ouch!”, October 23rd). The commitment not to cut the NHS budget is one that was shared by each of the three main parties in May’s general election. It was prominent in the Conservative Party’s poster campaign and was repeated frequently during spring’s television debates. This was not a minor issue for the electorate: protecting NHS funding was a key sign from the Conservatives that they were not the same party of yore.

Fulfilling manifesto commitments is an important part of British politics and a useful tool for voters to assess a party.

Tom Page
London

SIR – You referred to the Tories’“savagery” in cutting public spending. There is nothing savage about refusing to spend money you don’t have. It is the tax increases to pay for the spending extravaganza that are “savage”.

Joseph Benning
Summit, New Jersey

SIR – Writing about austerity Britain's global ambitions (October 23rd), Bagehot mentioned that
America’s secretary of state, Dean Rusk, raged incredulously in 1968 when he heard of the British withdrawal “east of Suez”. Rusk could not believe that “free aspirins and false teeth were more important than Britain’s role in the world”. Philip Larkin, in his 1969 poem, “Homage to a Government”, wrote ruefully:

“Next year we shall be living in a country That brought its soldiers home for lack of money... Our children will not know it’s a different country. All we can hope to leave them now is money.”

A pity that Larkin is not alive to write a sequel reflecting the recent defence cuts unveiled by this government.

Timothy Fearon
Kington Magna, Dorset

* Letter appears online only
Myanmar's election

Slowly, the army eases its grip

An unfair and unfree poll stirs plenty of cynicism. But a political transition may be starting at last

Nov 4th 2010 | MYITKYINA AND YANGON

NO MATTER who you vote for, as a wag once wrote, the government always gets in. Nowhere is such cynicism more apposite than in military-ruled Myanmar, formerly Burma, which goes to the polls on November 7th. The elections are the first to be held since 1990, when the opposition won by a landslide. The regime refused to budge, rounded up its critics and annulled the results. Democracy activists howled at these and other cruelties, and Western governments responded by isolating Myanmar's dictatorship and imposing sanctions, to little effect.

This election should go more smoothly, from the army's point of view. The playing field is tilted firmly in favour of the junta's Union Solidarity and Development Party (USDP), led by the prime minister. The USDP has vastly outspent its opponents, most of them puny upstarts put together at short notice with paltry resources. Parties had to stump up a $500 deposit for each candidate—a year's wages in Myanmar—so most parties are contesting just a handful of seats. Of the 37 registered parties, only the USDP has nominated candidates for all 1,157 elected seats. The second-largest contender, the National Unity Party (NUP), is stuffed with old faces from the previous junta. To be on the safe side, an additional 25% of seats in local and national parliaments are reserved for military men.

The National League for Democracy (NLD), which won the 1990 election and presumably had a shot at doing well this time, is not standing in protest at the unfair conditions. Its leader and Nobel laureate, Aung San Suu Kyi, is under house arrest, as she has been for much of the past two decades, though her current term expires on November 13th. Over 2,100 other political detainees, including NLD members, student activists and Buddhist monks, are rotting in jail. Military censors are busy, as ever, with their red pens. No opposition rallies are allowed. This is the sort of "disciplined democracy" beloved of Myanmar's generals.

Unsurprisingly, the generals have told diplomats that international poll monitors will not be invited in, and nor will foreign journalists, with the exception of accredited local staff. A national referendum held in 2008 to approve a new constitution was equally opaque. It was also a farce. Villages voted en masse, ballots were prewritten and the results were tallied in secret in Naypyidaw, the gaudy new capital. The outcome was a 93% endorsement of a controversial charter. Some in Myanmar fear a repeat performance, as do many Western leaders.
Nonetheless, on the streets of Yangon, the ramshackle former capital (once called Rangoon), politicians are out hustling for votes and eagerly talking up their chances. Weekly newspapers carry extra pages of election coverage. Teashop gossip and foreign radio broadcasts fill in the gaps. This election will not be an exact rerun of the rigged referendum. Ballots will be tallied at individual polling stations, and candidates can send representatives to watch. Unofficial poll monitors will quietly fan out to check for any obvious hanky-panky. At least in urban areas, the voting may be reasonably free of tampering, though polling stations in the countryside, where most voters live, will be much harder to watch.

There is very little free or fair about this election; but, all the same, it offers a path of sorts to political progress. The opposition will gain a legal footing in parliament and in other institutions. The top brass is finally retiring. Unlike the junta, the USDP is not monolithic, and nor is the NUP. Business interests and political calculations, not blind loyalty to a clique of generals, will begin to guide them. Under the constitution, power will be dispersed. The army may slowly ease its stifling grip, provided it does not feel threatened. Leaders of most of Myanmar’s ethnic minorities, a crucial element of any political reconciliation, will be around the table. In elected assemblies in their homelands, they may dominate. But others are still fighting the junta or have been politically stymied, sowing the seeds of future friction (see article).

Entrepreneurs and professionals are among those most eager to see a change of government. Some are standing for election, either under the umbrella of large parties or as independents, and pushing a pragmatic line. “We can’t wait any more,” says Phone Win, a doctor who heads Mingalar Myanmar, an aid group. If elected in his Yangon constituency, he says he will focus on health and education reforms. Other moderates in the opposition camp are pinning their hopes on parliament as a forum to air economic issues. They argue that parties can find common ground in drafting economic laws, which require a simple majority to pass. Such legislation can be a “comfort zone” for military loyalists and their opponents, says Tin Maung Thann, a businessman and co-founder of Myanmar Egress, another NGO.

A spoonful of cooking oil

Many residents of Yangon would simply be happy to get electricity. Even posh residential areas and industrial zones are not spared from power cuts that add to the sense of a blacked-out city cut adrift by an army bunkered down in Naypyidaw. Life is not cheap in Myanmar. A clapped-out 1982 Toyota taxi costs as much as $12,000. A permanent SIM card for a mobile phone fetches over $1,000. The profits on these accrue to the junta and its cronies, part of a distorted economy that, far more than Western sanctions, deters potential investors in Myanmar. A torrent of dubious privatisations carried out earlier this year has put even more assets in the hands of these cronies.

While Western companies stay away, Myanmar’s neighbours are less finicky. The government said recently that it had approved plans for foreign direct investment (FDI) worth $16 billion in the second quarter of 2010. Astonishingly, this is said to equal total FDI pledged in the previous 20 years, though only a small amount was actually spent. Thailand leads the latest wave of investors, followed by China. By far the biggest single investment is going into an offshore gasfield operated by South Korea’s Daewoo International and twin pipelines being built to carry gas and crude oil across Myanmar to southern China, a project awarded to China National Petroleum Corporation.

Myanmar’s overall economy is hard to assess. The government has not published a budget for years. The banking system is dysfunctional. The central bank has only a tenuous hold on monetary policy. Much of the economy is undeclared and untaxed. Official data record double-digit growth, and to suggest otherwise is probably not a clever career move under the present regime. As a Harvard research team wrote in 2009, facts in Myanmar “are negotiated more than they are observed”.
Aid workers say that in reality the nation has been driven deep into penury. One describes a “silent disaster” unfolding in rural areas that were vulnerable even before recent flooding wiped out crops. Agriculture is in a desperate state. The rains came late this year in the Irrawaddy Delta, which bore the brunt of a 2008 cyclone that killed over 130,000. But most problems are manmade: villages lack power, roads, threshers and storage for the harvest. Private banks may not lend to farmers, and the government agriculture bank is moribund. Loan sharks and rice merchants are more reliable. But interest rates are sky-high.

The World Food Programme, which has sporadic access to some of the worst areas, estimates that the vast majority of people have to spend over 75% of their income on food. The Harvard study reported that cooking oil was being sold by the spoonful to those who could not afford a larger measure. In Asia only Afghanistan has a higher rate of child mortality. Almost one in ten children in Myanmar do not make it to five.

The 2008 cyclone opened the door a crack to more foreign aid. Humanitarian assistance has since risen modestly; more local aid organisations have sprung up to plug the gaps and help towns and villages respond better. But the political deadlock between Myanmar and its Western critics casts a long shadow over development assistance. America opposes new World Bank lending to Myanmar, which in any case is in arrears on its previous loans.

As with aid, international reactions to Myanmar’s election are likely to be as predictable as the vote itself. Led by China, most governments in Asia will probably hail the vote as a landmark. Western reactions are unlikely to be as positive. Since last year, the Obama administration and the European Union have adopted a policy of engagement, while maintaining sanctions on the regime. Exiled Burmese activists are lobbying Western politicians to deny the legitimacy of both the election and the government that emerges from it. These politicians are inclined to agree.

Kurt Campbell, America’s assistant secretary of state for East Asia and the most senior envoy to visit Myanmar under the new policy, has admitted that he was disappointed with the results. But he told Congress recently that this did not mean engagement had failed. He predicted that the upcoming election might create “new players, new power relationships, new structures”, a view that is shared by plenty of diplomats in Yangon.

**Will the Lady turn?**

The one dissident who could probably recast this debate is Miss Suu Kyi, the international face of principled resistance to military rule. It is hard to imagine that the election date was not chosen with an eye to her scheduled release, six days after the poll, from her latest term of house arrest. As usual, the regime has dangled her release as a sop to Western opinion. Even if Miss Suu Kyi were set free, however, the generals would be watching closely to see what she does next. So would many ordinary Burmese, whose reverence for “the Lady” is undimmed by her enforced absence.

But Miss Suu Kyi will no longer be the lone voice of political opposition in Myanmar. Elected MPs can rightly stake a claim to speak for their constituents. The junta that Miss Suu Kyi opposes, and insists on talking to, is preparing to dissolve itself. It is not clear that a new government would be obliged to negotiate with Miss Suu Kyi, whose formal position is secretary-general of the NLD, a party that no longer exists. It was disbanded after it opted out of the election, on the advice of its detained leader.

The Lady’s exalted status transcends her party. Whatever happens next, she will remain a potent
political force and a magnet for Western governments. Many have long assumed that the road to change in Myanmar led through her lakeside house in Yangon. But the country has altered since her last spell of freedom, and not simply in terms of political participation, says Thant Myint-U, a historian and former UN official. The changes include many more NGOs, foreign and local, the flood of new foreign investment and pressing environmental and economic concerns. “The rise of a new Asia will be all around,” he says.

While the NLD is boycotting the election, a breakaway group is taking part as the National Democratic Force (NDF). This has caused uproar among exiles, for whom compromise is a dirty word, and has further divided the opposition. NDF officials hope Miss Suu Kyi will respect their choice to participate in the election. But she may take the opposite tack, arguing that the entire process is illegitimate. By rejecting the election, she would paint herself into the corner with “the radical element”, says a prominent NDF backer.

If Miss Suu Kyi is one constant in Myanmar’s poisoned politics, the other is Senior General Than Shwe, a former postal worker turned junta leader. Characteristically, he has kept everyone guessing as to his future role. A crowd of ageing generals have been cashed out; some are running for parliament as civilians. This shake-up in the ranks clears the way for younger officers to steer the army; the next commander-in-chief will probably be in his mid-50s. But Than Shwe appears to have retained his position, for now. Some fear that he could seek the presidency and remain as head of state. Under the constitution, the upper and lower houses of parliament will convene to elect a president who will then appoint his own cabinet, who may or may not be MPs. Finally the junta would formally transfer power to a new administration within 90 days of the election. In theory Than Shwe, junta leader, could pass the torch to Than Shwe, president.

A more likely scenario is that the prime minister or others in his cabinet would use their USDP power base to seek the presidency. Than Shwe would then ease into an honorary position either as patron of the ruling party or the army, from where he could pull some strings. Than Shwe understandably fears being hung out to dry, as happened to his predecessor, General Ne Win, who stepped down in 1988 and was later arrested. Than Shwe may look enviously at Singapore, where the former prime minister, Lee Kuan Yew, holds the post of Minister Mentor, a title created for him. A formal role may not be necessary; when Deng Xiaoping, China’s paramount leader, died in 1997 his only post was chairman of the China Bridge Association.

A government dominated by recycled generals would not be not a clean break after half a century of military rule. But given the steady erosion of virtually every other institution in Myanmar—universities, the civil service, trade unions—no other group was likely to emerge on top. Many think the next election, in 2015, will mark the start of a more dynamic contest both between parties and within the ranks of the ruling parties. The USDP may then be ready to jettison some of the old guard, particularly if they show themselves incapable of managing the economy.

Will soldiers block the way to progress again?

The army is not about to go away. In addition to its 25% block in parliament, it will have far-
reaching constitutional powers that place a deliberate check on civilian politicians. The commander appoints the ministers of defence, interior and border affairs and can declare a state of emergency that overrides much of the government apparatus. Army commanders in the provinces will continue to demand the co-operation of local authorities. This is similar to the “dual-function” system of Indonesia under President Suharto until he was ousted in 1998. The army may eventually prefer to follow the path of neighbouring Thailand, reserving the right to intervene, forcibly, in politics if its interests are threatened, but otherwise steering clear of day-to-day affairs.

Such abstractions are remote from the lives of ordinary voters, whose hopes for change are tempered by apathy, self-preservation and cynicism. “If they tell me to vote, I’ll vote,” shrugs a bookshop-owner. Politics, like so much else in Myanmar, is ossified. Parties are long on lofty statements, short on anything resembling a policy, and the opposition spends more time squabbling than devising a common platform. The NLD is urging voters to stay home. The generals seem to be alarmed by the prospect of a low turnout, though the election laws do not require a quorum. A state newspaper warned on November 1st that if too many voters abstain, the government “will have no choice” but to stay in power and prepare for another election, which, it said, “will take a long time.”
Myanmar's tribal conflicts
Excluded
Tensions on the borders are rising
Nov 4th 2010 | YANGON

NOT everyone is eligible to vote in Myanmar’s election. Villages in strife-torn borderlands have been excluded from the ballot, though the overall percentage is lower than in 1990, before a series of ceasefires with various insurgent groups. A few are still fighting along the border with Thailand. Others have stopped fighting but are holding out for a political settlement and refusing to disarm until they get it. This bodes poorly for an end to a civil war that has sapped Myanmar’s resources, brutalised combatants and civilians alike, and provided a ready pretext for military dictatorship to keep the nation together.

The junta’s failure to co-opt or crush insurgent groups is a blot on its own copybook. Last August it staged a surprise attack on the Kokang, a recalcitrant ethnic militia, causing over 30,000 refugees to flee into China. The Chinese have since pressed all sides to stick to negotiations and keep a lid on tensions. Some minorities fear that the army will strike again in the post-election lull.

Tensions have risen in Myitkyina, the riverside capital of Kachin state, as the election has approached. Talks broke down earlier this year between military negotiators and the Kachin Independence Organisation (KIO), which signed a 1994 ceasefire that now appears to be fraying. The KIO has refused to put its troops under the army’s command, as the junta demanded. In retaliation the election commission struck pro-KIO politicians from the ballot. “The ceasefire is finished,” says a community elder. The KIO is busy recruiting and training fighters, while insisting that it will not strike first.

Upriver from Myitkyina, China’s designs on Myanmar’s natural riches have stirred more unrest. A giant dam is being built near the source of Myanmar’s mightiest river, the Irrawaddy, to the dismay of local residents and Kachin nationalists, who may have been behind the deadly bombings in April. Once completed, the dam will supply power to China, leaving Kachins to pay the environmental cost. A mini-gold rush is already poisoning the river and driving out residents. At the river’s edge a widow in her 40s pans for golden specks that may fetch a few dollars. She has no illusions about Myanmar’s democracy. “Kachin is rich in resources but we’re all poor. It’s because we have a bad government,” she says.
“TONIGHT,” exulted Rand Paul, the victorious Republican candidate for the Senate from Kentucky, “there’s a tea-party tidal wave.” And so, in almost all respects, there was. The Republicans, energised by the enthusiasm of tea-party activists, have picked up at least 60 seats in the House of Representatives. That exceeds even the Republican landslide of 1994 in scale, and gives the party its biggest majority since the 1940s. It more than undoes the Democrats’ gains of 2006 and 2008, and serves as a massive rebuke to Barack Obama. The president can no longer count on a Democratic majority in Congress to enact his agenda; he will now have to recast his presidency in the light of America’s abrupt jerk back to the right.

The Democrats did manage to hold on to the Senate, but by a much diminished majority, giving up at least six seats and perhaps a seventh once a recount is done. That constitutes the faintest of silver linings for the party in an otherwise dismal night. Senate races that had been considered toss-ups, in such states as California, Nevada and West Virginia, broke their way in the end. Despite Mr Paul’s exuberance, prominent tea-party candidates, such as Sharron Angle in Nevada and Ken Buck in Colorado, did not do as well as expected.

But that was remarkable only because the election was otherwise such a resounding triumph for Republicans. They prevailed in almost all the close races in the House. Many of the Democrats’ newer members, who were only there thanks to two successive swings against the Republicans in 2006 and 2008, were shown the exit. Centrist “blue-dog” Democrats, many of them in Republican-leaning districts, fared especially poorly. Even stalwarts found themselves booted out of office: Ike Skelton, a congressman of 34 years’ standing and chairman of the House Armed Services Committee; Jim Oberstar, who had racked up 36 years in the House, the last four at the helm of the Transportation and Infrastructure Committee; and John Spratt, a 28-year veteran who runs the House Budget Committee.

Republicans returned to areas they had been evicted from two years ago, such as New England. Democrats, meanwhile, lost many of their toeholds in the Great Plains, the Rockies and the South. The rustbelt, from upstate New York to Illinois, was a particularly barren wasteland for American liberals. The Republicans picked up dozens of House seats in the region, plus Senate seats in Illinois, Indiana, Pennsylvania and Wisconsin, not to mention the governorships of Michigan, Pennsylvania, Ohio and Wisconsin and chambers in the legislatures of every state.
touching the Great Lakes save Illinois and New York.

In all, Republicans appear to have gained at least nine governorships, and won control of 11 state legislatures (see article). That will give them a big advantage next year, when the states redraw their congressional districts. They will now run the show both in most of the states that will gain seats, such as Florida, Texas and Utah, and in most that will lose them, including Michigan, Ohio and Pennsylvania. That, in turn, could give them a further electoral edge that will last ten years, until the 2020 census prompts the boundaries to be redrawn again.

These Republican advances could also hinder Mr Obama’s re-election campaign in 2012. The results in the rustbelt will cause particular consternation in the White House, as they suggest that a patch of the country critical to his election victory has moved clearly to the right. New Republican governors in the region may be able to help rally their states to the Republican candidate. The much-trumpeted Democratic get-out-the-vote operation in states like Ohio, which relied in part on the legacy of Mr Obama’s campaign there two years ago, did not prove nearly as formidable as Democrats had hoped. The Democrats performed alarmingly badly in other swing states too, slipping from ten out of 25 House seats to just six in Florida, for example, and from six out of 11 in Virginia to just three. These are all states that swung to Mr Obama in 2008 and ensured his victory.

However, Democrats may find solace in the fact that American politics is in the throes of its most volatile period in over 50 years. The House has now changed hands twice in four years—the most rapid turnover since the early 1950s. None of the five elections from 1996 to 2004 involved big swings in control of Congress (“wave elections” in the parlance of psephologists). But there have been big swells at all three subsequent polls. Voters without any party affiliation, it seems, are increasing both in numbers and in fickleness.

Exit polls suggest that it was the defection of independents from the Democrats that sealed the Republican victory. They made up almost a third of voters, according to CNN, a television network, and plumped for Republicans by a margin of 18 percentage points. The Democrats’ normal advantage among women evaporated, and their handicap among whites and the retired grew markedly. They retained a clear edge with young people and minorities, but relatively few of those bothered to vote. CNN reckons that 18-29-year-olds made up just 11% of the electorate, compared to 18% two years ago.

A few races remain so close they are bound to be the subject of painstaking recounts and protracted legal battles (one such battle lasted eight months last time). A Republican candidate for the House in Virginia who fell short by less than 1,000 votes is refusing to concede defeat. The Senate race in Washington, in which the two candidates are separated by barely a percentage point, will hinge on postal votes that will take days to trickle in. And in Alaska, the apparent victory of Lisa Murkowski, a Republican who was defeated in the primary by a tea-party candidate and who then ran as an independent write-in candidate, will not be confirmed for several weeks, as electoral officials pore over each handwritten vote in her favour.
None of that, however, detracts from the Republicans’ thumping victory. Even their likely gain of six Senate seats is fairly weighty by historical standards. Ms Murkowski, if elected, will vote with them. They would almost certainly have prevailed in Senate races in Colorado, Delaware and Nevada as well had tea-party activists in those states not saddled the party with unappealingly radical candidates. But that seems a small price to pay for the tea party’s resuscitation of the moribund conservative movement of 2008.

Time to triangulate?

Republican leaders, including John Boehner, the party’s presumptive choice as speaker of the House, and Sarah Palin, the most prominent standard-bearer for the tea party, have called on Mr Obama to heed the voice of the electorate, rein in his profligate ways and co-operate with Republican efforts to deflate the federal government. But they will not be able to force him to do so, since the Democrats still control the Senate, and the president retains his veto over new laws.

Analysts see two broad strategies that Mr Obama might now pursue: either tack to the centre, and seek to cut deals with the Republicans in Congress, or embrace the prospect of stalemate and reject Republican initiatives as too extreme. Both carry risks, of annoying the Democratic base and perhaps inviting a primary challenge in 2012 on the one hand, and of offending the electorate by appearing to ignore the popular will on the other. But both have worked for Democratic presidents in the past: Bill Clinton won re-election by embracing popular centrist causes such as welfare reform after the Republican takeover of Congress in 1994, whereas Harry Truman prevailed in 1948 by denouncing the “do-nothing” Republican Congress elected in 1946.

In a press conference the day after the vote, Mr Obama’s response to the Democrats’ drubbing was more businesslike than self-abasing (see article). He threw out a few pious phrases about bipartisanship, and suggested that energy policy and education might be areas for co-operation with the Republicans. He even signalled a willingness to set aside his desire for a cap on America’s emissions of greenhouse gases and to amend some elements of his health-care reforms.

But he also seemed to reject the notion that the election results constitute “a repudiation of big government”, as Mr Boehner had claimed the night before. Instead, he cited voters’ deep frustration at the state of the economy. That is plausible: after all, voters have been telling pollsters that that is their biggest concern for months, and the Democrats’ losses had a lot to do with their supporters staying at home out of anger at a government that has not done more to help them. The results look wonderful for the Republicans, but most soundings found that the electorate still has a slightly dimmer view of the Grand Old Party than it does of the Democrats.

Yet many of the new Republican congressmen argue they have a mandate to pursue dramatic reforms. Mr Paul, for example, is determined to balance the budget—no mean feat given the projected deficit this year of 8.5% of GDP. Mr Boehner, among others, has declared that the Republicans will not compromise about the need to cut spending and avert looming tax rises—issues that will soon come to a head (see article).

When the Republicans initiated a duel with Mr Clinton over the budget after their previous takeover of the House, in 1994, voters sided with the president, helping to pave the way for his re-election. More seasoned Republicans fear history will repeat itself if they adopt a similar approach this time around. And the new Republican cadres may alienate the independents who
have just handed them such a big win in other ways too: many of them are eager to abolish whole government departments, crack down on illegal immigration, ignore global warming and resist advances in gay rights, among other controversial stances.

The Republican leadership will try to curb the most radical of their new recruits. But Mr Boehner has had trouble talking previous, less fire-breathing Republican caucuses out of doctrinaire stances. All Republican congressmen will be wary of showing signs of moderation for fear of prompting primary challenges at the next election. It will not help, of course, that so many moderate Democrats have lost their jobs. What is more, Republican grandees who see the election results as a sign of Mr Obama’s vulnerability in 2012, will soon start jockeying for the party’s nomination, with all the grandstanding that entails. The speaker-in-waiting, who wept with emotion at his party’s revival last night, may soon find himself overcome by the difficulty of marshalling his new troops.
The speaker

Passing the gavel

A loathed but effective Californian gives way to a sun-tanned golfer

Nov 4th 2010 | WASHINGTON, DC

AT THE start of a new session of Congress, the leader of the minority in the House of Representatives hands the gavel to the newly elected speaker. When Nancy Pelosi first became speaker, she joked, “After giving away the gavel in the last two Congresses, I’m glad someone else had the honour today.” That someone was John Boehner, then the leader of the Republican minority, and now the speaker in waiting.

Whereas Mrs Pelosi, a Californian off to the left of her party, is an even more detested figure for the right than Barack Obama himself, Mr Boehner is an obscure figure. In a Gallup poll in October 56% of respondents had an unfavourable view of Mrs Pelosi and 29% a favourable one, but 42% could not muster any opinion at all about Mr Boehner (he rhymes with “trainer”).

The ten-term congressman from Ohio is known chiefly for his unwavering tan, the butt of some teasing from Mr Obama. No wonder, then, that Mr Obama’s attempts to demonise Mr Boehner during the mid-term campaign fell flat. With his sun-kissed complexion, natty clothes and love of the links, Mr Boehner looks like a textbook country-club Republican. A former businessman, he is chummy with lobbyists: he was once spotted on the House floor handing out cheques from a tobacco-industry group to other members.

But Mr Boehner is not all back-slapping. He has never requested an “earmark”, meaning funding for a pet project slipped into a bill. He has suggested he will not let his fellow Republicans use them, either, when he becomes speaker.

His politics can be combative. He delighted right-wingers by throwing a copy of the Obama administration’s 1,100-page stimulus bill to the floor of the House with a thump in protest at its rushed passage and by shouting “Hell, no!” about the president’s health-care reforms. He has voted in line with the preferences of the American Conservative Union, a right-wing pressure group, 96% of the time.

All this gives Mr Boehner some credibility with his newly elected Republican colleagues. But he has struggled to keep his caucus in line in the past. Barely a third of them, for example, followed his instructions to vote for the first version of the TARP bill, though he did a much better job in rallying opposition for the stimulus and health-care bills. Eric Cantor, his ambitious deputy, is thought to be snapping at his heels. And the new Republican recruits, fired up by the party’s triumph at the election, will doubtless be on the lookout for any signs of ideological impurity.

All this may limit Mr Boehner’s ability to work with the Democratic minority or the White House. He has in the past co-operated across party lines on education reform. And he has promised to encourage more open debate as speaker, giving the minority more freedom to introduce amendments and eschewing the sort of procedural tricks the Democrats have used in recent years to squelch dissent and avoid awkward votes. But then again, Mrs Pelosi promised “we have an obligation to reach beyond partisanship to work for all Americans.” In practice, she spent most of her tenure rather effectively, but not very pleasantly, strong-arming recalcitrant Democrats.
and fending off Republican objections by hook, crook and gavel.

United States
Barack Obama’s response

That tin ear

An impenitent president

Nov 4th 2010 | WASHINGTON, DC

NOW it is official: Barack Obama does not do contrition well. The usual form after your party has had an electoral thrashing is to appear on television looking ashen and justly chastised, promising to heed the message of the voters and reform your ways. That is what Bill Clinton did with superb theatricality after suffering his own mid-term setback in 1994. Mr Obama’s manner in this week’s day-after White House press conference was one of sombre defiance, in which he appeared graciously to forgive voters for their natural impatience at the pace of economic recovery.

True, the president conceded that he had received a “shellacking” at the polls, and that “some election nights are more fun than others.” He accepted that the ultimate responsibility for the disappointment of voters rested with him. He claimed to be ready for compromise with the Republican leadership in the House of Representatives, offering to “mix and match” ideas and, where necessary, disagree without being disagreeable. “I’ve got to do a better job, just like everybody else in Washington does,” he said. But the strenuous efforts of the White House press corps to get Mr Obama to say that his policy decisions of the past two years on health care, the stimulus package or anything else might have been mistaken came to naught.

As to that mixing and matching, the president said that the parties ought to be able to work together on energy and education, hinted at flexibility on the expiring Bush tax cuts and allowed that he might “tweak” health care here and there. But he also gave warning against spending the next two years “relitigating” the battles of the past two. Perhaps mercifully, he was due to escape Washington on November 5th for the pomp of a ten-day visit to Asia. It will not be an easier town to work in when he returns.

United States
Economical policy

Countdown

Deadlines loom, but a gridlocked government may not be able to act

Nov 4th 2010 | WASHINGTON, DC

WALL STREET wisdom holds that political gridlock is good for the economy. When Democrats and Republicans are busy quarrelling, the theory goes, they have less time to tie up business in red tape or to bust the budget.

That wisdom is about to be tested. On October 29th the government reported that GDP grew no more than 2% at an annual rate in the third quarter, barely enough to keep joblessness from rising, much less to create work for the 8m who lost their jobs during the recession. Growth in the current quarter looks no healthier.

Meanwhile, a series of economic-policy deadlines looms over the next four months (see table). If Barack Obama and Congress cannot meet them, the result could be budgetary disarray and a damaging tightening of fiscal policy.

Mr Obama is proposing several scaled-down stimulus initiatives, such as $50 billion in infrastructure spending and a business-investment tax credit, and will probably press to renew expiring provisions of the old stimulus plan. Extended unemployment-insurance benefits, for instance, expire on November 30th, and Mr Obama’s “making work pay” tax credit on December 31st. But Republicans are unlikely to be receptive, having just won Congress by arguing that stimulus doesn’t work.

Just keeping fiscal policy from tightening unintentionally could prove a challenge. The federal government is now operating without a budget. Congress, unable to pass any of the necessary 12 appropriations bills for the fiscal year that started on October 1st, is relying on a stopgap “continuing resolution” that funds the government at existing levels, but only until December 3rd. Failure to pass a budget, or at least to renew the resolution, would force much of the federal government to shut down, as it did for 21 days in 1995-96 during a standoff between Newt Gingrich’s Republicans and Bill Clinton.

George Bush’s tax cuts all expire on December 31st as well. Mr Obama wants to keep them only for the 98% of households earning less than $250,000 a year. Republicans, and some Democrats, want to extend all of them. Without a deal, says Dave Greenlaw of Morgan Stanley, taxpayers will see the taxes withheld from their pay-cheques jump by an average of 12% in January. Finally, some time between March and April, Congress will have to vote to raise the statutory limit on how much the Treasury can borrow. The “debt ceiling” now stands at $14.3 trillion, about $600 billion above the current level of the debt. Failure to raise it could force huge spending cuts or even raise the spectre of default.

None of those things needs to happen. The bespectacled Eric Cantor, who is likely to take over as majority leader of the House of Representatives, recently told the Wall Street Journal that he did not want the government to shut down.

The elements of a compromise on taxes are already in place: permanent extension of the middle-class tax cuts, plus a temporary extension of the upper-income tax cuts. But there’s many a slip. Republicans have little incentive to co-operate during the post-election session, knowing they will
have far more leverage in January, when the newly-elected members take their seats. But the party’s much bigger “tea-party” contingent may make it even harder to strike deals then. Stalemate, even shutdown, could be in store next year.

Despite that, there are potential areas of agreement: Republicans will back Mr Obama’s efforts to complete a free-trade agreement with South Korea. They may also look favourably on any stimulus based on tax cuts not higher spending.

A bipartisan fiscal commission, charged with working out how to balance America’s budget, offers another possible meeting place. Rather than recommending the sweeping changes to taxes and entitlements that America needs, the commission, which is due to report by December 1st, will probably produce modest proposals to trim the deficit in the medium term that can win support from its own members. Even if Congress ignores them, Mr Obama could nevertheless incorporate them into his own budget proposal, which is due by February.

A fight over the debt ceiling could, in fact, force the two sides to negotiate. Or it could do exactly the opposite: prove that, in America, political gridlock makes rational fiscal policy impossible.
The governors' races

In the red

Republicans now control the majority of mansions. Tough work lies ahead

Nov 4th 2010 | CHICAGO

NO GOVERNOR had more help, if you can call it that, than Ohio’s Ted Strickland. Barack Obama visited Ohio nine times this year, becoming a regular in Youngstown, Columbus and Cleveland. “I implore you,” he begged voters on behalf of the governor last month. In 2006 Mr Strickland was elected with a 24-point margin. On November 2nd he was forced to concede, having lost by three points.

This year’s fight for Congress was matched by a tense battle in the states. Thirty-seven held elections for governor. Forty-six held elections for their legislatures, with a total of 6,115 seats in play. Money poured into Republican coffers. From January to September the Republican Governors Association (RGA) raised $59m, almost double what the Democrats could manage and an amazing three times the amount it had raised in the same period in 2006. Not surprisingly, Mr Strickland’s demise was echoed elsewhere. Republicans seized 11 governors’ mansions (though they also lost a couple) and hundreds of legislative seats. These tectonic shifts at state level may turn out to be even more important than those in Congress.

Republican gains were not universal. Democrats seized the governorship in Hawaii and, as The Economist went to press, seemed set to win those in Minnesota and Connecticut. The Republican assaults in Illinois looked likely to fail, as it did in Oregon. The biggest Democratic triumph was in California. Meg Whitman, the former chief of eBay, spent more than $160m on her campaign. It didn’t buy her love; and a fiasco with a former housekeeper didn’t help. Jerry Brown, the Democratic candidate, will become California’s oldest governor; when he became governor first, in 1974, he was one of its youngest.

Third-party candidates also fared rather well. In moderate Maine Eliot Cutler, an independent who had worked for the Carter administration, only narrowly lost to the Republican candidate. In Rhode Island Lincoln Chafee, a former Republican senator turned independent, won a tight three-way race with 36% of the vote. (Mr Obama, an admirer of Mr Chafee, did not endorse the Democratic nominee. The candidate said the president could “shove it”.)

These gains, however, were scanty compared with the Republicans’ victories. The mountain West, where Democrats had recently scaled their way to power, saw Republicans hold on to governorships or win them. In Nevada Harry Reid’s son, Rory Reid, never caught up with the Republican candidate. In Wyoming and New Mexico, Republicans replaced retiring Democratic governors.

But it was the economically battered Midwest that saw the most dramatic change. Ohio, Iowa, Michigan and Wisconsin—all now controlled by Democratic governors—will be led by Republicans from January. In Michigan Rick Snyder walloped his Democratic opponent by bragging about his managerial skills. In Wisconsin Scott Walker, a Republican county executive, rode a Republican wave that also submerged the state’s Democratic junior senator and two House seats. Incumbents in Ohio and Iowa, Mr Strickland and Chet Culver, respectively, were punished for their states’ economic woes.

Republicans also did well in state legislatures. They finally seized the chambers in Alabama and
North Carolina, remnants of the Democratic South. Chambers in Indiana, Michigan, Minnesota and Wisconsin were among those to fall. In all, Republicans now control more legislative seats than they have since 1928.

This has significance not just for individual states but for America as a whole. States will redraw congressional districts next year. Republicans’ seizure of the governors’ offices and state assemblies in Ohio and Pennsylvania, for example, will enable them to scratch out Democratic districts. New Republican governors will also be able to rally their foot-soldiers against Mr Obama in 2012. In 2008 Mr Obama won the swing states of Iowa, Michigan, New Mexico, Ohio, Pennsylvania and Wisconsin. All replaced their Democratic governors with Republicans.

These new state leaders may relish their political victories. Any satisfaction, however, will be short-lived. Revenues remain depressed and money from the federal stimulus is running out. States are likely to face $140 billion in budget shortfalls next year, according to the Centre on Budget and Policy Priorities, a research outfit. It is unclear how new leaders will close these gaps, without deeply denting their present popularity.
Ballot initiatives

Change we can do without
In deciding policies directly, voters proved small-c conservative

Nov 4th 2010 | LOS ANGELES

EVEN the supporters of California’s Proposition 19, the historic ballot measure that would have legalised marijuana, seemed surprised earlier this year when polls showed the Yes campaign in the lead. Usually, they cautioned, voters become more conservative, in the sense of cautious, as election day nears—and so it proved in this case. California will not legalise cannabis after all.

In practical terms it won’t matter much, because another law, signed this year by Governor Arnold Schwarzenegger (who opposed Proposition 19), in effect decriminalises cannabis, making the penalty for owning a bit of pot equivalent to a traffic ticket. But the defeat of the most prominent of this year’s initiatives set a trend: voters across the country were sceptical of sweeping changes. Those in Arizona and South Dakota, for instance, said no to legalising even medical marijuana.

Small-c conservatism may also explain why voters in the state officially called the State of Rhode Island and Providence Plantations woke up the next morning, having rejected dropping the Providence Plantations (with their whiff of slavery) from its name. Voters in Arkansas, South Carolina and Tennessee amended their state constitutions with the explicit right to hunt and fish, but that hardly changes life in these states. (Arizonans voted No on the same matter, perhaps seeing no need.) Voters in Kansas decided to put the right to bear arms into their state constitution, which is more redundant than radical.

Voters in Washington state rejected a proposal put on the ballot by Bill Gates senior, the father of America’s richest man, to introduce a personal income tax for wealthy people. Washington thus remains one of the seven states without an income tax. Voters seem to have given way to fear, skilfully stoked by the No campaign, that a tax on the rich could easily become a tax on everybody. Washingtonians passed another initiative that requires a supermajority, as opposed to a simple majority, in the legislature to raise any tax at all.

Voters in Colorado rejected an initiative to redefine, in the state constitution, the meaning of “person” to begin, in effect, at conception, probably sensing that this could have paved the way for more radical changes in abortion policy. Voters in Arizona and Oklahoma voted for a measure that prohibits mandatory participation in the new federal health-care law (those in Colorado rejected such a measure). In part, this was to send a message to Washington against big government, in part another hedge against unwanted change.

The rejection by Californians of Proposition 23, which would have suspended the pioneering environmental and energy legislation that the state adopted in 2006, marks a West-coast brand of conservatism. The existing law aims to make California’s cars, trucks, houses and appliances more efficient, and to foster green industries. None of this would ever have become controversial in California, had not oil companies from Texas and Kansas poured money into the effort to kill the law. All they did, however, was provoke a backlash against out-of-state meddling.

Where voters did endorse real change, they had excellent reason to do so. In Illinois they voted
for a mechanism to recall governors, no doubt with their recent and ethically compromised governor Rod Blagojevich in mind. And in perhaps the sanest decision anywhere, Californians voted, in effect, to end gerrymandering (the designing of congressional districts for political advantage). They passed one initiative that extends the remit of an independent redistricting commission, and rejected another that would have abolished it.

Californians also voted to let their state legislature pass budgets with a simple majority, instead of a two-thirds majority, while keeping a two-thirds requirement for any tax increase. California had been the only state to require supermajorities for both taxes and budgets, thus all but assuring perennially late budgets.

Meanwhile, Oklahomans overwhelmingly voted to amend their state constitution to ban international law—specifically sharia law—from being used in their state courts. It was a conservative vote, to be sure. And a touch paranoid.

United States
And now on to the White House
But the Republicans may have to fight a civil war on the way

Nov 4th 2010

SUCH is the relentlessness of democracy in America that even before this week’s votes were counted, Republican heads were swivelling towards the next big question. What—or, rather, who—will it take to move from triumph in the mid-terms to reconquest of the White House in 2012?

Only a few months ago even Republicans would admit in private that the job of unseating Barack Obama seemed daunting. This week the president looks abruptly diminished and the choice of plausible Republican challengers correspondingly wider. But after the wine of victory has been drunk and the party begins to sober up, the job will come to look trickier again. That is because although the voters spoke this week, nobody can be sure what they intended to say.

For example: were they voting for the Republicans, or against the Democrats? Were they repudiating the whole Obama agenda or just registering a protest against hard times? Are voters more enthusiastic about the tea-party insurgents who set the grass-roots on fire, or the safer hands of the establishment types who wrote the cautious, bet-hedging Pledge to America, the nearest thing the Republicans offered to a manifesto? If the Republicans end up nominating an insurgent for the presidency, they risk alienating the voter in the centre. But if they choose a more conventional candidate they risk extinguishing the fire that lit up the mid-terms. A mistake could give Mr Obama a fair chance of being re-elected in 2012, just as Bill Clinton was two years after the Democrats’ clobbering in the disastrous mid-terms of 1994.

The insurgent who terrifies the Republican establishment most is Sarah Palin. The darling of the tea-partiers has undergone a brilliant reinvention since showing herself unready as John McCain’s running-mate. After quitting her job as Alaska’s governor she has relied on native wit, celebrity and a genius for slogans (“death panels”, “lamestream media”) to turn herself into a formidable political force. And yet two out of three voters still say that she is not qualified to be president. Several of her tea-party protégés were defeated on election day.

*Politico*, an online newspaper, reported last weekend that because the main contenders agree that she is polarising, superficial and a potential disaster in 2012, they are colluding to block her. John Heilemann, co-author of a bestselling history of the 2008 campaign (and a former writer in this space), has argued that she could win if Michael Bloomberg, New York’s mayor, ran as an independent, thus depriving Mr Obama of a majority in the electoral college and leaving the final
vote to the Republican-controlled House. In other words, it would take a miraculous concatenation of improbable events to make her president.

Is there a Palin-style insurgent with added gravitas? Re-enter Newt Gingrich, architect of the Republican victory in the 1994 mid-terms and, in his own estimation, an authentic intellectual. Did he not write a doctoral thesis on Belgian education policy in the Congo, 1945-60? Yet he would also be a dangerous pick. A man who cheated on one of his three wives while seeking to impeach Mr Clinton over the Lewinsky affair, and divorced another when she was in hospital with cancer, is bound to repel the more fastidious sort of voter. Others could well be put off by his often eccentric judgment. His scaremongering over the Manhattan mosque could be put down to the usual demagoguery. But the average voter might think that his recent fuss about the imminent danger of America submitting to sharia law is simply deranged.

If Mrs Palin and Mr Gingrich are too wild and woolly, the Republicans are not short of more conventional politicians to throw into the fray against Mr Obama. Standing at the head of this queue, flush with cash and experience, is Mitt Romney. Since losing to Mr McCain in 2008 he has prepared methodically to run again. But some of the weaknesses that hurt him last time will be hard to overcome, such as a perceived want of firm convictions and his Mormon faith. This time, too, party rivals will be able to accuse him of having pioneered as governor of Massachusetts a version of Mr Obama’s own reviled health reform. Also in the queue is a group of successful governors such as Tim Pawlenty of Minnesota, Mitch Daniels of Indiana and Haley Barbour of Mississippi. Others—Chris Christie of New Jersey, Rick Perry of Texas and Jeb Bush, the former governor of Florida and brother of George—say they will not run. But they might be drafted, as, just possibly, might General David Petraeus.

Many of these men are considerable politicians, and by no means without talent, flair and colour. Mr Barbour is a good ol’ boy with a fluent southern charm; Mr Daniels glides through Indiana on a Harley. By definition, however, they are a duller lot than the insurgents, and will seek if they run to emphasise their pragmatic successes in government rather than ideological radicalism of the sort that animates the tea-party movement.

The place, and price, of purity

Which points to another obstacle on the Republican path to the White House. Having established a foothold in Congress, the tea-partiers and their patrons are already on guard against betrayal. Men such as Senator Jim DeMint of South Carolina, who helped purge the party of moderates during the primaries, may or may not run themselves, but will not support the nomination of a candidate who softens the ultra-conservative message just because that might play better against Mr Obama. Is that not the mistake that led the party into the big-government conservatism that was its undoing under Mr Bush? Maybe the Republicans can find a chameleon: Marco Rubio, Florida’s boy wonder, might fit the bill. But if they cannot, here lie the seeds of a possible Republican civil war that might, just might, let the Democrats hold on to the White House in 2012, despite their beating this week.
Brazil’s next president
Stepping into outsize shoes
Lula propelled Dilma Rousseff from obscurity to the presidency. Continuing his work while proving she is her own woman will not be easy

Nov 4th 2010 | SÃO PAULO

BLOCKED by term limits from running for president for the first time since 1989, Luiz Inácio Lula da Silva joked in March that he would fill the electoral void by changing his name to Dilma Rousseff and putting that on the ballot instead. The strategy worked. Thanks to his endorsement, Ms Rousseff, his former chief of staff, won a run-off on October 31st to become Brazil’s first female president, beating José Serra of the Party of Brazilian Social Democracy by 56% to 44%. Ms Rousseff, who has never before held elected office, will now have to show whether she is a mere proxy for Lula or a leader in her own right.

Since the vote, the president-elect has focused on reassuring the country that she will provide continuity. After Lula was elected in 2002 investors dumped Brazilian assets, fearing that the former socialist firebrand would scrap his predecessor’s orthodox macroeconomic policies. Instead he stuck with them, providing the stability needed for the country to boom.

Ms Rousseff faces similar worries. She belonged to a guerrilla group that fought Brazil’s military dictatorship in the 1960s. She comes from a wing of the Workers’ Party (PT) that is particularly keen on state industrial policy and intervention in the economy. Most of her supporters came from the poor north and north-east, and her staunchest backers in the more developed south were government employees. Richer and better-educated voters, along with private-sector workers, mostly plumped for Mr Serra instead.

To comfort these groups, she described her economic plans the day after the election as “nothing that makes waves or creates confusion”. But her thin record means that her early appointments will come under extra scrutiny. Investors hope she will persuade Henrique Meirelles, the hawkish governor of the Central Bank under Lula, to stay on. They will also pay close attention to Antonio Palocci, who oversaw Lula’s embrace of market-friendly policies as his first finance minister and is part of Ms Rousseff’s transition team. If Ms Rousseff chooses him to be her chief of staff, or better yet, returns him to the finance ministry, her standing with businessfolk will soar. If he ends up in health or
Once she takes office on January 1st, critics will probably focus on an area where some differentiation from her predecessor might be welcome: handling the public purse. Despite strong tax receipts, the government will balance its books this year thanks only to the sale of oil concessions and some creative accounting. Since the election Ms Rousseff has preached fiscal responsibility. However, she also supports new spending on the poor.

To keep both promises, she will have to trim the fat from those parts of the budget that Lula left alone, such as public-sector pensions. But attacking such generous perks would anger her base and the unions, who are still a considerable force in the pt. "It's hard to see anything that justifies the belief that she is serious about greater fiscal discipline," says Mauro Leos of Moody's, a ratings agency.

On paper, if Ms Rousseff does decide she is ready for a fight, she will have a better chance of getting her way than Lula did. Unlike her predecessor, she will command a congressional coalition with the three-fifths majorities in both houses needed to amend the constitution. The PT also holds more state governorships than it did under Lula. And though Ms Rousseff’s margin of victory was smaller than Lula’s, she still has a strong mandate.

Even so, the new president will find it hard to impose her will on her party and coalition. The PT owed its position in government to Lula, and knew it. But Ms Rousseff is indebted to those who helped her rise to power. And without a leader bigger than the party, the PT’s out-and-out socialists will be more likely to squabble with its social-democratic reformers. Moreover, Ms Rousseff is new to coalition horse-trading. The PMBD, a wily grouping of regional barons that is the PT’s main partner, will probably try to take advantage of her inexperience to satisfy its appetite for pork and spendthrift ministries, even though it lost seats in the election.

The man who could help her surmount these hurdles is Lula himself. He says he will fade into the background. But that seems unlikely: reports on his preferences for Ms Rousseff’s appointments have already surfaced in the press.

For now, the president-elect is handling the situation graciously. “I will often knock at his door and I’m sure I will always find it open,” she said in her acceptance speech. But letting Lula remain the power behind the throne would set a bad precedent—Brazil instituted term limits for a reason. Ms Rousseff will have to convince the doubters that she is not simply Lula in lipstick.
Spying and corruption in Colombia

The dark side
The former president and his aides are called to account for dirty tricks

Nov 4th 2010 | BOGOTÁ

DURING Colombia’s presidential campaign this year Antanas Mockus of the Green Party did surprisingly well by accusing the incumbent, Álvaro Uribe, of skirting the law in his efforts to make the country safer. Mr Mockus lost to Juan Manuel Santos, Mr Uribe’s candidate. But even though Mr Uribe left office three months ago, judicial probes into spying, bribery and corruption scandals have kept the country focused on the less savoury habits of his highly popular government.

The most explosive charges almost reach Mr Uribe himself. In 2009 Semana, a news magazine, reported that das, Colombia’s domestic intelligence agency, was illegally wiretapping and monitoring judges, journalists, politicians and human-rights activists deemed to be opponents of Mr Uribe, and had designed smear campaigns against them. The story prompted criminal investigations in which several former das officials testified that the intelligence was destined for the president’s top advisers. Mr Uribe has said he “never ordered, insinuated or considered an illegal option”. Now, however, he will have to repeat that denial under oath: Congress’s investigative committee began hearings on the topic on November 3rd. Mr Uribe asked for the normally closed-door proceedings to be made public, but the committee has kept them sealed.

Some of Mr Uribe’s closest aides have also been hauled into court. Jorge Noguera, his first director of das, is on trial for collaborating with paramilitary warlords, and has been accused of a part in the murder of three union activists. Two of his successors also face probes. Sabas Pretelt, a former interior minister, is charged with bribing a congressman to vote to let Mr Uribe run for re-election in 2006.

Many more of his officials have faced administrative penalties. Bernardo Moreno, Mr Uribe’s chief of staff, has been banned from holding public office for 18 years for “exceeding his authority” by inquiring about intelligence on Supreme Court justices. And just as Andrés Felipe Arias, a former agriculture minister, was heading to Italy last month as Colombia’s new ambassador, the government’s auditor accused him of diverting subsidies meant for small farmers to rich families. In return, the recipients reportedly gave money to Mr Arias’s bid for the Conservative Party’s presidential nomination.

Despite all this, the ex-president’s reputation has barely been tarnished. His approval rating a month after leaving office was 80%. And a recent poll found that were he to run for mayor of Bogotá, the capital—a post that interests him—he would get 56% of the vote. That might bother Mr Mockus, who held the job twice, more than losing the presidential election.

The Americas
Foreign investment in Canada

The government puts the kibosh on a bid for PotashCorp

Nov 4th 2010 | OTTAWA

WHEN BHP Billiton, the world’s biggest mining company, announced a $40 billion hostile takeover offer for PotashCorp in August, few expected the business-friendly government of Stephen Harper to get in the way. Being the world’s largest producer of potash, an ingredient of fertiliser, is hardly strategic. And to reject the Anglo-Australian firm’s bid would send an unwelcoming message to foreign investors, upsetting Canada’s business leaders, who had asked the government not to intervene.

However, Mr Harper was put in a bind when Brad Wall, the premier of PotashCorp’s home province of Saskatchewan, asked him to block the deal. Once Mr Wall had lined up support from four other provincial leaders, all three opposition parties in the national legislature, and a few dissident executives, the government buckled. On November 3rd the industry minister, Tony Clement, said that Canada planned to reject the bid. In the past 25 years, the country has shot down only one other foreign takeover, a case involving satellites and space missions that was vetoed on grounds of national security.

BHP Billiton has 30 days to plead its case before a final decision, and Mr Clement said that Canada’s investment law prevented him from explaining why the deal was not “likely to be of net benefit to Canada” until then. But opposition leaders quickly pointed out that approving it was not likely to be of net benefit to the minority government of Mr Harper’s Conservative Party, which depends on mps from Saskatchewan, Alberta and Manitoba. The premiers of all three, as well as Quebec and New Brunswick, opposed the deal. Mr Harper knows how much damage one angry premier can do. In 2008 Danny Williams of Newfoundland and Labrador campaigned against the federal Conservatives over a funding dispute, depriving them of any seats in his province.

Just a few years ago, the Conservatives approved a bundle of foreign purchases of natural-resource companies, including Inco and Falconbridge, two nickel miners, and Alcan, an aluminium maker. But back in 2006-07 a commodity-fuelled growth spurt kept economic nationalism at bay. Since then, Canadians have been hit by the world recession and disappointed by unfulfilled promises from foreign firms—the government is suing US Steel for failing to honour job and production guarantees it made when buying Stelco, a steelmaker. As a result, warnings about foreigners gaining near-monopoly control over a national resource have more resonance.

Moreover, Mr Wall’s professed fondness for free markets was apparently surpassed by his solicitude for the provincial purse. According to a study that was carried out by the Conference Board of Canada, a think-tank, the deal would cost Saskatchewan an estimated C$200m ($198m) a year in tax revenues, because BHP Billiton could write off a C$12 billion potash mine it is developing in the province.

BHP Billiton could still sweeten its bid. The company said in a terse news release that it was disappointed and was reviewing its options. A Russian buyer recently expressed interest, although the government would probably reject an offer from that quarter too. A stronger contender might be a group of aboriginal Canadians who say they have amassed a $25 billion war chest from foreign investors and pension funds, which could “recapitalise” PotashCorp as a stand-alone company. They would not only enjoy automatic regulatory approval, but could also file for an injunction to block rival bids in defence of their indigenous treaty rights.

No matter who controls the company, however, the damage to Canada’s reputation as a place to
do business is done. Now that the Conservatives have joined the protectionist bandwagon, investors have lost their chief ally in Ottawa. Other countries will doubtless be more welcoming.
AMID a flurry of international summitry in Asia, arguments between China and Japan are proving an embarrassment. At a meeting of regional leaders in Hanoi on October 30th, the two countries’ prime ministers managed a mere ten minutes of chat. America even offered to help mediate between them—in vain. An angry China is proving unusually hard to placate.

The diplomatic rupture between Asia’s two largest economies began when China responded furiously to Japan’s detention of a Chinese fishing-boat crew on September 7th. It has continued far longer than almost anyone expected. The swift release of the crew, and on September 24th of their captain, did little to restore calm.

At a gathering on October 4th of European and Asian leaders in Brussels, China’s prime minister, Wen Jiabao, spoke in a corridor with his counterpart, Naoto Kan, for 25 minutes. But as with the encounter in Hanoi, no more than the barest of courtesies appear to have been expressed. A more formal meeting did look set for Hanoi, but the Chinese abruptly cancelled it, accusing Japan of acting in “collusion” with other countries (for which, read the United States) to inflame the dispute.

Now China’s persistent anger threatens to overshadow a G20 summit in Seoul on November 11th-12th, and a meeting soon after of Asia-Pacific leaders in Yokohama, Japan. President Barack Obama and his Chinese counterpart, Hu Jintao, are due to attend both. Mr Kan hopes to meet Mr Hu in the margins, with no guarantee that Mr Hu will agree, despite a promise by Mr Wen in Brussels that the two leaders could meet “at an appropriate time”.

In Hanoi, American officials say, the secretary of state, Hillary Clinton, made it clear to both Chinese and Japanese diplomats that she wanted the temperature lowered. Yet her offer of mediation has been tartly rebuffed by China.

More is involved than mere routine outrage over the arrest of the fishermen off Japanese-controlled islands (the Senkaku islands, or Diaoyu in Chinese) which China claims as its territory. The trawler captain’s release could have prompted China to retire, content that Mr Kan’s government had been made to look weak despite apparently reckless behaviour on the part of
the fishing boat. The Japanese say the skipper was steaming drunk. On November 1st 30-odd Japanese politicians were shown a video they say left no doubt of a deliberate ramming of a Japanese coastguard vessel.

But instead of quietly celebrating Japan’s capitulation, China demanded an apology and compensation, which Japan refused. Public opinion in China might be making it difficult for Chinese leaders to climb down. The dispute has triggered the biggest anti-Japanese protests in five years, with thousands taking to the streets in several inland cities.

What is puzzling, however, is that these only erupted on any scale a full three weeks after the captain’s release. Perhaps officials tacitly approved of the demonstrations at first. But by the end of October students were being ordered to remain on university campuses over the weekend as some cities tried to prevent further unrest. Similar protests in 2005 also gave the impression of government attempting to put a lid on demonstrations which they had had a role in encouraging.

Michael Yahuda, of the London School of Economics, says China’s hard line probably has a lot to do with jockeying for power among Chinese leaders, as sweeping changes to the party and government hierarchy are contemplated for 2012-13. China’s foreign ministry may have argued that the rhetoric should be dialled down. But it has never had real clout. The foreign minister, Yang Jiechi, is not even in the Politburo, let alone on the standing committee, pinnacle of Communist Party power. The ministry has found itself further marginalised, as conviction grows within the party that the West is in terminal decline and that it is time for China to assert itself as a global power. Military types privately criticise the foreign ministry for wetness in dealing with Japan and the West.

Recent American behaviour has fuelled the hardliners’ belief that the time has come for China to flex some muscle. America has taken to describing freedom of navigation in the South China Sea, most of which China claims as its own, as a “national interest”. Mrs Clinton repeated this during the East Asia Summit in Hanoi where Mr Kan and Mr Wen briefly met. When she made similar remarks in July the Chinese response was sufficiently furious to unnerve China’s South-East Asian neighbours. She earned further rebuke from China (though much praise in Japan) on October 27th, when she emphatically stated that the Senkaku are covered by America’s security alliance with Japan.

Mr Obama’s tour of Asia from November 5th-14th is likely to reinforce impressions in Beijing that America is stepping up efforts to keep China in check. It takes him to four democracies: India, Indonesia, South Korea and Japan. Chinese hawks are particularly worried that America might be trying to cosy up to India in order to contain Chinese power in the region. Elite Reference, a Beijing newspaper, quoted unnamed commentators as saying Mr Obama was deliberately leaving China out of his trip.

For all that, some leaders worry about China being seen as threatening. For instance, Mr Yang, China’s foreign minister, apparently assured Mrs Clinton in Hanoi that China would be a "responsible supplier" of rare earths. At the height of the fishing-boat dispute, China stopped exports to Japan of these minerals, which are crucial for the manufacture of many high-technology products. Still, an official in Tokyo says that Japan has not received a single shipment since the captain’s release. He also says that the Chinese have even hinted to Japanese manufacturers that if they want rare earths, they should move their factories to China. To the Japanese, that sounds like a menacing invitation to hand over their most valuable technologies—and is anyway a move unlikely to still Chinese anger.
A Russo-Japanese tiff

Unsettling territory

A discomfiting lesson for Japan about the growing clout of neighbours

Nov 4th 2010 | TOKYO

THE southernmost of the Russian-occupied Kurile islands are so close to Japan’s northeastern tip that when the fog lifts, there they are. They were, indeed, once part of Japan, which gathered its secret attack on Pearl Harbour in the Kuriles’ fastness. But in the days after Japan’s surrender in 1945, Soviet forces seized the islands. Thanks to the dispute over what Japan calls its Northern Territories, Russia and Japan have never signed a peace treaty ending the second world war.

Now, for the second time in two months, Japan to its dismay is getting beaten about by neighbours over lumps of territory. On November 1st President Dmitry Medvedev became the first Russian leader to visit the islands, less than two weeks before he flies to Japan for an Asia-Pacific Economic Co-operation (APEC) summit. To rub in more salt, he posted Twitter snapshots of Kunashiri island and added: “How many beautiful places there are in Russia!” Japan temporarily recalled its ambassador to Moscow. Mr Medvedev so loves the place he says he’s coming back.

It is now not clear on what terms Mr Kan can meet Mr Medvedev at the summit. An uneasy standoff with both the Russian and Chinese presidents would overshadow Mr Kan’s biggest diplomatic shindig since he took office in June. Domestically, the issue can only harm him. Even before Mr Medvedev’s photographic jaunt, support for Mr Kan’s government had plunged, largely because of foreign-policy failures.

Mr Kan’s opponents say that Russian and Chinese assertiveness has been encouraged by strains in Japan’s longstanding security alliance with America ever since the Democratic Party of Japan (DPJ) took office in 2009. These have mostly been over the relocation of a military base on the southern island of Okinawa, an issue still not settled pending an election for governor in late November. It has all left Japan looking rudderless.

The American administration says it is sympathetic to Japan’s Northern Territories claims, but that defending them does not fall under the terms of the security alliance. As for that, the outstanding base relocation means that when President Barack Obama and Mr Kan meet next week, they will probably forgo the chance to announce a strengthening of the two countries’ alliance on its 50th anniversary.

Some say it is unfair to lay too much blame at the DPJ’s door. Hitoshi Tanaka of the Japan Centre for International Exchange says the island incidents simply illustrate a growing geopolitical clout of countries like China and Russia. This week this shifting clout was underscored by a camera-touting tourist on a remote, windswept island.
Indian corruption
Scam-flat millionaires
A big property scandal reveals the grimy side of Indian politics
Nov 4th 2010

TO JUDGE by their recent actions, India’s leaders have little appetite to take on the chronic corruption that bedevils their country’s politics. Sonia Gandhi, boss of the ruling Congress party, did force Ashok Chavan, chief minister in the western state of Maharashtra, to squirm in public and offer his resignation on October 30th, after evidence emerged of grimy financial misdemeanours. But then, like a cat toying with a mouse, she failed to accept it. By the time of a big party meeting on November 2nd, not a word was said about his scandal or about the theft of taxpayers’ cash that blighted October’s Commonwealth games in Delhi.

Such hesitation looks puzzling. Voters, sick of the tales of graft that fill their newspapers, would have cheered swift action. Mr Chavan is not a lovable figure. His late mother-in-law and other family members profited from the scam, by picking up flats in a luxury tower block in Colaba, southern Mumbai, reportedly paying a fraction of the going rate. The 31-storey building went up without proper permits. Worse, the flats were supposedly reserved for “Kargil heroes”—veterans and widows of a brief, high-altitude war with Pakistan in 1999 in Indian-controlled Kashmir. None of the heroes benefited.

Mr Chavan’s skin has been saved, for now. Barack Obama begins his tour of India on November 6th in Mumbai. Congress may have felt it bad form to sack a man poised to welcome the American president. But a bigger problem is finding a cleaner pair of hands to take over. A long list of cabinet members, bureaucrats, former chief ministers and leading military folk have also been exposed in the property scam.

The opposition Bharatiya Janata Party (BJP) is crowing, urging the Maharashtra governor to sack the entire state government. It threatens to expose more scandals. But for Congress, the greater danger lurks in its own ranks. To hound Mr Chavan may spur party factions to expose other cases of graft as a way of doing down rivals. There is no shortage of stories to tell.

Such a wretched state of affairs carries a price for India. Few trust their public officials. The main organiser of last month’s games, Suresh Kalmadi, was publicly booed by Indians for the blighted event. Mr Kalmadi, a Congress man who is also from Maharashtra, is now under official investigation. Indian hopes of hosting the Olympics, perhaps in 2020, are sadly diminished.

Every big scandal has the effect of making the poor feel more disenfranchised. This week Rahul Gandhi, Sonia’s son and probably the next leader of Congress, talked of there being “two Indias”, one rich and one not. How important it is, he argued, to connect the two. The obvious but regrettably untested way would be to confront the graft more keenly.
Freedom of speech in Singapore
You can cage the singer
A writer tests the tolerance of Singapore’s legal system
Nov 4th 2010 | SINGAPORE

“PLEASED as punch” was how Alan Shadrake’s ebullient lawyer described his client after listening to the judge’s verdict in his hearing for contempt of court on November 3rd. Mr Shadrake, for his part, looked more punched than pleased. After all, he had just been found guilty of scandalising the judiciary in a country that does not take these things lightly. He is sentenced on November 10th.

Mr Shadrake, a rumpled British journalist, first went to Singapore in 2003 to write for its tourism board. His latest scribbling does nothing to flatter his former home. “Once a Jolly Hangman: Singapore’s Justice in the Dock”, is a critical look at the allegedly extensive use of the death penalty in the city-state. In July Mr Shadrake was arrested and charged with contempt of court. His trial has drawn rare attention to the death penalty and raised broader issues of freedom of speech.

Foreign writers and publications, including this one, have often found themselves in trouble when writing about Singapore’s internal affairs. Usually, they run foul of laws on “defamation”, ie, libel. The country’s elder statesman, Lee Kuan Yew, whose son is now prime minister, has brought and won a number of suits over the years to defend his reputation from criticism in the press or from political opponents. The International Bar Association (IBA) and America’s State Department have both raised concerns over the repeated use of defamation suits against critics, and questioned the independence of the courts. The government has responded that the IBA report based its allegations on feeble evidence. Singapore’s defenders also point out that its libel laws are based on inherited British laws.

Mr Shadrake may yet face defamation proceedings. This conviction was for crossing another line. Singapore is quick to defend the judicial system again any accusation of bias, and Mr Shadrake’s offence fell under that rubric. Justice Quentin Loh concluded that Mr Shadrake’s case was not about the merits (or not) of the death penalty, but about the impartiality—or otherwise—of the administration of justice. The defendant had suggested that the judiciary was “influenced by political and economic situations and biased against the weak and the poor.” The attorney-general argued that 14 passages in the book were contemptuous of the judiciary, and in 11 of those cases Mr Justice Loh agreed: Mr Shadrake’s allegations were riddled with “falsehoods”.

Yet Mr Shadrake’s lawyer, M. Ravi, remained optimistic after the verdict, even arguing that the judge had advanced the cause of freedom of expression in Singapore a bit by making it harder to bring these contempt cases. Critics say Singapore’s courts have set a low bar; prosecutors simply have to show that a defendant could have given an average reader an impression of judicial bias or impropriety. This is in contrast to many other jurisdictions, which require that, for there to be contempt, a comment must create a “real risk” of prejudicing the administration of justice. According to Mr Ravi, this “historic” ruling allowed the “real risk” defence for the first time. Mr Ravi felt his client had done relatively well in the case. Mr Shadrake says he was given a “fair hearing”.

But Mr Shadrake still has to be dealt with. He could be fined, or worse. He could also be charged under the Official Secrets Act for publishing interviews with Darshan Singh, the now-retired hangman in the book’s title. Mr Shadrake sees his book on alleged abuses in Singapore as part of a righteous cause against the death penalty. The authorities say that hanging drug traffickers and
murderers has made the city a safer place, and polls suggest that most locals agree. But there is almost no public debate on the issue. Mr Shadrake’s book would have been an exception, were it widely on sale. Copies are selling fast across the causeway in Malaysia.
Indonesia’s police

Cop killers

Indonesia’s police are brutal and corrupt—and apparently untouchable

Nov 4th 2010 | JAKARTA

TEN years ago, as Indonesia emerged from economic chaos and the military-backed Suharto regime, the government was everywhere planting seeds of democratic reform. Among them was to split the national police from the armed forces in 2000. Ever since Indonesia declared independence in 1945, the police had been the neglected, ill-equipped little brother of the army. The idea of detaching them was to make them solely responsible for law enforcement across the vast Indonesian archipelago, while the armed forces retreated to their barracks.

A decade on, this reform effort has worked—but not necessarily in the ways that its drafters envisioned. The army is relatively quiet these days, having been forced to begin selling its business interests and attempt, somehow, to modernise despite tiny budgets and antiquated equipment. What is more, it has not intervened in the democratic process.

The national police, meanwhile, have indeed managed to assert themselves as the country’s enforcers of law, including taking the initiative against Indonesia’s home-grown Islamist extremists. Unfortunately, capturing or killing terrorist suspects is just about the only thing they are applauded for these days. Most people see the police as a liability: deeply corrupt and untrustworthy.

The past several months have been particularly troubling, even by the force’s low standards. In late June Tempo, a prominent Indonesian news magazine, ran a cover story revealing that more than a dozen senior police officials had suspicious bank accounts, some of which held millions of dollars. A week later an anti-corruption activist who helped expose those bank accounts was brutally beaten by unknown men, apparently in retaliation.

In mid-August the police’s top brass were forced to admit that they had no evidence implicating two senior anti-corruption officials caught up in a sensational graft investigation in 2009. This gave credence to allegations that the police had conspired to frame the pair because of a personal grudge. Separately, on August 31st police officers in Central Sulawesi province fired into a crowd of people protesting the death of a local man in police custody. Five people were killed and 34 injured. In mid-September in West Papua province police killed two men and injured a woman after a traffic dispute boiled over.

Two days before the West Papua incident, the police’s counter-terrorism unit, Densus 88, was accused of torturing independence activists in Maluku province. The unit, funded by the United States and Australia, was alleged to have tortured the activists during a visit by President Susilo Bambang Yudhoyono in early August.

The allegations came just as another Maluku separatist, Yusuf Sipakoly, died in custody of injuries his family claims were caused by torture at the hands of the police. The allegations fit a familiar pattern. Last year Amnesty International released a report detailing a pattern of widespread torture, sexual abuse and exploitation by police, and ill treatment of suspects during arrests, interrogation and detention in Indonesia. And the police have been accused of standing by as minority Christian groups in towns outside Jakarta have been repeatedly harassed in recent weeks by hardline Islamist groups. Police have even been accused of colluding with radicals in local extortion and thuggery rackets.

So far, aside from appointing an “anti-mafia” committee to help clean up the police as well as a
corrupt judiciary, the president has shown little interest in reining in the force. Mr Yudhoyono, a retired army general, has refrained from punishing senior police officials for their long list of alleged transgressions. Sometimes he gives the impression of defending them. In early October the president nominated Timur Pradopo, the Jakarta police chief, to run the national force, despite allegations of his involvement in the killings of student demonstrators in the build-up to Suharto’s ejection from power back in May 1998, and again on a university campus later that year.

During his final press conference in late October the outgoing national police chief, Bambang Hendarso Danuri, attempted a *mea culpa*, apologising, profusely and repeatedly, for the excesses committed on his watch. The public, however, are unlikely to be forgiving. The force has had successes in its counter-terrorism operations, which have seen hundreds of terrorist suspects killed or put behind bars, including some of South-East Asia’s most wanted fugitives. But even that has come at a price. In September armed men attacked a police station in Medan, North Sumatra province, killing three officers, in an apparent retaliation for the capture or killing of terrorist suspects. The public was shocked by the ambush, but there was a notable absence of outward sympathy for the three slain officers. Given the force’s recent conduct, that kind of reaction could become depressingly familiar.

Asia
China’s ten-yearly census

The world’s biggest headcount

Gauging China’s population is made harder by waves of migrants

Nov 4th 2010

SOME 6m people in China have been mobilised to conduct a ten-day survey of the world’s largest population. The census is complicated by surging numbers of migrants from rural to urban areas. Debates over the accuracy of the counts will not be laid to rest.

This is China’s sixth nationwide census as a communist country. The previous one, in 2000, was already fiendishly hard because of a loosening of controls on internal migration. Surveys suggest that since then the number of people who have moved out of the countryside and taken up urban residence for more than six months has grown by 85%, to 145m.

Such people will often not tell the authorities they have moved, in order to avoid all the bureaucracy and possible costs involved in registering a new residence. Migrants are particularly fearful of revealing any children born in violation of China’s frequently strict family-planning regulations.

Now officials are trying to convince people that personal data gathered by census takers will be kept secret, even from other government departments. Still, state media reports that many are evading the enumerators. Preliminary data are due to be released in April. The problem will be how to handle the inevitable undercounting.

In 2000 the census takers reported an undercount of 1.81%. Officials deemed this to be within acceptable limits. To compensate, they added more than 22m notional people to the total, to produce a population of 1.27 billion. Many of the uncounted were so-called “black children”, ie, those born in breach of regulations that limit urban couples to a single child. From sample surveys, officials estimate the population at the end of 2009 to have been 1.33 billion.

In this census, migrants will be counted both in their home town and in their new city so that figures can be cross-checked. Foreigners will be included for the first time. But academics say census data are still being moulded to fit official projections. China’s fertility rate may be much lower than official estimates.

Motivating poorly paid enumerators to do their job properly is another problem. The same number who gathered data from 350m households in 2000 must cover 400m this time round. Not just migrant workers but also the new middle class dislike official prying. In Beijing some census workers have already resigned, citing the pressures.

Asia
AT A glance, the calf-length cape that a good-looking young model swirled around on stage appeared to be made of shaggy sheepskin, wildly inappropriate for the tropical climate of Pattaya, a seaside resort in Thailand. In fact its composition was more apt, if no less uncomfortable: hundreds of dangling prophylactics. Pattaya has one of Thailand’s highest concentrations of go-go bars, massage parlours and other shop windows for the sex trade. Parts of it call to mind Sodom-on-Sea. But this “Condom Fashion Show” was not part of the sleaze. It was staged at a recent United Nations-led “consultation”. The theme—sex workers and HIV, the virus that causes AIDS—was deadly serious, and the effort to turn it into burlesque rather heroic.

The consultation differed in more fundamental ways from the usual run of international conferences. Several dozen sex workers from eight countries (Cambodia, China, Fiji, Indonesia, Myanmar, Pakistan, Papua New Guinea and Thailand) attended as full-fledged participants, not just models in the fashion show. Sex workers are on the front line in the struggle against an epidemic that in Asia still claims 350,000 new infections each year. A 2008 report prepared for the United Nations by an independent commission confirmed that “men who buy sex are the single-most powerful driving force in Asia’s HIV epidemics.” It is thought that about 10m Asian women sell sex to 75m men, who in turn have a further 50m regular partners.

A simple and effective way to cut HIV transmission is to ensure that sex workers have access to condoms, know how to use them and always do so. Yet the UN estimates that only a third of Asia’s sex workers are reached by HIV-prevention programmes. And in some countries possession of condoms is taken as evidence of involvement in prostitution, and hence a cause for harassment, extortion or detention.

Yet sex workers themselves are normally excluded—or exclude themselves—from the air-conditioned conference halls where officials and NGOs discuss their plight. One reason is a poor grasp of English, a language, one male Thai sex worker complained, that “we learned only from our clients”. More importantly, sex workers often suffer from official disdain or condescension and are seen as the problem, not the solution.

Of course, the sex industry has not been ignored in the battle against AIDS. Thailand’s early successes are perhaps best-known. It was the first country in Asia to launch a “100% condom-
use programme” in the early 1990s, and it managed to cut HIV prevalence sharply. The danger now is of complacency.

The best prevention schemes involve sex workers themselves. As a Chinese delegate put it, given the chance they do a far better job of educating and helping peers than do the UN or government. Myanmar, not normally cited as an outpost of progressive policy, has an HIV-prevention scheme seen as a model. Population Services International, an international NGO, has set up a “peer-to-peer” network with 18 drop-in centres around the country. There, 350 staff, mostly former or present sex workers themselves, dispense advice, discounted condoms and treatment for sexually transmitted infections. HIV prevalence among sex workers dropped from over 30% in 2000-06 to 18% in 2008.

Still, a Burmese sex worker made a passionate intervention at the conference lamenting the stigma her profession carries. In Myanmar as elsewhere, sex workers suffer at the hands of the authorities. And the worst perpetrators are often the police and other official protectors. Take Cambodia, recognised for bringing down HIV prevalence, partly through a condom-use programme. In 2008 a law on “the Suppression of Human Trafficking and Sexual Exploitation” led to the closure of brothels and a shift of the sex trade to bars and other places, complicating measures to prevent HIV. Worse, Human Rights Watch says, it has helped the police to beat, rob and rape sex workers “with impunity”.

As many sex workers see it, another force bedevils them: the lobby against human trafficking. In September, when The Economist held an online debate on the legalisation of prostitution, a group of Cambodians wrote: “Our lives and our industry have been ruined by the anti-trafficking industry. We used to work in a brothel where we have safety and solidarity... Now we are scattered on the street where it is more dangerous.”

This is an extreme example of two problems besetting efforts to help sex workers. One is that, in most places, sex work is illegal, and almost everywhere frowned upon. Indonesian delegates complained that a new “Puritanism” accompanying a slow Islamisation of public life is forcing the sex trade underground and so making it more dangerous. As our debate showed, arguments for and against decriminalising prostitution are fierce and complex. But as long as it remains a criminal act, sex workers will be vulnerable to arbitrary abuse.

Heavy traffic

Second, the debate about sex work has become drowned in a campaign against human trafficking. That campaign, however justified its goals, fosters an assumption that all sex workers ply their trade against their will. Yet most migrant sex workers have left home for good reasons of their own—among them a desire to work away from their families, and to earn more money.

Parts of the debate, such as terminology, are as old as the oldest profession. One side regards “sex worker” as a dangerously obfuscatory euphemism. The other sees “prostitute” as degrading and derogatory. One sees those who sell sex inevitably as the victims of exploitation. But those seeking to be heard in Pattaya wanted recognition as independent actors who have made their own choices. They demand to be treated with basic human dignity just as they are.
The Israeli-Palestinian peace talks
Can Israel now say boo to America?
Barack Obama’s mid-term setback at home does not mean he will give up his search for peace in the holy land. But it won’t make it any easier
Nov 4th 2010 | JERUSALEM

THE first reaction of Binyamin Netanyahu, Israel’s prime minister, when he heard that Republicans had taken over America’s Congress, may have been a whoop of delight. His closest American friends are Republican. There is a widespread feeling in Jerusalem that Barack Obama lacks the gut sympathy for Israel that his immediate predecessors possessed. The American president, some Israeli hawks may be thinking, will now have to get off Israel’s pecked back. As for the Palestinians and their Arab friends, they almost universally fear that Israel has seen off Mr Obama and that he may be tempted to deflect his attention elsewhere, especially at home. In other words, the prospects for a peace deal, already dim, seem to have faded even further.

Yet this additional gloom is unjustified even though the diplomatic mood is bleak. Direct negotiations between Israelis and Palestinians, which reopened in September and lasted barely a month, have been postponed for just as long. Mr Netanyahu is refusing, after a ten-month freeze, to stop Israelis building settlements on the West Bank, the core of a Palestinian state. The Palestinians say they will not return to the table as long as construction continues.

But the stalemate can still be broken, even if the chance of an early and durable deal remains remote. The main reason for this guarded optimism is that many seasoned watchers in Jerusalem expect Mr Netanyahu to resume the freeze on settlement building, excluding, as before, the area on the rim of East Jerusalem, which Palestinians foresee as their future capital. It could last at least another few months.

This might enrage some bits of his ruling coalition; were Mr Netanyahu later to make concessions over borders or the sharing of Jerusalem, his government might collapse. Meanwhile Mr Netanyahu’s partner on the left of the coalition, Ehud Barak, the defence minister, who heads the Labour party, has been facing demands from his colleagues that his lot should also secede from the coalition if negotiations with the Palestinians have not resumed by the end of the year. “I smell elections in the air already,” says a minister, predicting a poll next year. Mr Obama’s people have long hoped that a centrist Israeli party, Kadima, led by Tzipi Livni, would join a reshaped and more peace-minded coalition less vulnerable to the demands of the right.

In any event, whatever Mr Obama’s relations with a new Congress, his American mediators are still casting around for ways to break the impasse. A breakthrough on borders is still the big
hope. If the two sides could agree to adjustments along the 1967 boundary, with land swaps giving equal territory to the Palestinians while leaving three or four of the biggest settlement blocks within Israel’s bulged-out boundary, then the argument over a settlement freeze could probably be ended—and the negotiators could move on to final issues.

The other tricky one that has come to the fore is Mr Netanyahu’s insistence that the Palestinians should acknowledge Israel as a Jewish state, perhaps as a quid quo pro for a further freeze. The Palestinians oppose this because, in their view, it would pre-empt their claim to a “right of return” of refugees, even though, in a final deal, they know that only a symbolic number would be allowed back to their homes in what is widely accepted as Israel proper. The Palestinians also fear that such an acknowledgment might relegate their Arab-Israeli brethren in Israel as second-class citizens. In any event, outside mediators are fairly confident that a formula can be found to accept the Jewish character of Israel with crucial addenda to enshrine the rights of Israel’s non-Jewish citizens.

By contrast, the Palestinians, led by their embattled president, Mahmoud Abbas, sensing that the impasse may persist as long as Mr Netanyahu seems loth to dump his coalition’s right-wing partners, have begun to push harder for the UN to recognise a Palestinian state within the 1967 line, even while Israel still militarily occupies the area. Some European governments, too, are toying with the idea of raising Palestine’s status at the UN from that of observer to full member. Israel’s government is confident, probably rightly, that the United States would veto such a move. But the notion of it is gaining ground, making some Israelis queasy.

In sum, it is not yet clear whether Mr Obama will tackle the Middle East conundrum with renewed vigour. There is no big reason why not, and no solid evidence that his perceived lack of love for Israel recently lost him many votes at home. But Palestinian gloom would deepen if, as has been rumoured, George Mitchell, whom the Palestinians respect, bows out in frustration as Mr Obama’s chief envoy, while Dennis Ross, widely perceived as more partial to Israel, takes up a more influential role. If the logjam persists, calls for Mr Obama to present the Israelis, perhaps on their own turf, with his own detailed peace plan, will get louder.

Mr Netanyahu, not Mr Obama, is the real enigma. His record suggests a reluctance to make the compromises that could bring a deal. But neither his American nor his Palestinian nor even his Israeli interlocutors find him easy to interpret. No one is sure whether, from Israel’s current perceived position of strength, he genuinely wants a lasting peace that would give the Palestinians a proper state. He leaves room for manoeuvre. He is flexible to a point of opportunism. Some of his age-old detractors think that he, like other Israeli hawks before him, could yet surprise everyone with a bid for a place in peacemaking history. But there is no sign of that yet.
Elections in Jordan

Judging by turnout

Expect a nice election but ponder the number who fail to vote

Nov 4th 2010 | CAIRO

JORDAN seems to be the Canada of the Middle East. Well-run compared with the neighbours, it has safe and tidy streets, good schools and steady if plodding economic growth. Its police are tough and efficient but generally pretty nice.

Jordan even runs better elections than most. The one on November 9th, for the lower house of parliament, has 763 candidates competing for 120 seats, 24 of them reserved for women and minorities. The campaign has been peaceful and festive so far, with plenty of banners and posters and catchy sloganeering. Foreign observers are expected to give the vote a clean bill of health. Its likely outcome is a solid pro-government majority sprinkled with mild dissent.

The trouble is that few Jordanians seem to care much, for good reason. For the past 20 years their rulers, first King Hussein, now his son Abdullah, have promised meaningful democratic reform. Lots of lofty-sounding changes have been decreed, such as a new election law in May, which boosted the quota for women and allotted new seats to some under-represented districts. Yet the meaningful part has been largely absent.

Even with the new districting, for instance, a vote cast in the crowded capital, Amman, carries only a quarter of the weight of one cast in the dusty provincial town of Ma’an. This is because most people in Jordan’s bigger cities are of Palestinian descent, and therefore seen as less attached to the monarchy. By contrast, natives to the east side of the Jordan river, many of whom retain strong tribal ties, dominate in the hinterlands. Tribes still supply much of the manpower for Jordan’s security forces, and in tacit reward for such patronage have historically remained staunchly loyal to the ruling Hashemite family.

In any case, Jordan’s legislature does not have much influence. The king appoints the upper house, chooses the prime minister and cabinet, and can dissolve parliaments he dislikes. He has done this twice since ascending the throne in 1999, and during those legislative hiatuses ruled by decree. Loopholes and fuzzy laws let him muzzle the press and stifle dissent, much as happens in the meaner-looking countries next door.

This is why Jordan’s only real opposition, the Islamic Action Front, tied to the global Muslim Brotherhood, is boycotting this year’s polls. Its stand marks a break from the past, when the Islamists have traded loyalty to the Hashemites for a wider margin of manoeuvre. The growing stridency of the front, which supports Hamas, the Palestinian Islamist movement, and bridles at Jordan’s 16-year-old peace treaty with Israel, has heightened tension with the Hashemites. So the question in many Jordanian minds is not who will win seats in the election but how many people will vote at all. What will remain unclear is how many of those who abstain will have done so in sympathy for the Islamists and how many simply could not be bothered.
Iraq’s insurgency

Another spasm

A wave of atrocities raises the spectre of a return to sectarian mayhem

Nov 4th 2010 | BAGHDAD

BAGHDADIS were badly shaken this week when dozens of Christians died in a massacre in a church in the city’s centre, followed two days later by at least 14 car bombs exploding in mostly Shia areas of the capital, killing another 100 or so people. The atrocities were presumed to have been the work of Iraqi Sunni groups tied to al-Qaeda. After eight months of vicious political infighting since March’s inconclusive election, tension was already high. The strain on Iraq’s fledgling security services and fragile institutions has been mounting.

Yet the attacks, though the worst for two months, were not that unusual. In August, just before American combat forces left the country, more than 20 car-bombings and other attacks occurred simultaneously across Iraq. Al-Qaeda, regenerated after two of its leaders were killed earlier this year, seems to be concentrating on spectacular attacks every few months. American commanders have often said that assaults would fall only to an “irreducible minimum”. But two large-scale attacks in a week, as well as a bomb in a Shia area in Diyala, a mixed Shia-Sunni province north of Baghdad, where another 25 civilians were killed, raise the spectre of widespread sectarian violence if a national-unity government is not formed soon.

Despite such recent setbacks, the burgeoning Iraqi army and police, numbering more than 400,000 in all, have been coping better. They have generally contained the insurgency. The violence is still far less intense than it was three years ago.

But the security forces are plainly unable to stop the occasional big attack. Factionalism does not help, with branches of the forces loyal to different political leaders and ministries. Intelligence gathering, a crucial tool in counter-terrorism, is still patchy, because different branches are reluctant to share information with each other. American forces still share intelligence across the board, but have shifted many of their best people and units to Afghanistan.

In particular, the Sunnis are still underrepresented within the intelligence services. The Awakening Councils, drawn largely from Sunni former insurgents, whose recruitment by the American army was instrumental in lessening sectarian violence during the American military surge in 2007, have not been adequately incorporated into the Iraqi forces. As a result of the ensuing resentment, extremism may once again become more tolerated among Sunnis. Last year’s budget freeze after the fall in oil prices in 2008 has left little money for training forces in intelligence. A new budget cannot be passed until a government is in place.

The incumbent prime minister, Nuri al-Maliki, and his Shia-led State of Law group are still trying to build a ruling coalition, as is his chief rival, Iyad Allawi, whose mainly Sunni-backed group won two more seats than Mr Maliki’s. Mr Maliki was recently boosted by the endorsement, with Iran’s approval, of an anti-Western, Shia religious party led by Muqtada al-Sadr, a fiery populist. The Kurdish parties are back as kingmakers but have a long list of tough demands still to be met. After a court ruling, it has been decided that members of parliament must meet on November 8th to choose a speaker, who might in turn speed up the search for a new government.

No one is betting on one soon. But one thing is sure: if Mr Allawi fails to get a top job, bringing his group into government, the disaffected Sunni minority will make it much harder for the security forces to prevent the sort of atrocities that occurred this week—and which, if they again become frequent, could plunge the country back into wholesale sectarian violence.
EVER since Morgan Tsvangirai’s victorious Movement for Democratic Change was forced into a power-sharing government with President Robert Mugabe’s losing Zanu-PF party nearly two years ago, it has been widely assumed that, if truly free and fair elections were held again, the MDC would win hands down. But now that Mr Mugabe has indicated that fresh polls could be held as early as next June, some MDC officials are no longer quite so confident of winning outright again. And even if they do, they wonder if they will ever be able to achieve real power. Few can imagine Mr Mugabe, Zimbabwe’s dictator for 30 years, ever quietly retiring to the country to tend to his cattle.

Besides, some in the MDC fear it is losing popularity as it fails to get its hand on the levers of power and improve people’s lives. “We’ve done a lousy job in government,” says a senior MDC man. “While Zanu-PF have used the last 21 months to refocus and reinvent themselves, we’ve lost our identity. Zanu-PF are as brutal and corrupt as before, but much richer. They’ve got an almost total grip on the Marange diamonds [in the east of the country] and still control the media and security forces. They’re much better organised than we are. The polls may still show us in the lead, but almost half the electorate refuse to say how they will vote. There’s likely to be massive apathy among MDC supporters. If we went to the polls now, I think we could lose. We’ve got to start fighting.”

At a two-day retreat in Johannesburg in the middle of last month, the assembled MDC leadership reached the same conclusion. Despite repeated pledges by Mr Mugabe to the Southern African Development Community (SADC), the 15-country regional club that is overseeing the supposed sharing of power in Zimbabwe, he has refused to implement most of the pact he signed with Mr Tsvangirai in September 2008. Invasions of white-owned farms, human-rights violations and blatant disrespect for the rule of law persist. The MDC complains that the 86-year-old president, who despite his growing physical frailty is as cunningly manipulative as ever, has been blocking it at almost every turn. Frustrated by its impotence, the MDC says it is time to take the gloves off.

But what does that mean? Its efforts to be more assertive have been repeatedly stymied. Mr Tsvangirai is loth to pull out of the unity government. To do so would let Mr Mugabe and his generals rule the country at will until at least 2013, when both the president’s and parliament’s
five-year terms come to an end. But the power-sharing pact looks increasingly moribund.

Mr Tsvangirai’s latest hope, once again, is to persuade SADC to intervene more forcefully. But few Zimbabweans believe that what they regard as little more than a mutual self-protection club will do any better than before. Jacob Zuma, South Africa’s president and SADC’s “facilitator” on Zimbabwe, is striving to strike a deal whereby the European Union lifts the targeted sanctions against Mr Mugabe and some 200 of his closest comrades (who are banned from visiting the EU and whose assets there are frozen) in return for a pledge that the election will be free of violence and monitored by international observers.

But many Zimbabweans are sceptical. They do not believe the old man will ever keep his word when his power is at stake. Many fear a return to the murderous level of violence meted out by Zanu-PF militias for several months after the MDC’s victory in the general election and the first round of the presidential one in 2008. Several Zanu-PF leaders have made clear that the party will not make the same mistake again: this time, the violent intimidation could start well before the next election. Some say it has already begun.

Mr Tsvangirai has called for SADC and African Union peacekeeping forces to be sent into the country a full six months before the poll and to remain for several months after. But he must know this is most unlikely to happen. There has been renewed talk in Brussels and London of ways to bring about fresh elections under wider supervision. Mr Mugabe has put out feelers to Britain’s new government under David Cameron. But the British are wary of re-engaging without an enforceable new plan. They and the other Europeans, as well as the AU, still see Mr Zuma as the main diplomatic conduit for mediation. Some in the secretariat of the Commonwealth, from which Zimbabwe is currently suspended, are exploring ideas for locking Mr Mugabe into conditions under which the next elections can be fought, with the Commonwealth back as observers.

However, apart from the unyielding Mr Mugabe, no one knows quite what to do. Just as Zimbabwe’s economy has slowly begun to revive, the country once again faces uncertainty and fear.

Middle East & Africa
Diplomacy over Western Sahara
Morocco v Algeria
Can yet another bout of talks break a 35-year-old stalemate?
Nov 4th 2010 | LAAYOUNE

DURING the sweltering day, an oddly subdued mood hangs over the sleepy city of Laayoune. Only at night, after the sun has set below the desert horizon and the smell of grilled camel drifts out of the sandwich shops that dot the broad boulevards, does the city come to life. For Morocco Laayoune is a hub for fishing and phosphate mining. For the separatist Polisario movement it is the occupied capital of what should be the independent Sahrawi Arab Democratic Republic (SADR). The rebel movement has never come close to running the place—and, as things stand, probably never will. Yet the impasse still blocks the resumption of proper relations between Morocco and Algeria, which has long backed Polisario.

For a good three decades, the UN has been trying to arrange a deal. Sometimes it has seemed close to giving up. But on November 8th-9th representatives of Morocco’s government and Polisario are to meet under the world body’s aegis in Manhasset, New York, along with officials from Algeria and Mauritania, to try to find a solution. If they fail as usual, the bad blood could get worse. The UN’s latest envoy, Christopher Ross, says the status quo is “unsustainable”.

The row has been going on since November 1975, when Morocco’s then king, Hassan II, got 350,000 of his people to mass on its southern border, in order to bully Spain, which controlled Spanish Sahara, as it was then called, into ceding the territory. Spain duly did so. The following month, the Moroccan army marched in, prompting a 16-year war with Polisario fighters backed by neighbouring Algeria.

By Moroccan standards, Laayoune is prosperous. The government in Rabat has invested a lot of cash in an effort to win hearts and minds. And yet, despite a ceasefire since 1991, a nervy atmosphere permeates the city. At its eight checkpoints, zealous secret police and UN peacekeepers’ white jeeps stand by. The indigenous people are far from happy.

Since early October thousands of Sahrawis have gathered at Gadaym Izik, ten minutes’ drive outside the city, where they have pitched some 8,000 tents. Campaigners say it is the biggest demonstration since Morocco took control of Western Sahara. But the demands of the tent people are not overtly political. Instead, they are calling for economic equality and a proper say on the exploitation of the territory’s resources. Morocco is renegotiating a fishing agreement with Europe which includes the seas off Western Sahara.

The protests are fraying nerves. After a 14-year-old boy was killed, the authorities said he had been bringing guns to the tented camp, which foreign journalists have been prevented from visiting. Al-Jazeera’s offices in Rabat have been closed because of the satellite channel’s alleged “prejudice against Morocco”.

Native Sahrawis now account for only a fifth of the city’s 200,000-odd people, most of whom areMoroccans lured by subsidies and government jobs. In the mainly Sahrawi district of Maatala, where SADR flags and pro-Polisario graffiti can occasionally be seen, doors are reinforced with steel against police raids.

A year ago Ms Haidar was turned back at Laayoune’s airport, apparently for writing “Western Sahara” as her country on her landing card. She spent the next month on hunger strike at an airport in the nearby Canary Islands, which belong to Spain, before the Moroccans were persuaded (apparently by Hillary Clinton, the American secretary of state, among others) to let her back in.

Her expulsion came a week after King Muhammad VI, who succeeded his father, King Hassan, in 1999, had hardened his line against the separatists. “One is either a patriot or a traitor,” he said. “One cannot enjoy the rights of citizenship and at the same time plot with the nation’s enemies.”

Such comments make diplomacy go backwards, says Ms Haidar, who echoes the Polisario view that, as Morocco initially agreed, the territory’s future should be determined by a referendum. But in 2000, after Morocco and Polisario had failed to agree on a range of issues, the UN had to abandon a census that would have enabled a voters’ roll to be drawn up. Since then, Morocco, with a French and American nod, has proposed autonomy as the only solution. Morocco is now proceeding with a plan for a regional authority to be set up as a step towards autonomy.

“The parties…do not yet possess the political will to enter into genuine negotiations on the future of the Western Sahara,” wrote Mr Ross in June. Since then he has been calling on the Group of Friends of Western Sahara, consisting of Britain, France, Russia, Spain and the United States, to stop the stumbling talks between Morocco and Polisario from breaking down altogether. The upcoming meetings are at least partially the result of his efforts.

But it is an uphill task. Earlier this year flights between Laayoune and Tindouf, the nearest big town in Algeria, close to Polisario’s main camps in exile, were hailed as a confidence-building measure. But the flights have since been cancelled. Ms Haidar’s treatment and the arrest in Tindouf of Mustafa Salma, a senior Polisario man, after he had declared his support for Morocco’s autonomy proposal, worsened the mood. Mr Ross wants Algeria’s government, Polisario’s main backer, to become a fully-fledged party to the talks, but it has refused so far to join in, saying that only Polisario can speak for the Western Saharans. Along with Mauritania, it will only observe the talks.

“Sahrawis are pawns in the rivalry between Algeria and Morocco,” concludes Eddah Laghdaf, who directs a state-run television station in Laayoune and backs Morocco’s autonomy idea. “We Sahrawis are obliged to choose between Algeria and Morocco, since an independent state would be an Algerian satellite,” he adds. “I choose Morocco as it offers at least a glimmer of hope for democratisation.” Algeria, he implies, is a deadlier dictatorship. But that hardly means Saharans are itching to stay under Moroccan control.

Polisario’s SADR is recognised by at least 50 countries today, though the movement says more than 80 governments at one time did so. But African countries, especially, have blown hot and cold, sometimes granting recognition and then withdrawing it, often depending on their relations with Morocco and Algeria. Uncertainty, it seems, is pervasive.

Middle East & Africa
Italy’s beleaguered prime minister

A step too far

A fresh sex scandal and a former ally, Gianfranco Fini, behind his back. Is this the beginning of the end for Silvio Berlusconi?

Nov 4th 2010 | ROME

IT IS as if, in the past 18 months, Italy’s public life had described a huge, futile circle. In May 2009 the country was agog at the revelation of a mysterious friendship between its septuagenarian prime minister, Silvio Berlusconi, and a blonde, 18-year-old would-be actress. A year and a half later, attention centres on Mr Berlusconi’s links to another 18-year-old, a raven-haired daughter of Moroccan immigrants.

Karima el-Mahroug, which seems to be her real name (she prefers Ruby Rubacuori, or “Ruby Heartstealer”), first sashayed on to the political stage on October 26th, when it was reported that she had been questioned by prosecutors in Milan investigating allegations of procuring girls for prostitution that were surrounding three people close to Mr Berlusconi. Ms el-Mahroug was said to have told the prosecutors about parties at the prime minister’s villa, near Milan, involving numerous women. One allegedly ended in an erotic game known as “Bunga, Bunga”. Ms el-Mahroug, a runaway who worked as a belly dancer, has since said Italy’s billionaire leader gave her, unsolicited, €7,000 ($9,800) after she had told him her hard-luck story.

The affair is about more than just innuendo and the damage Mr Berlusconi is doing to Italy’s image. Last May police in Milan detained Ms el-Mahroug on suspicion of theft, but then let her go even though she was a minor who would normally have been put in care. The commander has said the station took a call from Mr Berlusconi’s office, and the prime minister has admitted sending an associate to take charge of Ms el-Mahroug. But on November 2nd Milan’s chief prosecutor ruled that the police had followed the correct procedures.

Mr Berlusconi’s response so far has added credence to the worst assumptions about him, saying that what happened at his home was his business, that he had no intention of changing his way of life and that, anyway, it was better to be passionate about pretty girls than to be gay—a remark that appalled liberal critics, but probably went down well with core Berlusconi voters who might otherwise be tempted by the even more reactionary appeal of the Northern League, Mr Berlusconi’s coalition partner.

Brazenness got the prime minister through the last bout of sex scandals in 2009. Will it work this time? Last year’s controversies battered an otherwise strong government. Mr Berlusconi had cleared Naples of the garbage mountains that helped topple the previous, centre-left
government. He had successfully fused his own party with that of the formerly neo-fascist Gianfranco Fini to create a single movement of the right, the People of Freedom (PdL). Italy’s banks had survived the credit crisis almost unscathed, and many voters still believed the government’s claim that the economy as a whole had fared better than any in Europe. Its popularity ratings were high.

Things look different today. One recent poll put the PdL just 2.5 percentage points ahead of the biggest opposition group, the Democratic Party. PdL supporters have been drifting away from the party since May when the government performed an abrupt U-turn, declaring that a package of painful adjustment measures was needed to prevent Italy going the way of Greece.

Paralysis has spread through the administration as it has been repeatedly distracted by financial scandals involving Mr Berlusconi’s ministers and officials, and by his attempts to provide himself with immunity from justice. Last month Corriere della Sera, a newspaper, calculated that, excluding routine legislation, parliament had approved only ten new measures this year. Consob, the body that regulates the stock exchange, has been waiting for the government to give it a new president for more than four months. Ominously, the Naples garbage is piling up again.

Mr Berlusconi’s critics have reacted to the latest scandal with a fury that was not detectable last year. More importantly, his supporters are notably less keen to defend him. Mr Berlusconi’s equal-opportunities minister, Mara Carfagna, whose own relationship with Mr Berlusconi has long been the subject of gossip, dissociated herself from his remark about gays. The same day, two deputies renounced the PdL whip.

There is a widespread view in Italy that the scandal marks the start of an endgame. But it could be a long and complex one, since the politician with the means to checkmate Mr Berlusconi is the very one with least to gain from doing so. Last July Mr Fini led a rebellion that saw his followers in parliament detach themselves from the PdL, robbing Mr Berlusconi of his majority in the lower house. They are setting up a new party. But it is not yet ready to fight an election, and Mr Fini knows that if he brings down the government he could be depicted by the prime minister as having betrayed the right and destabilised the country at a time when Italy, and the euro zone in general, needs a steady hand.

Mr Fini and his followers are due to decide on November 7th whether to leave the government. If they do, they may opt to back it in parliament until they are ready to kill it off. But will Mr Berlusconi let them have the best of both worlds? Instead he could resign, arguing that his former ally had made his position untenable. That would allow him to go to the country in the role he likes best—that of victim.

But there are risks to this course of action. Rather than dissolve parliament and call an election, President Giorgio Napolitano could decide to install a transitional, cross-party government. Even if the president did plump for an election, the polls suggest Mr Berlusconi would free himself of Mr Fini only to become a prisoner of the Northern League’s leader, Umberto Bossi.

Until the deadlock is resolved, Italy will remain a country adrift, its government unable to formulate the policies it needs (most urgently, a strategy for boosting economic competitiveness). Last month Emma Marcegaglia, the head of the employers’ federation, Confindustria, argued that Italy could “not allow itself” a new election. But nor can it permit itself a government that no longer governs.

Europe
Greece’s economic troubles
Pasok and its discontents
A tense mood in Greece ahead of high-stakes local elections

Nov 4th 2010 | ATHENS

A wave of failed letter-bombs targeting Angela Merkel, Silvio Berlusconi and Nicolas Sarkozy, as well as a clutch of foreign embassies, has revived Greek fears that local anarchist groups, who played a big role in last spring’s anti-austerity riots, are preparing a fresh round of violence to coincide with local-government elections on November 7th. This week police arrested two men with booby-trapped jiffy-bags in their backpacks close to the offices of a courier company where an employee had been slightly injured by an exploding package. The men are suspected of belonging to the Conspiracy of the Cells of Fire, an extremist group that specialises in headline-grabbing but unsophisticated attacks.

It was the kind of publicity that George Papandreou, the Greek prime minister, could have done without. He has already made the elections a high-risk test for his Panhellenic Socialist Movement (Pasok) by calling them a “referendum” on the harsh economic reforms required under Greece’s €110 billion ($145 billion) bail-out package from the European Union and the International Monetary Fund. On October 25th Mr Papandreou said that if voters turned away from Pasok he might call a snap general election in December, barely a year after winning the previous one. This could undermine Greek efforts to maintain the confidence of financial markets and avoid a forced restructuring of its debt.

Yiannis Ragoussis, the interior minister, spelled out what the prime minister meant. The decision on whether to call a general election will hinge on the outcome of 13 contests for the powerful post of periferiarch (regional governor), the first time in Greece that senior administrators have been directly elected. If Pasok candidates for periferiarch trail their conservative New Democracy rivals by a wide margin, the government will seek a new mandate.

Pasok supporters appear to be uncertain. Many say they will cast a blank ballot, or simply stay away on election day. Wage cuts for public-sector workers—Pasok’s core constituency—have angered party loyalists. But few are likely to switch to New Democracy, which ran the country between 2004 and 2009 and is blamed for running up the huge deficits that took Greece to the brink of bankruptcy.

The markets are worried. When Mr Papandreou made his threat, yields on Greek bonds shot up towards the levels reached in May, just before the EU and IMF stepped in. But things could get worse. If an election is held, the outcome could be an unwieldy coalition government. Antonis Samaras, the New Democracy leader, opposes the EU-IMF reform programme, as do Greece’s small left-wing parties. Fiscal consolidation would be likely to slow; structural measures would be postponed. Greece’s chances of avoiding default would be slimmer than ever.

Even now there are signs that reform efforts are flagging. Pieces of vital legislation behind schedule include the liberalisation of closed-shop white-collar professions. Tax collection is falling behind target: revenues were up by only 3.6% in the first ten months of the year, compared with a hoped-for 8.7%. Although VAT receipts jumped by around 15% in September and October, payments of income and corporation tax slowed down.

An ambitious scheme to settle arrears owed by businesses had got off to a poor start. Thousands of tax demands were sent to company owners who believed they were up-to-date on their liabilities—a mistake that is likely to cost votes. “How can I go on voting for a Pasok government...
when it treats me like a villain?” fumes Markos Papadopoulos, an importer who claims his books are in perfect order.
France's rigid labour laws

Labour pains

Two cases that help explain France’s high unemployment

Nov 4th 2010 | PARIS

CALM has returned to the streets and petrol to the pumps. But for all the turmoil and tear gas that the government’s mild pension reform prompted, it has left intact an underlying social model based on high taxes and onerous rules for firms and employees, plus generous benefits. Two recent controversies expose the wide gap between what the French expect and what foreign businesses will bear.

Last month Ryanair, an Irish low-cost airline, announced that it is to shut its only base in France, in Marseille, in January 2011. Some 200 jobs will be transferred out of France and 13 routes will be closed, including the one to Paris. This is not because of low demand. Since 2006 Ryanair’s passenger traffic to and from Marseille has jumped eightfold, to 1.7m, as French travellers snap up flights at a fraction of the prices charged by Air France. Rather, Ryanair is leaving as a pre-emptive response to a decision by prosecutors to investigate it for breaching French labour law.

Ryanair was employing 200 cabin staff and pilots in Marseille on Irish labour contracts, which are less burdensome than French ones. This is in line with European Union rules on mobile transport workers, the company argues, since the employees were on Irish “territory” (planes), working for a company resident in Ireland, where they were paid. That may have pushed the rules to the limit, but it made business sense. The tax “wedge” (the gap between what an employer pays and the employee receives) is as much as three times bigger in France than in Ireland.

The French were enraged. “A company with cowboy methods,” fumed La Provence, a local paper. The unions accused the firm of using illegal labour and of social dumping. Ryanair decided to pull out before it got to court. The prosecutors, declared Michael O’Leary, Ryanair’s boss, had “cost Marseille and France jobs, foreign investment and lost visitors”.

There was equal indignation over another foreign firm, Molex, an American electronic-parts maker that supplies the car industry. Last year Molex decided to close its French plant near Toulouse, which had been unprofitable for years. It agreed redundancy packages, which have so far cost it €30m ($42m), and helped finance alternative employment. But in September 188 former employees filed a suit against Molex, contesting their redundancy.

Molex promptly suspended further redundancy payments, arguing that it faced too much uncertainty over future costs. By chance, last week the group reported net profits in the three months to the end of September of $75m, after a loss in the same period of 2009. This sent the unions into a fury, and Christian Estrosi, the industry minister, to their defence. He called the firm’s behaviour “scandalous” and ordered French carmakers, including PSA Peugeot Citroën, a private company, to stop doing business with Molex. For its part, Molex denounced the “aggressive” approach of the French government and its “negative attitude to business and foreign investment”.

France is popular with foreign investors thanks to its skilled workforce and excellent
infrastructure. But many complain that labour law and heavy payroll taxes deter job creation. Bosses believe some workers try to get fired in order to win generous tax-free redundancy. Small firms buy machinery to avoid taking on staff. Yet most French reporting of these two cases, egged on by Mr Estrosi, has drawn a caricature of wicked bosses twisting the rules to exploit workers. Producer sympathy triumphs over consumer interest. And suspicion of profit precludes sensible discussion of the cost to France in lost jobs.
**Nordic politics**

**Love in a cold climate**

**Nordic countries revisit an old idea: union**

Nov 4th 2010 | REYKJAVIK

AS BIG get-togethers go, the Nordic Council’s annual sessions are chummy affairs. With several hundred politicians, diplomats and academics milling around one of the region’s capitals, it is more like a big family gathering than an international summit. The agenda is long on worthy initiatives and short on substance. Yet this week’s meeting in Reykjavik was different—and not just because signs were emerging of another flight-grounding Icelandic ash cloud.

The frisson came from a startling new book by Gunnar Wetterberg, a Swedish historian, proposing a pan-Nordic federation to unite Denmark, Finland, Iceland, Norway and Sweden under a single monarch: Denmark’s Queen Margrethe. The five countries (plus their autonomous territories of Greenland, the Faroe Islands and Aland) would retain individual legislatures for local matters. But economic and labour-market policy would be co-ordinated, and foreign and defence policy would be ceded to the federation. How this would chime with the European Union is not clear: three of the countries are in, Norway is out and Iceland is negotiating membership; only Finland is in the euro.

Yet Mr Wetterberg claims that “the united Nordic federation is a realistic Utopia that could be achieved within 20 years.” The union would have 25m citizens and a combined GDP of $1.6 trillion, making it one of the world’s 12 biggest economies and entitling it to a seat at the G20. The combined economies could be more dynamic and better able to sustain high welfare and living standards.

If Nordic union is such a good idea, why has it not already happened? Mr Wetterberg blames the failure of previous attempts at unity since the collapse of the Kalmar union in the 16th century on meddling foreign powers. The Hanseatic League, the United States and the Soviet Union all obstructed attempts at unification, he says. “Nowadays the great powers no longer interfere and for the first time in 600 years the Nordic countries have the opportunity to discuss their collective future in peace and quiet.”

A poll conducted by the Nordic Council before the summit found that 42% of Nordic citizens were positive or highly positive about political union. But the rest were opposed. And recent gains by far-right parties in Scandinavia suggest that the pull of national sovereignty may be rising. A Nordic union may yet have to wait another century or two.
Ukraine’s government

Life under Yanukovich
Dodgy local elections provide a glimpse of the new Ukraine

Nov 4th 2010 | KIEV AND ODESSA

STRONG nerves and a loaded gun are important attributes for a mayor of Odessa, and Eduard Gurvits has both. It is 1am on November 1st. Local elections have taken place across Ukraine. Reports of ballot-box stuffing are already coming in, but other than the odd raised eyebrow and the occasional outburst, the veteran boss of this picturesque Black Sea port remains calm. After having been on the end of a couple of assassination attempts in the 1990s and a few stolen elections here and there, Mr Gurvits is a hard man to surprise. “They used to shoot us. Now they are just trying to cheat us,” he says.

As the voting in Odessa had drawn to a close, two trucks had mysteriously appeared in the courtyard of the election-commission building, apparently to store the bags of ballots. But the half-dozen young, thuggish-looking men who said they were “furniture handlers” hired to shift the ballot bags hardly inspired confidence. As The Economist went to press the election results in Odessa, and many other regions, were yet to be declared (or decided by Kiev). Mr Gurvits and his main opponent both declared victory.

Ukraine’s opposition parties issued a joint statement saying that the local elections were not free and certainly less fair than the presidential election won by Viktor Yanukovich early this year. The list of complaints is long and colourful. It includes allegations of clone parties, refusal to register candidates, and physical violence and intimidation. International observers were unimpressed; EU and American officials criticised the elections.

The Odessa campaign was certainly grubby. Alexi Kostusev, Mr Gurvits’s main rival, who enjoyed the backing of Ukraine’s prime minister and a regional governor, directed anti-Semitic remarks against the mayor and his family. “Look at his long fingers, his strange eyes, his pointed ears, and you will realise what forces he represents,” he said. The time of independent mayors is over, Mr Yanukovich’s Party of the Regions said in the run-up to the elections. Now everyone has to be part of a vertical power structure, from the president down to local mayors.

Yet the local elections were as much about Mr Yanukovich dividing the spoils of his presidential victory among his supporters as they were about consolidating power. There has been plenty of time for that already. In fact, tightening his grip on power has been one of the main features of Mr Yanukovich’s first year in office. Constitutional changes forced through by the president give him powers that exceed those enjoyed by Leonid Kuchma, Ukraine’s president before the 2004 Orange revolution. Changes to the election law blatanty favour the president’s party.

Mr Yanukovich’s aides say he needs to consolidate power inside his own party to push through economic reforms, such as cutting red tape and passing a new tax code. It is certainly true that the Party of the Regions is hardly a disciplined political unit. Rivalry between competing factions, each with its own business interests, makes it all but impossible to co-ordinate reform efforts. To overcome the dangers of sabotage from within the government, the administration plans to appoint a number of special “commissars”, selected by McKinsey, a consultancy, to see through planned reforms.

The government also says it is determined to fight corruption. Yet so far the law has been applied solely to Mr Yanukovich’s opponents. Supporters of the president allege that the previous government developed a number of staggeringly corrupt schemes. The trouble, says Yulia
Mostovaya, the editor of Zerkalo Nedeli, an independent weekly, is that although their operators may have changed, many of these schemes have stayed in place.

On the face of it, some of Mr Yanukovich’s steps mirror those of Vladimir Putin, Russia’s former president and current prime minister. But unlike Russia, Ukraine does not have enough resources to carry on without reform. “Yanukovich needs to win over small and medium-sized businessmen,” says a senior adviser to the president. “Economic reforms are the only way for him to stay on for a second term.” The danger is that if Mr Yanukovich fails to see them through, the temptation to hold on to power by repressive means may be hard to resist. As the Orange revolution showed, this would only push the country into deeper crisis.
VALDIS DOMBROVSKIS is an unassuming man. But few would be surprised were the newly reappointed Latvian prime minister to reveal that his hobbies included fire-walking. Other European leaders may find cutting slivers of state spending hard, but Mr Dombrovskis has already pushed through a fiscal adjustment worth 8.5% of GDP in 2009 and 4% in 2010. Some wages shrunk by a third. GDP last year fell by 18%. Yet nobody rioted. Mr Dombrovskis’s Unity party won last month’s election with a promise of even more cuts to meet the conditions of an IMF-led €7.5 billion ($10.9 billion) bail-out in 2008.

The problem before he took office again as prime minister on November 3rd was his choice of coalition partners. The election runner-up was the opposition Harmony Centre, backed mainly by ethnic Russians. Talks foundered when Harmony’s leaders refused to say publicly that Latvia had been “occupied” in the Soviet era. Without that, in the eyes of many Latvians, the party leans unacceptably far towards Russia. Some of its new deputies find speaking Latvian hard.

Mr Dombrovskis’s nationalist former allies were also problematic. They have become more radical after their tie-up with a newish party, “All for Latvia”. Its polished leadership struggles to dispel old aromas of chauvinism and gay-bashing. Moderates in the Unity party insisted that the newcomers were unfit for office. So Mr Dombrovskis ended up with the small Greens and Farmers union, which has a different image problem: its main backer is a controversial tycoon, Aivars Lembergs, who is under investigation for bribery and money laundering (he denies all wrongdoing). The party has gained a clutch of ministries, but not the important ones of foreign, defence, finance and the interior.

Few observers expect the government to serve a full four-year term. At some point a coalition with Harmony Centre is on the cards, perhaps when the austerity era is over. The government must cut $790m from next year’s budget to get the deficit down from 8.5% of GDP this year to 6% next year and 3% in 2012 (a prerequisite for following Estonia into the euro, in 2014).

It must also reform public services, raise battered morale among senior officials, biff the oligarchs, resist Russia’s siren calls, improve the business environment, squeeze the illegal economy, lift the political culture and lure migrant Latvians home. Oh, and Mr Dombrovskis needs to stamp his authority on his disunitd Unity party. After what he has already endured, this...
should be a doddle.
IN BRITAIN it is the bogeyman that comes to take away naughty children. In Italy it is fear of the “black man” that makes them eat their greens. In the European Union, it seems, the creatures that the people dread are the red-cloaked members of the Bundesverfassungsgericht, the German constitutional court. Only fear of the judges in Karlsruhe can explain how Angela Merkel, Germany’s chancellor, has persuaded her fellow European leaders to swallow her unpleasant remedy for the euro’s ills.

A new EU treaty to create a permanent system to save countries that cannot pay their debts. Until a few weeks ago most other countries were resisting German calls for a treaty revision, not just to create a crisis-resolution mechanism but, more contentiously, to withdraw the voting rights of those in persistent breach of fiscal rules. The long nightmare of pushing through the Lisbon treaty, which came into force only last December, was so grim that most leaders vowed not to do it again for a long time, if ever. At best they saw amending the treaty as a dangerous distraction, at worst as a plot to disenfranchise smaller members. Better, they argued, to toughen up the rules quickly within the existing treaties to allow more intrusive monitoring of fiscal policies and impose harsher penalties on transgressors. Treaty change should be postponed.

Yet in the small hours of October 29th an EU summit agreed to make a “limited” treaty amendment. Why the change of heart? Because, Mrs Merkel told her colleagues, she had to placate the judges in Karlsruhe. The court is considering the legality of the €750 billion ($950 billion) IMF-backed temporary rescue fund for the euro zone, created in May at the height of the sovereign-debt crisis. Critics say this breached the “no bail-out” clause of the existing treaties. Germany says it was a temporary, “last-resort” measure to save the euro zone, and as such was justified under a clause permitting financial help to a country struck by natural disasters “or exceptional occurrences beyond its control.”

This argument may stretch the treaties too far for the liking of Karlsruhe, which is zealous in protecting national sovereignty and limiting the EU’s powers. Anyway, the exceptional has become the enduring. The financial crisis rages on and the temporary safety-net must be made permanent.

The German government worries that Karlsruhe may yet declare the temporary fund illegal, leaving the euro unprotected. But if the court sees a permanent replacement being created, it may stay its hand. In any case, Mrs Merkel says she will not extend the safety-net beyond 2013.
without big changes, such as ensuring that bondholders—not just taxpayers—bear some of the cost of future rescues. Without a lawyer-proof amendment, the euro could become “a plaything in the hands of the market”. If Karlsruhe doesn’t get you, the speculators will.

Are such threats a trick? The Karlsruhe court has huffed about the democratic deficit of Europe: bodies and puffed about vital sovereign powers that may not be delegated to Brussels, but it has never stopped European integration. Indeed, the preamble of Germany’s Basic Law talks of promoting “world peace as an equal partner in a united Europe”. The court in 1993 endorsed the Maastricht treaty on the grounds that a single currency did not turn the EU into a federal state. Similarly, it approved the Lisbon treaty. And it refused to grant an injunction to halt the financial safety-net, saying this could endanger the euro. The quiet view of most EU lawyers is that the rescue fund does not violate the treaties, because it is designed to prevent a bail-out. Even a permanent system would be used only in exceptional circumstances. But at least one former Karlsruhe judge, Dieter Grimm, thinks the treaty needs to be tweaked because the Maastricht judgment makes explicit reference to the no bail-out clause.

The EU must satisfy not one but two sets of judges. It seeks a treaty amendment that is sufficiently robust to satisfy Karlsruhe. But it also cannot risk crossing the Irish constitutional court’s threshold, set in the 1987 Crotty judgment, for submitting treaty changes to a referendum. The hope is to change the treaty under a simplified procedure requiring only approval by European leaders, without an inter-governmental conference, let alone a fully fledged convention. Moreover, it should not touch the no bail-out clause. Yet for most the question is less one of law and more one of politics. As Romania’s president, Traian Basescu, put it, EU leaders should help Mrs Merkel because they might in turn need her help (and German money) in future

### Releasing the troubles

Even so, starting the business of treaty change is a lot easier than stopping it. The European Parliament may want more powers. British Eurosceptics are still hoping to repatriate some things to Westminster. Any one of 27 national parliaments could block a new treaty, as could voters if any country calls a referendum. Fear of Irish voters is one reason why Mrs Merkel agreed to set aside the suspension of voting rights (that would hardly be a small change). She made other concessions to get her way: at France’s request politicians will enjoy greater control over any sanctions, and Britain received German backing for a tight EU budget.

Worse, the treaty could precipitate a new financial crisis. The president of the European Central Bank, Jean-Claude Trichet, was slapped down for warning EU leaders that even talking of imposing losses on bondholders is dangerous. This week’s fresh sell-off of bonds from troubled countries such as Ireland, Portugal and Greece came almost on cue. The spread demanded by investors to hold Irish bonds rose to a new euro-era record, and spreads on Greek and Portuguese bonds also shot up.

Re-opening the EU treaties may be an understandable bid to appease the red bogeymen of Karlsruhe. But it could yet release the even scarier ghouls, goblins and ogres of the bond markets.
IN A sleepy Wiltshire town preparations are under way for a sad sort of ceremony. On November 5th the body of Sapper William Blanchard, killed in Afghanistan, will pass through Wootton Bassett on its way from RAF Lyneham to a hospital in Oxford. This will be the 143rd repatriation that the town has marked since April 2007, says Anne Bevis, a resident who organises them, and several hundred family, friends, veterans and well-wishers will no doubt be on hand. What started as an impromptu gesture of respect by a few members of the Royal British Legion (RBL), Britain’s biggest services charity, has become a ritual that focuses the attention and grief of a nation.

Britain cares about its military prowess, as the brouhaha over this week’s Anglo-French defence accord suggests (see article). Whatever people may think of the war in Afghanistan, most support the troops waging it. Campaigns to improve pay, housing and other support for serving soldiers have borne some fruit.

So too has pressure to increase compensation for those who have been physically injured. Servicemen are coming back from war with injuries they might not have survived five years ago, such are the advances in battlefield medicine. Charities are raising millions of pounds to build and run facilities to boost their recovery.

Some sacrifices are less obvious than others, however. Take Mark Morgan, who has spent much of the past eight years ricocheting between the street and prison. In 1997, aged 17, he joined the Royal Regiment of Wales. He was sent to Northern Ireland in time for the terrorist bombing in Omagh in 1998. After Bosnia, his next deployment, he went AWOL. When he came back six months later, doctors at a mental-health clinic recommended a medical discharge. In the end he was simply let go.

In the years that followed he lived a recurring cycle of drink and violence, often sleeping on the beach or under the pier in Brighton. Diagnosed with Post-Traumatic Stress Disorder (PTSD), he was unable to manage his own home or a stretch in rehab. While he was in prison in 2009 his solicitor made contact with the RBL, where a quietly persistent ex-navy man helped him sort out his life. He still suffers mood swings but has a steady girlfriend, is broadly off the booze and hopes to study criminology at university. “At least”, he says, “I have inside knowledge of the
Mr Morgan is not typical. An encouraging 94% of those who leave the services for civvy street are said to make the transition successfully. But neither is he unique. Some 20,000-22,000 people are demobbed each year; if 6% of them struggle, that still amounts to a lot of social and economic distress. Whether they cannot deal with something appalling they saw or did on duty; find they cannot function outside an all-providing institution; discover they still have the problems they hoped joining up would solve; or just fail to find their feet in the harsher economic climate outside, many fall by the wayside.

The invisible 6%

Start with mental problems, which are often behind other failures. In a report in September the King’s Centre for Military Health Research found that 3-5% of those coming back from Iraq and Afghanistan were suffering from PTSD (a lower proportion than among American troops, who tend to deploy for longer). But PTSD can take as long as 14 years to reveal itself. Another indicator of mental health was less reassuring. Alcoholism is growing, especially among young servicewomen. And figures on suicide dug out by academics at Manchester University hold a depressing message about young veterans in particular: those aged 24 and under are two to three times more likely to kill themselves than their wider cohort.

There are a fair number of former servicemen in prison, too, though accurate figures are hard to come by. The Ministry of Defence thinks they account for maybe 3.5% of the total behind bars; the National Association of Probation Officers put it last year at up to 10%. The lower estimate suggests veterans are less likely to go to prison than adult men in general. That sounds positive, but vets seem far more prone to commit violence and sexual abuse.

Homelessness is a third problem. A decade ago estimates suggested that veterans made up more than a fifth of the homeless total, but both services and charities have tried hard to put roofs over their heads since then. The RBL reckons that the proportion now is closer to 4%, though not everyone is convinced that the fall has been quite so dramatic.

There is a consensus over who is most at risk: servicemen who leave before completing four years in the armed forces or are discharged before the end of their contracts. They are entitled to minimal help preparing for civilian life. And it is mainly ex-army folk at risk. Infantry regiments tend to recruit from poor areas where jobs are scarce and A-levels scarcer. When these soldiers leave, they often have little in the way of work or family to go back to.

The coalition government has grasped the need to do something about all this. Problems are more easily solved if caught early, but soldiers are often reluctant to discuss them while they are serving and don’t know whom to talk to after they leave. A mental-health hotline is to be launched and more specialised nurses provided. But funds are in short supply; a lavish American-style GI Bill of Rights is unlikely.

So the veterans’ charities, which are already doing more for people whom the government has put in harm’s way than some are comfortable with, will continue to do most of the hard graft. Chris Simpkins, director general of the RBL, fears the effect of spending cuts on general benefits and housing entitlements, as well as on service budgets. “I am planning for a bow-wave of demand for our welfare support,” he says. He worries about having the resources in a decade or two to deal with problems being sown today.

Does all this amount to a nation “honouring the covenant” (as Liam Fox, the defence secretary, puts it) and showing living soldiers the respect that Wootton Bassett accords the dead? Veterans have not, of course, paid the ultimate price, but many have paid a pretty stiff one. As the streets fill this week with poppies in advance of Remembrance Sunday, Britons will be thinking of the past and of the troops presently serving in Afghanistan. They ought perhaps to think also of a future that, for some servicemen, is likely to be bleak.
Cutting out the middle men
The most efficient way to spend money on the homeless might be to give it to them
Nov 4th 2010

WHEN the workers in the City of London head home each evening, a hidden legion of homeless people shuffles out of the shadows to reclaim their territory. The Square Mile has more rough sleepers than any other London borough except Westminster: 338 were identified by Broadway, a charity, over the past year, most of whom had spent more than a year on the streets. Policymakers have long struggled to find ways to shift such people, some of whom take deluded pride in their chaotic circumstances, resist offers to come in from the cold and suffer from severe drug, drink or mental-health problems (sometimes all three).

Broadway tried a brave and novel approach: giving each homeless person hundreds of pounds to be spent as they wished. According to a new report on the project by the Joseph Rowntree Foundation, a think-tank, it worked—a success that might offer broader lessons for public-service reform and efficiency.

The charity targeted the longest-term rough sleepers in the City, who had been on the streets for between four and 45 years (no mean achievement when average life expectancy for the long-term homeless is 42). Instead of the usual offers of hostel places, they were simply asked what they needed to change their lives.

One asked for a new pair of trainers and a television; another for a caravan on a travellers’ site in Suffolk, which was duly bought for him. Of the 13 people who engaged with the scheme, 11 have moved off the streets. The outlay averaged £794 ($1,277) per person (on top of the project’s staff costs). None wanted their money spent on drink, drugs or bets. Several said they cooperated because they were offered control over their lives rather than being “bullied” into hostels. Howard Sinclair of Broadway explains: “We just said, ‘It’s your life and up to you to do what you want with it, but we are here to help if you want.’”

This was only a small-scale pilot project—though its results have been echoed by others elsewhere in Britain—but it underlines the importance of risk-taking in the provision of public services. In this case, although finance directors (and many voters) might balk at buying the homeless caravans, the savings should outweigh the costs. Some estimates suggest the state spends £26,000 annually on each homeless person in health, police and prison bills.

The scheme also reinforces the view that handing control to the users of public services, even in
unlikely circumstances, can yield better results. It is perhaps the most radical application yet of “personalised budgets”, increasingly used in Britain for the disabled and chronically ill. That is itself in keeping with an emerging international trend to use “conditional cash transfers” to solve intractable social problems.

Roland Fryer, a Harvard economist, has invested more than $6m to test the proposition that paying pupils can improve poor schools. The most successful method was the simplest, in which children in Dallas were rewarded for reading books. Similar schemes are proliferating in the developing world. In Malawi, the World Bank recently gave a trial to the idea of paying adolescent girls to stay in school. That worked, too. Researchers also found that rates of HIV infection were much lower among girls paid to stay in classrooms: one more lesson in the power of responsibility and self-control.

Britain
The Anglo-French defence pact
Divided we fall
Britain and France need each other to continue as great(ish) powers
Nov 4th 2010

They may not always see eye to eye, but when it comes to defence, the interests of France and Britain converge. The two countries are respectively the third and fourth biggest military spenders in the world. Both see themselves as global players, ready and willing to project expeditionary force. But fiscal austerity has threatened the ability of both to live up to those grandiose ambitions. Only by working much more closely together, they have concluded, can two medium-sized European countries hope to stay in the great-power game. Hence the 50-year defence and security co-operation treaty signed this week in London by David Cameron and Nicolas Sarkozy.

The main items in the pact are a combined joint expeditionary force and an agreement to operate aircraft-carrier strike groups using aircraft and escort vessels contributed by both countries. But much of the treaty deals with less glamorous equipment and capabilities. Training and maintenance for the new A400M transport aircraft that the two nations are buying will be pooled. Britain is keen to share its new A300-based aerial tankers, if a financial deal to do so can be reached.

The two countries will jointly develop nuclear-submarine technologies, satellite communications and maritime-mine countermeasures. The big defence industries of both will be encouraged to co-operate on the next generation of surveillance drones and assorted new missiles, with the aim of forging a single prime European contractor for “complex weapons”.

Most dramatically, a separate treaty has been signed on nuclear co-operation. This is remarkable, given the different approaches that France and Britain have taken towards their nuclear deterrents (Britain depends heavily on American kit, while France’s force de frappe is a supreme symbol of national sovereignty). With the blessing of the United States, Britain’s Aldermaston research establishment will concentrate on developing technology, while its French counterpart at Valduc will carry out simulated warhead testing.

Predictably, there was much harrumphing in Britain’s jingoistic popular press. A few retired politicians were dragged out to reminisce about slights suffered at the hands of the perfidious Frogs. The reaction in France was more muted, perhaps because the agreement carefully avoids any of the visionary language about European architectures that excites French imaginations, but which many British Conservatives, such as the defence secretary, Liam Fox, viscerally loathe.

In fact, most of the objections raised seem either ignorant or anachronistic. Even before France rejoined NATO’s integrated military structure last year, British and French forces had frequently worked and fought together under the command of one or other country. With the exception of the Iraq controversy, the two have rarely found themselves on opposite sides during recent international crises. For example, Britain’s defence secretary during the Falklands war, John Nott, revealed in his memoirs that France had been Britain’s staunchest ally, providing information that helped to render the Exocet anti-ship missiles used by Argentina ineffective, and supplying Mirage and Super-Etendard fighters for British Harrier pilots to pit themselves against in training.

Difficulties could arise, however, over shared use of the two countries’ aircraft carriers, if national
priorities and policies do not coincide during future conflicts. One solution would be for Britain not to sell the second carrier it is currently building, which at present seems its likely fate, but to operate it on a timeshare basis with the French. That way it could be made available without caveats to whichever country needed it when its main ship was in refit (a three-year job required every seven years or so). Just don’t call it *Trafalgar*.
The Murdochs and Sky

Patience, Rupert

The government calls for scrutiny of News Corporation’s bid for Sky

Nov 4th 2010

APART from The Economist, Britain’s news outfits have lined up to oppose News Corporation’s bid to take over British Sky Broadcasting. So it wasn’t surprising that, on November 4th, Vince Cable, the business secretary, asked Ofcom, the communications regulator, to scrutinise the deal. He thus set in motion a lengthy and awkward process that might end with a full investigation by the Competition Commission.

News Corporation already owns 39% of Sky, which emerged from a network built by Rupert Murdoch in the 1980s. Yet opponents argue that the New York-based media conglomerate should not be allowed to own all of Britain’s richest television firm as well as four of its national newspapers. As Ivan Lewis, Labour’s shadow business secretary, put it in an article in the Guardian, they fret that “the Murdoch empire has sometimes crossed reasonable boundaries with overzealous business practices and assertion of political power.”

Assuming that News Corporation wins over Sky’s shareholders, the deal is likely to go through anyway. British rules on media ownership are largely designed to prevent media barons from acquiring large stakes in ITV, a terrestrial broadcaster that was once immensely profitable. In any case, News Corporation already has a controlling stake in Sky. If the company is not really changing hands it is hard to see what the regulators can do.

Yet News Corporation is not just a large media company. Mr Murdoch and his son James, his heir apparent and a moving force behind the Sky deal, have inserted themselves into British politics, backing the Conservatives in this year’s general election after many years of supporting Labour (which has sounded more sceptical about them since it lost power). They have upbraided media regulators and the BBC. Obstruction and scrutiny of their dealings is bound to have political consequences.

Britain
Paying for higher education
The cap fits

Tuition fees are set to triple at some English universities

Nov 4th 2010

HOW much? That was the big question left by the report on university finance in England produced by Lord Browne, a former boss of BP, on October 12th. Lord Browne concluded that the current cap on tuition fees of £3,290 per year should be removed (though he suggested the Treasury claw back funds from universities that set high fees, reducing the incentive to charge more than £6,000). At the time, the government made it clear that it would retain a cap of some kind. On November 3rd David Willetts, the universities minister, specified its level: universities should be able to charge up to £9,000 a year, he said, if they implement as yet unspecified policies to attract students from poor families.

Tuition fees are sensitive for the coalition government. The Liberal Democrats’ general-election manifesto pledged to abolish them. In the agreement they made with the Conservatives when the coalition was formed, they won the right to abstain on legislation arising from the Browne review. The pledge has now been ditched—at least by the party’s leadership. Last month Vince Cable, the Lib Dem business secretary whose department covers universities, said opposition to fees was unfeasible in the current economic climate. As if to prove him right, George Osborne, the chancellor of the exchequer, slashed direct state funding for teaching in universities by 40% in his spending review.

Mr Willetts’s proposal retains the system of maintenance grants and loans to cover tuition introduced by the previous Labour government. Students need pay nothing upfront: only after they graduate and earn more than £21,000—up from the present £15,000—would they begin repaying their loans, at a rate of 9% of their income above that level. Whereas student loans have in the past attracted no interest in real terms, graduates would in future pay a variable interest rate of up to 3% above the retail-price index of inflation while they are making repayments. But the interest rate would fall to zero in real terms if the graduate lost his job or entered low-paid work. Debt still unpaid 30 years after graduation would be cancelled.

Should the increase be implemented across the board, it would make England one of the most expensive countries in which to study (see chart). In practice, with such a high cap, universities are likely to vary their fees considerably (under the current system, all universities charge the maximum fee for all their courses). Students taking courses that are expensive to teach and lead to lucrative careers, such as medicine, are likely to be charged the full whack; those studying at elite institutions can also expect to pay more. A proper market in higher education should emerge. (Scottish students who attend universities north of the border currently pay nothing, though that may change after next year’s elections to the Scottish Parliament.)

Many Lib Dems and others worry that students from poor backgrounds will be deterred by much higher fees. And in the stampede for university places that has taken place over the past 20 years, clever children from poor families have indeed lost out to dimmer peers from prosperous ones. But cost does not seem to be the explanation: previous hikes in tuition fees did not dent demand from rich or poor. Rather, it seems that poorer pupils tend to aim lower. Research by the Sutton Trust, a charity, found that bright pupils from independent schools made more than twice
as many applications to the best universities as those from comprehensives. Universities seem broadly satisfied by Mr Willetts’s proposals: those which wanted the cap to go altogether will mostly be content with a much higher limit. Apart from prospective students, the proposals will inflict the greatest discomfort on rank-and-file Lib Dem MPs. Two former party leaders and a few backbenchers say they cannot support the proposals. But their rebellion is unlikely to prevent the government from getting its way.

Britain
AN EAST London train station, austere and damp, is an unlikely venue for a crash course in futurism. But in a recently renovated and temporary—or “pop-up”—exhibition space at Hackney Downs station, commuters can school themselves in it. The project, named Banner repeater, is typical of many pop-up art installations: intellectual, obscure and distinctly not for profit. But another type of pop-up has recently prospered: unashamedly commercial shops-cum-marketing tools.

Independent galleries, theatres, bars (not always licensed) and front-room restaurants, all with intentionally short lifespans, have been popping up suddenly, often overnight, in the hipper parts of large British cities for several years. The exigencies of the recession encouraged retailers to emulate them: the previous government set up a £3m fund to fill empty shops; landlords became more willing to sign short-term leases.

Last year the people behind an ice-cream brand named The Icecreamists ran a pop-up shop, complete with in-house band and catwalk shows, inside Selfridges in central London; this month they open a new temporary store in Covent Garden. The brand’s slogans—one of which promises to “liberate the world one lick at a time”—wouldn’t be out of place at Banner repeater. But its ambitions are different.

Matt O’Connor, the outfit’s founder (and a PR man), says his first pop-up let him launch his brand for a tenth of the normal cost, while testing product ideas. For established brands, the format provides a direct way of interacting with customers, turning each day’s trading into a consumer focus group. For their part, landlords and hosts can associate themselves with strong brands.

Firms in other countries were quicker to see the high-impact potential of the pop-up technique. In 2004 Comme des Garçons, a Japanese designer label, opened a ‘guerrilla store’ in Berlin. Pop-ups promoting high-end fashion appeared in New York at around the same time. The pop-up practitioners in Manhattan today are more prosaic: during the summer Kellogg Company launched a pop-up in Times Square promoting, inevitably, Pop-Tarts.

Likewise, many recent British pop-ups have been offbeat ventures by mainstream firms. Indesit, a washing-machine manufacturer, hosted a two day launderette-nightclub last month; comparethemarket.com, an insurance-comparison website, opened a shop to promote the
autobiography of Aleksandr Orlov, the fictional meerkat in its television adverts.

Roland Smith of Theatre Delicatessen, a theatre group (currently based in a building yards from Selfridges), talks of the “thrill” of the transient but tangible pop-up experience in a world increasingly dominated by the impersonal internet. He says he “grudgingly admires” corporate pop-ups, but feels they miss the radical point: “We take a local environment, subvert it and respond to it—they are just another shop.” Still, perhaps commerce has a claim to have come up with the idea in the first place: before the pop-up came the car-boot sale.

Britain
EVERY year, as bonfire night approaches, Britons are warned about the dangers of fireworks and accidental conflagrations. This year Londoners would do well to pay close attention. On November 1st around 5,500 firemen downed hoses for an eight-hour strike as part of a dispute over working hours. As The Economist went to press, another strike was planned to start on November 5th.

Choosing Bonfire Night is deliberately provocative: London’s firemen typically deal with three times as many calls on November 5th as on normal nights. Worse, the soldiers who provided cover in past strikes are already stretched, and the ancient Green Goddess fire engines they once piloted (see picture) have been sold. Instead, a bare-bones service will if necessary be provided by a private firm. The strike—and the prospect of others, as unions prepare to battle public-spending cuts—have led to calls for tougher laws.

Nadhim Zahawi, a Conservative MP who takes a keen interest in the emergency services, thinks firemen should be forbidden from striking, on the grounds that they provide an essential service. Soldiers, policemen and prison warders are already barred. Boris Johnson, the mayor of London, suggested in October that Tube workers (who walked out on November 2nd in an unrelated dispute) should be included in the proscription, too. The Confederation of British Industry, an employers’ body, wants the law changed to make it harder to strike, by requiring at least 40% of union members to vote in a strike ballot for it to be lawful.

It is hard to see why firemen should be permitted to strike when policemen and soldiers can’t. Some other countries are less tolerant. American public-transport workers generally cannot strike. Many individual states have their own prohibitions: government employees in New York, for instance, are forbidden from walking out. Sarah Veale of the Trades Union Congress (TUC) points out that the European Convention on Human Rights explicitly protects workers’ right to withdraw their labour. But strike bans can be justified on national-security grounds: in strike-happy France, some firemen are covered by one.

But in most other ways British union laws are already among the toughest in the developed world, says Richard Hyman of the London School of Economics. In contrast to other European countries such as France and Italy, Britain’s common law recognises no formal right to strike. In theory, unions can be sued for inducing workers to breach their contracts, says Nicholas
Lakeland, an employment lawyer at Silverman Sherliker. Unions can immunise themselves by following elaborate procedures, but officials complain that doing so is hellishly bureaucratic. “I’m not sure there’s ever been a strike that’s been 100% legal,” says one TUC official.

Although it might appeal to many commuters and voters, further tightening of the law could provoke legal challenges. In any case, the law and reality often differ: despite being forbidden from striking, prison warders walked out in 2007 over a pay dispute. Ministers chose to negotiate. Vital workers whom the government might ban from striking are precisely those who can cause the most damage if they do so anyway. “Even if official action is proscribed,” says Mr Hyman, “that could just lead to unofficial strikes, which would be much harder to cope with.”
Terror and dissent

Away from economic policy, the Liberal Democrats are influential—as the row over control orders shows

Nov 4th 2010

VISITING in 1911, the Earl of Rosebery, a former prime minister, crossed out the name Chevening on some headed notepaper and replaced it with “Paradise”. A century on, Nick Clegg, who these days shares the grace-and-favour retreat with William Hague, the foreign secretary, would probably scribble “Haven”. In the outside world the Liberal Democrat deputy prime minister is the target of jokes from politicians who doubt his power in the government, and of personal abuse in the streets from voters enraged by his collaboration with the Conservatives. His party has lost nearly half of its support in opinion polls since May. In person, he sometimes cuts a beleaguered figure.

The Lib Dems are following their leader’s injunction to “own” everything the coalition does instead of openly carping at policies they dislike. They are a contrarian bunch; many expected them to try to be in government and somehow in opposition at the same time. They have been more grown-up than that. Still, for its own credibility, the party must be seen to be making a difference to policy. On the big issue of the day, they are failing. The coalition is cutting the fiscal deficit as aggressively as the Tories could have wished if they were governing alone. The Lib Dems, who campaigned in the general election to delay the public-spending cuts until next year, have struggled to explain their change of heart. Costly pet causes, such as the party’s opposition to higher university-tuition fees, have been ditched.

But not all politics is economics. Some of it is life and death. And here, the Lib Dems are influential. Take the government’s current dilemma over control orders. These restrictions, which amount to house arrest for a few suspected terrorists, were introduced by the previous Labour government to deal with those who could not be brought to trial because evidence was scant or sensitive. Earlier methods of protecting the public from them, such as prolonged incarceration without charge and deportation to countries where they might be tortured, had been ruled unlawful. Critics of control orders—including almost all Lib Dems—say they are “Kafkaesque” violations of liberty. Their defenders, who include Theresa May, the home secretary, and the security services, doubt that the proposed alternatives, such as allowing evidence obtained by intercepting e-mails and phone conversations to be used in court, would solve the problem.

A purely Tory government would probably have retained control orders. In opposition the party promised to review the policy but, unlike the Lib Dems, did not commit to abolishing them. The
Tories harbour some libertarians (Ken Clarke, the justice secretary, and Dominic Grieve, the attorney-general, among them) but they are outnumbered by hardliners. Some previously ambivalent ministers have been won over by advice from the security services. With the Lib Dems to please, however, it is uncertain whether David Cameron, the prime minister, will ultimately decide to keep the orders. If the Home Office review that is currently examining counter-terrorism laws recommends their retention, the junior branch of the coalition will rage.

Recent weeks have provided other glimpses of the Lib Dems’ influence on non-economic matters. On November 1st the government was forced to concede that Britain’s blanket ban on prisoners voting was unsustainable under the European Convention on Human Rights. On October 29th Mr Cameron accepted a 2.9% increase in the European Union’s budget. True, both of these very un-Tory things might have been inevitable. But many Conservative MPs are convinced, probably rightly, that Mr Cameron would have fought harder against them were he not having to keep Mr Clegg’s libertarian, Europhile party on side.

This is the exact opposite of what many expected at the founding of the coalition. Back then, the distribution of cabinet posts seemed to speak for itself: many important economic jobs were handed to Lib Dems (including the roles of chief secretary to the treasury and business secretary) while Tories monopolised home and foreign affairs, justice and defence.

**The soft underbelly**

But perhaps the Lib Dems’ clout on issues such as counter-terrorism should not be so surprising. On economics, the party is split between liberals and social democrats. But on home and foreign affairs, it is perhaps the most united of the three main parties. And Tory thinking in these areas was a vacuum waiting to be filled. Following the resignation of David Davis in 2008, Mr Cameron failed to settle on a home-affairs spokesman. Ms May was his unexpected choice after the election.

If the Lib Dems’ sway on these issues was foreseeable, so are its political dangers. One is Tory anger. Even some of the Conservative MPs who agree with the Lib Dems on control orders worry about their liberal line on crime. Behind the scenes, figures from both parties are coming together to plan “coalition 2.0”—a policy programme for the second half of the parliament. Among the rumoured Tory representatives are confirmed hawks such as Michael Gove, the education secretary, Owen Paterson, the Northern Ireland secretary, and Tim Montgomerie, a well-known blogger. They are likely to press for a grittier home-affairs policy.

A bigger worry for the coalition should be broader public opinion. Some of Mr Cameron’s advisers say that the coalition allows them to jettison policies favoured by their party’s right-wing fringe. But on terror and crime, most voters are in tune with the Tory right; and that is before the dreaded prospect of another terrorist attack in Britain. The Labour opposition, if it resolves its own divisions on home affairs, could wound the government by portraying it as ideologically hostile to the state in all its functions, whether in protecting people’s livelihoods or indeed their very lives.
Yemen’s local and global terrorism

No quick fixes

Fighting terrorism in Yemen requires patience and partners

Nov 4th 2010

JUST as mist often cloaks its spiky mountain peaks, Yemen tends to fade from outsiders’ view until an alarming event there commands sudden interest. The foiling of al-Qaeda’s Halloween plot to sneak two parcel bombs onto aircraft bound for America is just such an attention-grabber.

The attackers hid the devices in ink cartridges inside computer printers and sent them by scheduled courier services from the Yemeni capital, Sana’a, addressed to synagogues in Chicago. The plan may have been to explode them en route, perhaps as the plane was landing. That highlights a security hole in global transport (see article) as did a separate series of primitive bombs sent, apparently by Greek leftists, to the German chancellor Angela Merkel and other European targets.

The accuracy of the tip-off that prompted the search for the Yemeni bombs, and the inter-agency teamwork that located them in cargo sheds in Dubai and Britain are a welcome success in international counter-terrorism and cause of much back-patting. The clue apparently came from a former al-Qaeda fighter, Jabir al-Fayfi. Transferred from Guantánamo in 2006 and "deradicalised" by Saudi specialists, he rejoined al-Qaeda in Yemen; he may have been a double agent all along.

But the plot has rightly revived worries about the murderous resilience of the global terror network’s Yemeni branch. With rugged terrain and a dispersed population, fearsomely armed and bound by tribal loyalties, the country has long been an ideal refuge for bandits, rebels and, lately, terrorists. Yemenis have been prominent in al-Qaeda since the 1990s and are the biggest group in Guantánamo. Osama bin Laden is of Yemeni descent. Al-Qaeda attacked the USS Cole in Aden harbour in October 2000.

Yemen has rarely enjoyed strong central government. After taking power in 1978 its president, Ali Abdullah Saleh, relied on earnings from oil exports to arm loyalists and to buy off tribal leaders. But oil earnings tumbled and foreign investment dried up, even as the population tripled. Some 40% of Yemenis live on less than $2 a day. Child hunger is rampant. The water shortage is dire. A tribal insurrection in the north has led to six rounds of fighting since 2004 and displaced some 350,000 people. An independence movement is growing in the south, where al-Qaeda is most active,

Mr Saleh’s dealmaking has sometimes tilted towards using the terrorist threat to attract foreign
sympathy and cash, while giving leeway to jihad-inclined radicals who are occasional allies against his leftist and Zaydi (a Shia sect) opponents. After September 11th 2001 Mr Saleh supported the "war on terror". His security services (with American help) largely shut down the local branch of al-Qaeda. But a drone attack in 2002 on the group’s leaders enraged local feeling. Combined with fury over the invasion of Iraq, it made helping America politically toxic. Some analysts mark the suspicious “escape” of 23 al-Qaeda inmates from a Yemeni jail in 2006 as the start of the group’s re-emergence.

These local jihadists merged with fugitive Saudi al-Qaeda operatives to form al-Qaeda in the Arabian Peninsula (AQAP) in January 2009. Since then Yemeni terrorism has grown bolder. Although its international attacks get most publicity, AQAP’s main effort has been in Yemen and, to a lesser extent, in Saudi Arabia. A suicide bomber there came close last year to killing the man who chased them out of the country, the kingdom’s head of counter-terrorism, Prince Muhammad bin Nayef.

AQAP’s local targets are government security forces, energy infrastructure and foreigners. Twice in the past year British diplomats in Sana’a have narrowly escaped assassination. Others have been less lucky. A murder campaign against Yemeni security and intelligence officers, designed to destabilise the government while avoiding the large-scale civilian casualties that helped turn the Iraqis and Saudis against al-Qaeda, has been particularly relentless. At the end of Ramadan (September 9th), AQAP published a hit list of 55 senior security officers. It has now gunned down half a dozen on the list, having previously murdered more than 60 people this year. In June its guerrillas stormed a prison in Aden and freed an unknown number of comrades. Since September, says Yemen’s president, 70 of his men have died in clashes with AQAP cells that have seen the government besieging towns, using helicopters and fighter jets.

American spooks reckon that whereas only 100 al-Qaeda fighters are left in Afghanistan and about 300 are in Pakistan, AQAP has several hundred. These comprise Yemenis, Saudis, other Arabs and an increasing number of Westerners, including Americans, such as the notorious Anwar al-Awlaki. He is linked to three people bent on attacking America—Umar Farouk Abdulmutallab (the “underpants” bomber); Nidal Malik Hasan (the perpetrator of the Fort Hood massacre); and Faisal Shahzad (the Times Square bomber)—as well as a Muslim student convicted in Britain this month for trying to kill an MP. Home-grown terrorists, radicalised by the internet and often trained abroad are a new and growing problem for America.

Some fear that Yemen could now join nearby Somalia in a zone of violent anarchy straddling one of the world’s main shipping lanes. Such alarmism may be misplaced. Until recently, Yemenis tended to dismiss their government’s talk of the threat from AQAP as scaremongering, aimed at garnering Western aid. Now the public is more sympathetic to the goal of quashing the radicals and the government has been jolted into a more serious effort.

America has boosted aid to Yemen to some $300m this year. Better armed and trained Yemeni forces have begun to take the offensive against AQAP strongholds. A more systematic and better-funded effort to enlist local tribes is also producing results. In recent weeks even the Awlaki tribe, whose most famous son is the terror chief of that name, appears to have joined government efforts to chase AQAP from its base in the southern Abyan region.

America is not showing any signs of renewed direct intervention since the attack. It maintains a discreet training and advisory mission, conducts secret operations with local forces and has fired cruise missiles at suspected terrorists. But in December 2009 an air strike was blamed for killing more than 40 civilians as well as a handful of intended targets. Another on May 25th killed a deputy provincial governor working as a mediator between the centre and some al-Qaeda elements. Local tribes protested by attacking infrastructure and closing roads to the capital.

Since then, American attacks have almost ceased, despite pressure in Washington for more dramatic action. Rick Nelson of the Center for Strategic and International Studies, a think-tank, says “tactical decisions must not undermine strategic objectives. Simply capturing and killing bad
guys is not a long-term solution.”

AQAP portrays itself as the defender of the Yemeni population against a despised government and American aggression. A highly visible Western security role in Yemen risks stoking the grievances that fire al-Qaeda and others. Most counter-terrorism experts think America should mainly work with nearby rulers in Saudi Arabia, Qatar and the United Arab Emirates. All have large Yemeni populations, a stake in regional stability and the cash to ease Yemen’s many woes. This is America’s war, but not exclusively America’s fight.
A history of parcel bombs

Going postal

Sending explosives through the post has a long and murky history

Nov 4th 2010

PRINTER cartridges and air freight may be new, but lethal misses are not. The Bandbox Plot of November 4th 1712, foiled by Jonathan Swift (author of “Gulliver’s Travels”), was an attempt to kill Robert Harley, Earl of Oxford and Lord Treasurer. A hatbox left at his door was configured to fire cocked pistols when the lid was lifted.

On January 19th 1764 a Danish diarist, Bolle Willum Luxdorph, described perhaps the first successful parcel bomb. A Colonel Poulsen received a box by post. “When he opens it, therein is to be found gunpowder and a firelock which sets fire unto it, so he became very injured.”

Politicians have long been targets of such attacks. One was aimed at Senator Thomas Hardwick and exploded (unsuccessfully) on April 29th 1919. It was the first of nearly 30 devices sent by anarchist groups to politicians, judges and businessmen, all intended to explode on May Day. A campaign in June involved eight larger bombs that killed several people, including one of the anarchists.

In June 1939 50 letter-bombs exploded in postboxes and post offices in London, Birmingham and Manchester. The Irish Republican Army claimed responsibility, as part of their S-Plan campaign, encouraged by Nazi Germany, to disrupt Britain.

Governments have used parcel bombs too. In 1961 Israel’s secret service, Mossad, sent one to Alois Brunner, a fugitive Nazi; it cost him an eye. Another attack in July 1980 took four fingers.

On February 21st 1970 Swissair Flight 330 to Tel Aviv crashed after a parcel bomb exploded in its cargo hold; 38 passengers and nine crew died. This was a rare case of a parcel bomb (as opposed to a baggage bomb) crashing an airliner. The blame fell on Palestinian terrorists.

On September 19th 1972 a letter-bomb in London killed Ami Shachori, an Israeli diplomat. Almost all the 51 similar bombs posted to Israeli embassy employees around the world were intercepted. Following the Munich Olympics massacre in 1972, Israel launched the Wrath of God operation, which dispatched many parcel bombs to its foes.

In December 1977 Donald Woods, a journalist and anti-apartheid activist, received a package containing children’s T-shirts laced with acid: his young daughter was badly burned. He blamed the South African authorities, which were also probably behind explosive parcels that killed anti-apartheid figures, including Ruth First (in Mozambique in 1982) and Jeannette and Katryn Schoon, wife and daughter of the activist Marius Schoon (in Angola in 1984).

America’s best-known postal terrorist was the “Unabomber”, Ted Kaczynski, who sent 16 bombs, claiming three lives (see this week’s special report). One of his devices ignited, but failed to explode, in the cargo hold of an American Airlines passenger plane.

Letters containing anthrax spores were sent to American senators and news outfits in autumn 2001, killing five and infecting seventeen. The main suspect, Bruce Ivins, died in an apparent...
suicide in 2008, his **motive unknown**.
Air freight and counter-terrorism

Turbulence

Bureaucracy not technology

Nov 4th 2010

BOSSES in the aviation industry and their government counterparts have had a tricky relationship since September 11th 2001. Knee-jerk reactions from politicians have caused headaches aplenty. By chance, both groups met in Frankfurt at this year’s AVSEC, a conference on aviation security, just after news of the Yemeni-launched parcel bombs broke.

Rather than rushing through ill-considered and potentially disruptive measures, both sides were keen to keep calm and carry on. Although the latest attack was aimed at cargo rather than passengers, neither the technology nor the thinking behind it was a step change. John Pistole, head of America’s Transportation Security Administration, highlighted “a delicate balance” between responding to the latest threat and safeguarding an industry that carried 26m tonnes of freight last year—just over a third of the total value of internationally traded goods.

Although most countries have temporarily grounded packages from Yemen and Germany has banned all direct flights from there, the emphasis is on helping the Yemenis improve their cargo-screening by deploying teams of inspectors to work with the authorities in Sana’a. Isolating Yemen from the global economy would only worsen its economic woes and heighten popular grievances.

Giovanni Bisignani, the director-general of IATA, the airline industry’s trade body, said that securing the supply chain was the first priority in ensuring that cargo was safe to carry. America’s Certified Cargo Screening Programme makes shippers, forwarders and manufacturers take responsibility for their part of the supply chain. In Britain “known consignors” are approved by transport department officials who inspect every aspect of the supply chain. IATA is promoting an initiative called Secure Freight designed to help other governments do something similar.

An IATA programme known as e-freight aims to do for cargo what e-tickets have done for passengers. It will soon cover up to 80% of cargo shipments and save the industry around $5 billion a year. It should also improve security, providing a common data set that gives the authorities electronic access to some 20 documents that describe who is shipping what, whence, whither and to whom.

The big unsolved problem is scanner technology. The X-ray machines that screen passenger baggage have a patchy record. America is speeding up the introduction of controversial new full-body scanners. Their effectiveness is questionable but Europe is likely to have to follow suit. Yet it is intelligence tip-offs, not airport checkpoints, that have foiled the vast majority of attempted attacks on aircraft (including the most recent one).

Work is under way to come up with technologies to screen air freight. But no device is yet certified by governments to scan standard-size cargo pallets and large items. Mr Bisignani this week urged a faster passage from the laboratory to the airport for freight scanners. But, for the time being, airlines will have to put their faith in disciplined adherence to more prosaic screening procedures rather than any technological fix for terrorism.
Bomb-making for beginners

Bangers
An explosive cat-and-mouse game

Nov 4th 2010

CONFLICT creates arms races. As in the struggle against computer hacking or drug detection, stopping bomb-makers is a race between two kinds of innovation: creating the bad stuff and detecting it. Intelligence agencies regularly draw up lists of “substances of interest” and pass them on to firms that design and supply detection technology, says Kevin Riordan, of Smiths, an aviation-security firm. But once a substance can be routinely detected, terrorists will either attempt to conceal it better, or make something else.

A dog’s nose is still a good detector for many explosives. Some have suggested bomb-sniffing bees as a further step. But technology is the basis of the explosive-detection business and it usually works either by examining the density of material using X-rays or by using spectroscopy to detect the mass and mobility of molecules. For more advanced machines, detecting a new explosive can be as simple as upgrading the software. First, the new target is characterised, then an algorithm (a series of rules programmed into a computer) is devised to detect it in scanned samples.

John Wyatt, a terrorism expert at SDS, a security company, says that only the most advanced X-ray machines can flag up the pentaerythritol tetranitrate (PETN) used in the Yemeni cargo bombs. Other X-ray machines may find it if the operators know what to look for (it should show up orange instead of blue). Swabs should pick it up too (removing traces of most explosives requires thorough scrubbing) but poor training means that operators often use them incorrectly.

As military high-explosives have become harder to get hold of, terrorists have moved to commercially available materials. Counter-terrorism experts fret about home-made high explosives. But made in any useful quantity, these require large amounts of suspicious substances. They are tricky to concoct and more likely to kill their makers than their targets.

PETN, for example, is found in military devices such as landmines, and it is sold commercially as a heart drug. But making it yourself requires two nasty acids to be heated to 800°C. ”If you don’t know what you are doing,” says Keith Plumb, of Britain’s Institution of Chemical Engineers, “you have a 100% chance of death”. PETN is also not particularly easy to detonate. That stymied the “underpants bomber” on a Detroit-bound plane at Christmas.

Although American and British authorities have said the devices dispatched from Yemen were intended to blow up aeroplanes and were capable of doing so, experts in explosions and explosives are more cautious. Whether a bomb of this size could bring down a plane would depend on the size of the aircraft and where in the hold it was placed (next to the hull would be ideal). The bomb-maker has no control over either.

Hans Michels, a professor of safety engineering at London’s Imperial College, estimates that about 1.5lb (0.7kg) of PETN could be packed into the kind of printer cartridges used in the
bombs. That is around a tenth to a fifth of the power of the bomb that blew up a London bus in the bombing in July 2005. Something of this size, he reckons, would destroy two rooms in a suburban dwelling. Or a synagogue.
What if there were two worlds, the real one and its digital reflection? The real one is strewn with sensors, picking up everything from movement to smell. The digital one, an edifice built of software, takes in all that information and automatically acts on it. If a door opens in the real world, so does its virtual equivalent. If the temperature in the room with the open door falls below a certain level, the digital world automatically turns on the heat.

This was the vision that David Gelernter, a professor of computer science at Yale University, put forward in his book "Mirror Worlds" in the early 1990s. "You will look into a computer screen and see reality," he predicted. "Some part of your world—the town you live in, the company you work for, your school system, the city hospital—will hang there in a sharp colour image, abstract but recognisable, moving subtly in a thousand places."

Even two decades later that sounds like science fiction. But this special report will argue that Mr Gelernter was surprisingly prescient: mankind is indeed building more and more "mirror worlds", or "smart systems", as they are often called. The real and the digital worlds are converging, thanks to a proliferation of connected sensors and cameras, ubiquitous wireless networks, communications standards and the activities of humans themselves.

This convergence may not be instantly discernible, because it is happening in many places at once and is often not understood for what it is. It is most advanced in controlled environments. For example, software developed by Siemens, a technology conglomerate, maintains virtual replicas of factories to monitor and reconfigure them. But it is spreading everywhere and has developed a language all of its own. Glen Allmendinger of Harbor Research, a consultancy, calls it the "virtualisation of the real world". Researchers at MIT's Media Lab who connect real-life objects with copies in Second Life, a virtual world, refer to the result as "cross reality". Google’s Earth and Street View services are the first, if static, replicas of the entire world; sensors placed in cows allow the tracking of their every move from birth to abattoir; smart power meters tell utilities in real time how much electricity is used.

The many uses of smartphones

Yet it is the smartphone and its "apps" (small downloadable applications that run on these
devices) that is speeding up the convergence of the physical and the digital worlds. Smartphones are packed with sensors, measuring everything from the user’s location to the ambient light. Much of that information is then pumped back into the network. Apps, for their part, are miniature versions of smart systems that allow users to do a great variety of things, from tracking their friends to controlling appliances in their homes.

Smartphones are also where the virtual and the real meet most directly and merge into something with yet another fancy name: “augmented reality”. Download an app called “Layar” onto your smartphone, turn on its video camera, point at a street, and the software will overlay the picture on the screen with all kinds of digital information, such as the names of the businesses on the street or if a house is for sale.

These and other services are bound to grow together into what Jan Rabaey, a computer scientist at the University of California at Berkeley, grandly calls “societal information-technology systems”, or SIS. Technological progress is sure to supply the necessary components. Moore’s law, which holds that the processing power of a single computer chip roughly doubles every 18 months, applies to sensors, too.

More processing power and better connectivity also allow the construction of computing systems capable of storing and crunching the huge amounts of data that will be produced by these sensors and other devices. All over the world companies are putting together networks of data centres packed with thousands of servers, known as “computing clouds”. These not only store data but sift through them, for instance to allow a smart system to react instantly to changes in its environment.

**The next big thing**

Information-technology (IT) firms have identified smart systems as the next big thing. Predictably, the most ambitious designs have been produced by the industry’s giants, particularly IBM, where Sam Palmisano, the firm’s boss, made smart systems a priority. A couple of years ago the company launched a campaign called “Smarter Planet”, touting digital technology that would make energy, transport, cities and many other areas more intelligent. Other firms have followed suit, each with a different take reflecting its particular strengths.

Cisco, the world’s biggest maker of networking gear, is trumpeting “Smart+Connected Communities”. Hewlett-Packard, number one in hardware, intends to spin a “Central Nervous System for the Earth”. Siemens and its competitor General Electric, which are more at home in the physical world, plan to put together lots of smart systems in which they can deploy their deep knowledge of certain industries, such as healthcare and manufacturing. And there is a growing wave of “smart” start-ups, offering everything from services to pinpoint a device’s location to platforms for sensor data.

Governments, too, have jumped on the bandwagon. Many countries have been spending large chunks of their stimulus packages on smart-infrastructure projects, and some have made smart systems a priority of industrial policy. The “internet of things”, another label for these systems, is central to the European Union’s “Digital Agenda”. The main contenders in this market are countries that are strong in manufacturing, above all Germany and China.

But the bandwagon is not just rolling for the benefit of technology companies and ambitious politicians. It has gained momentum because there is a real need for such systems. In many countries the physical infrastructure is ageing, health-care costs are exploding and money is tight. Using resources more intelligently can make taxpayers’ money go further. Monitoring patients remotely can be much cheaper and safer than keeping them in hospital. A bridge equipped with the right sensors can tell engineers when it needs to be serviced.

China is a good example. It is becoming urbanised on a scale unprecedented in history. By 2025 an additional 350m Chinese—more than the current
population of the United States—will have moved to cities, according to a study by McKinsey, a consultancy. Without an infrastructure enhanced by digital technology it will be very hard to provide the country’s newly urbanised population with enough food, transport, electricity and water.

Most important, smart systems may well be humankind’s best hope for dealing with its pressing environmental problems, notably global warming. Today power grids, transport systems and water-distribution systems are essentially networks of dumb pipes. If the power grid in America alone were just 5% more efficient, it would save greenhouse emissions equivalent to 53m cars, calculates IBM. In 2007 its congested roads cost the country 4.2 billion working hours and 10.6 billion litres of wasted petrol, according to the Texas Transportation Institute. And utilities around the world lose between 25% and 50% of treated water to leaks, according to Lux Research, a market-research firm.

With so much to gain, what is there to lose? Privacy and the risk of abuse by a malevolent government spring to mind first. Indeed, compared with some smart systems, the ubiquitous telescreen monitoring device in George Orwell’s novel “1984” seems a plaything. The book’s hero, Winston Smith, would soon have a much harder time finding a corner in his room to hide from Big Brother.

Second, critics fear that smart systems could gang up on their creators, in the way they did in “The Matrix”, a 1999 film in which human beings are plugged into machines that simulate reality to control humans and harvest their bodies’ heat and electrical activity. Fortunately, such a scenario is likely to remain science fiction. But smart systems might be vulnerable to malfunctioning or attacks by hackers.

Third, some people fret that those with access to smart systems will be vastly better informed than those without, giving them an unfair advantage. Mr Gelernter highlighted this risk in “Mirror Worlds”.

There are plenty of other concerns, and unless they are dealt with they could provoke a neo-Luddite reaction. The world has already seen one extreme example: the Unabomber, a disaffected American who targeted, among others, computer scientists with mail bombs. Two years after the publication of “Mirror Worlds” he sent one to Mr Gelernter, who was seriously injured—though fortunately he survived.
A special report on smart systems

A sea of sensors
Everything will become a sensor—and humans may be the best of all

Nov 4th 2010

GERMANS are known to separate their rubbish diligently. Some even have dedicated containers for different kinds of metal. But they may soon need yet another bin: for electronic labels, also known as radio-frequency identification (RFID) tags. If not kept and treated separately, these could be very difficult to recycle, Germany’s Federal Environment Agency said last year. The number being thrown away each year could rise from about 86m now to 23 billion by 2020, according to the agency.

RFID tags, which have been used to identify everything from cattle to tombstones, will not be the only type of sensor crowding the planet. Anything and anyone—machines, devices, everyday things and particularly humans—can become a sensor, gathering and transmitting information about the real world.

The concept of the “internet of things” dates back to the late 1980s, when researchers at Palo Alto Research Centre (PARC) in Silicon Valley imagined a future in which the virtual and the real world would be connected. In the following years much of the academic work concentrated on bringing this about with RFID tags, which are reliable, inexpensive and do not require a power supply. When exposed to a radio signal, they use its energy to send back the information they contain, mostly a long number identifying an object.

Now it is “active” tags (which have their own power source) and, even more, wireless sensors that are attracting most of the interest. As with all things electronic, these are becoming ever smaller and more versatile. “Tell me what you need, and we can build it for you,” says Reinhold Achatz, head of corporate research at Siemens. Start-ups, too, are producing devices that sense everything from the rarest chemical to the most exotic bacteria. Optiqua, a Singaporean firm, has come up with a chip that measures how fast light passes through a water sample to detect contaminants. And a biosensor developed at the Lawrence Livermore National Laboratory in Berkeley, California, can identify about 2,000 viruses and 900 bacteria.

Researchers are also on the way to solving two big problems that have held back the deployment of sensors. One is power. Having to run wires or regularly replace batteries would be too difficult. But sensors have started to power themselves by scavenging for energy in their environment, for instance in the form of light and motion. Similarly, some sensors already make more efficient use of another scarce resource: radio spectrum. Smart power meters form “mesh networks” to relay their readings.

Engineers working on sensors think this will eventually lead to “smart dust”—sensors as small as dust particles that can be dispersed on a battlefield, say, to spy on the enemy’s movements. Such devices are still far off, but at Hewlett-Packard (HP) in Silicon Valley a taste—or more precisely, a feel—of things to come is on offer even now. To demonstrate the firm’s new accelerometer, a device the size of a cigarette box that measures the acceleration of an object, Peter Hartwell, a researcher, puts it on his chest, and a graph of his heartbeat appears on a screen beside him. “This sensor”, he proudly explains, “is one thousand times more sensitive than those in your smartphone.”

One day, Mr Hartwell and his colleagues hope, a network of one trillion sensors will cover the world and deliver data to anybody who needs them, from carmakers to municipal governments. For now, the firm has teamed up with an oil company, Royal Dutch Shell. The computer-maker
plans to dot a prospecting area with thousands of wireless sensors. They are designed to pick up the echo of the seismic vibrations created by contraptions called “thumper trucks” pounding the ground. The data thus gathered allow them accurately to pinpoint pockets of oil and gas.

Yet RFID tags, wireless sensors and, for that matter, digital cameras (so far the most widely deployed sensor thanks to the popularity of mobile phones) are only half the story. Many objects no longer need an electronic tag or even a barcode to be automatically identified. For example, Goggles, a service offered by Google, can recognise things like book covers, landmarks and paintings. Users simply take a picture and send it to Google’s computers, which will send back search results for the object.

Many of the innumerable machines and devices that populate the physical environment also already come with some data-generating digital technology. More and more are getting connected so that they can communicate the information they contain to the outside world. Examples range from coffee machines and refrigerators to aircraft engines and body scanners in hospitals. These can all now phone home, so to speak, and provide their makers with fountains of data.

People power

Most important, however, humans themselves have turned out to be excellent sensors. Many provide information without any extra effort, just by carrying around a mobile phone. TomTom, a maker of navigation devices, uses connection data from mobile networks to update directions if there are delays. Others are connecting additional sensors to smartphones. Such devices and smartphones are gradually turning people into the sensory organs of the internet, say John Battelle, boss of Federated Media, an online advertising agency, and Tim O’Reilly, who heads O’Reilly Media, a publishing house. “Our cameras, our microphones, are becoming the eyes and ears of the web,” they write in a paper entitled “Web Squared”.

More surprising than such “crowdsensing”, as it has come to be known, is the willingness of many people actively to gather and upload information. The best example is Twitter, the micro-blogging service whose 160m users send out nearly 100m tweets a day (see chart 2). When they see, hear or read something, they type it into their computer or smartphone, 140 characters at a time. “Twitter is the canary in the news coalmine,” wrote Jeff Jarvis, a new-media savant, after the service beat mainstream media to news about the earthquake that struck China’s Sichuan province in May 2008.

But there are plenty of other examples. At OpenStreetMap, a wiki-style website, some 250,000 volunteers record their wanderings, using their smartphones’ positioning functions. And SeeClickFix, a start-up, has come up with a smartphone app that allows users to report such things as broken streetlights or rubbish that needs to be picked up.

Too much of a good thing

It does not take much imagination to see that all these sensors will generate immense amounts of data. “They don’t make enough disk space in the world to save all the data if every household had a smart meter,” says Jim Goodnight, the boss of SAS, one of the pioneers of analytics software, programs that sift through data. “In fact the most difficult question is to decide what to discard.”

The quantity of data likely to be produced is anybody’s guess. Estimates by IDC, a market-research firm, need to be taken with a pinch of salt, because they are sponsored by EMC, a
maker of storage systems. But for what they are worth, they suggest that the “digital universe”—the amount of digital information created and replicated in a year—will increase to 35 zettabytes, or 35 trillion gigabytes—enough to fill a stack of DVDs reaching halfway to Mars. Even that may prove a conservative estimate if sensors and other data-generating devices spread as predicted.

Fortunately, the tools to deal with this data deluge are getting better. Give a marker and a whiteboard to Bijan Davari, a researcher at IBM, and he will draw you a picture of the future of computing as he and his employer see it. On the left side there are small squares, representing all kinds of sensors. The data they produce are fed into something he calls the “throughput engine”, a rectangle on the right. This is a collection of specialised chips, each tailor-made to analyse data from a certain type of sensor. “A system that can’t deal with these streams separately would quickly become overloaded,” says Mr Davari.

IBM has already introduced a product based on what it calls “stream computing” that can ingest thousands of “data streams” and analyse them almost instantaneously. The natal care unit at the University of Ontario is testing such a system to monitor babies born prematurely. It takes in streams of biomedical data, such as heart rate and respiration, and alerts doctors if the babies’ condition worsens.

Analytics software is improving, too. It has long been used to crunch through data that are “structured”, or organised in a database, and develop models to predict, for example, whether a credit-card transaction is fraudulent or what the demand for flights will be around a public holiday. Now such programs can also interpret “unstructured” data, mainly free-form text. Earlier this year SAS launched a product capable of analysing the “sentiment” of chatter on social media, including Facebook and Twitter. The software is also able to find the people who post the most influential comments on specific companies on Twitter, who can then be sent special marketing messages. Indeed, Twitter itself is a kind of collective filter that continuously sorts the content published on the web. And Facebook users, by tagging friends in the pictures they upload, allow the service to recognise these people on other pictures. “Meaning is ‘taught’ to the computer,” write Messrs Battelle and O’Reilly.

But the main goal of smart systems is “to close the loop”, in the words of a report on the internet of things published in March by the McKinsey Global Institute. This means using the knowledge gleaned from data to optimise and automate all kinds of processes. The number of potential applications is vast, ranging from manufacturing to heading off car collisions. Yet the most promising field for now may be physical infrastructures.
A special report on smart systems

Making every drop count
Utilities are getting wise to smart meters and grids
Nov 4th 2010

LONDON’S streets can be a bit of a maze, but below ground things are even more complex. Water pipes crisscross the city in all directions. Some areas used to have competing water companies, each of which built its own system. Not even Thames Water, the utility that operates the British capital’s water-supply network today, knows exactly where all the pipes run.

Moreover, the network is ageing. Only a few years ago more than half of the 10,000 miles (16,000km) of water pipes below the streets of London were over a hundred years old and often burst. It did not help that over many years Thames Water, which was privatised in 1989, failed to invest enough. By the mid-2000s London had one of the leakiest water-supply systems in the rich world. Every day nearly 900m litres of treated water were lost and 240 leaks had to be fixed.

Over the past five years, though, Thames Water has replaced 1,300 miles of cast-iron Victorian mains, those most likely to break, with plastic ones, reducing leakage to 670m litres per day. And when the firm puts in new pipes, it also installs additional wireless sensors, giving it a better view of its network. “We can now tell where we have a broken main even before customers call us,” says Bob Collington, its head of asset management.

Thames Water not only needs to know what is going on in its network, but to be able to act quickly on the information. The same is true of infrastructure operators around the world. Whether in water, power, transport or buildings, all are trying to turn their dumb infrastructures into something more like a central nervous system. That makes them pioneers of the convergence of the physical and the digital world.

Putting sensors and actuators (devices to control a mechanism) into physical infrastructures is not exactly new. Known as “supervisory control and data acquisition”, such systems have been around for decades. But many still require human intervention: workers have to be sent out to download sensor readings or to fix problems. And even if sensors and actuators are connected, different types often feed into incompatible systems, so they cannot be easily combined to automate processes.

The operations centre of Thames Water in Reading, to the west of London, is a good place to see both the old and the new—and soon the future. A big video screen shows expected precipitation over the next few hours, and workers monitor the water level of reservoirs on their own screens. But if one of the pumps fails, they may still have to make a call: not all the valves can be remotely controlled.

Thames Water is investing £100m ($158m) so it can take action remotely and automate a lot of its processes. If the project works, the system will not only automatically deal with leaks but also schedule work crews and send text messages to affected customers. Employees in the operations centre, explains Jerry White, the utility’s head of operational control, will then spend less time monitoring the network and more on making the utility’s processes more efficient.

A big chunk of this work will be analysing the data collected by all the systems and correlating them with other information. Not every unexpected spike in the water flow is the result of a leak, says Mr White. For instance, water use leaps after dark during Ramadan and at half-time during World Cup football matches.

One day soon Thames Water may even be able to send out work crews before a main actually
breaks. In early 2010 the firm began using a web-based service provided by TaKaDu, an Israeli company, that acts as the network’s “eyes and ears”, in the words of Amir Peleg, its founder and boss. The firm analyses historical and online data to provide a basis for comparison, enabling its algorithms to detect things that are about to go wrong.

Similar progress is being made all over the world. The scope for preventing waste is enormous, in the water industry and elsewhere. Power utilities are well ahead, not least because they can use the grid itself to collect sensor data and control switches. Transport systems are behind, particularly roads, which often use nothing more than traffic cameras. Even buildings are getting more automated, with continuous checks on their energy use.

At the edge

For infrastructures to become truly smart, however, it is not enough to put more intelligence into the core of a network. The edge—the interface with users and devices—also has to become clever. This is the idea behind smart metering, which has made a good deal of progress in the power industry. According to Accenture, a consultancy, there are about 90 smart-grid projects around the world today. By the end of last year more than 76m smart meters had been installed worldwide. That number will almost treble by 2015, to 212m, estimates ABI Research.

Smart meters and other gear needed to make grids more intelligent will not come cheap. Morgan Stanley, an investment bank, predicts that the worldwide smart-grid market alone will grow from $20 billion last year to $100 billion in 2030. Yet the benefits also promise to be huge: power savings, reduced investment in electricity generation and lower carbon emissions.

The place to go to see the technology in action is Boulder, Colorado, home to what is considered the world’s first fully fledged “smart grid”. The local utility, Xcel Energy, did not skimp. It deployed equipment that automatically reports power cuts. It installed more than 20,000 smart meters, connected them via a fibre-optic network, launched a website to track power use and has started to offer pricing plans that encourage shifting consumption to off-peak hours. It has even equipped some households with gear that tells air-conditioning systems to turn themselves off when demand for electricity is high, a mechanism called “demand response”.

The results so far are mixed. The system has certainly helped Xcel to run its grid more efficiently. The utility now knows what is happening in its network and power cuts have become rare. Problems can be pinpointed and fixed much more quickly. But customers are not using much less power than they did before. Yet it is early days. Some firms are already beginning to show what can be achieved with demand response. EnerNOC, an American energy middleman, for instance, pays other firms for allowing it to shut down their non-essential gear at times of peak demand, thus freeing up capacity. By mid-year some 3,300 customers, from steel plants to grocery stores, had signed up. Their combined consumption, which can be made available to other users if needed, is 4,800MW, exceeding the output of America’s largest nuclear plant.

The ultimate point of smart grids, however, is to allow dynamic pricing, with electricity charges fluctuating in response to demand. This could cut power demand by 10-15% during peak hours, estimates Ahmad Faruqui of the Brattle Group, a consultancy—more than twice the reduction likely to be achieved by just giving customers real-time information about their usage. That number could easily double again, he says, with a combination of dynamic pricing and demand response.

The main objective of smart power meters is to lower the peak load and thus enable utilities to keep down their peak generating capacity. In the water industry the economics are somewhat different, explains Stefan Helmcke, a water expert at McKinsey. Water can be easily stored and consumers have less discretion over when they use it (for instance, people cannot defer going to the toilet, which uses more water than any other activity at home), so the case for smart water
Yet they are spreading all the same. Boston has long been the shining example. As early as 2004 the city’s Water and Sewer Commission had equipped almost all its customers with wireless smart meters. But it will soon be outdone by New York, which plans to install more than 800,000 of the devices at a cost of about $250m. Even Thames Water, most of whose customers have no meters of any sort, is now planning to install some of the smart kind.

Getting on board

In transport the equivalent of a smart meter is a vehicle’s on-board unit. That used to be a simple device, working like a radio-frequency identification tag when it passes under a gantry on a toll road, but it is also getting smarter. Germany’s Toll Collect system, which ensures that lorry drivers pay for using the country’s crowded motorways, relies on gadgets that are in some ways as clever as a smartphone. Among other things, they keep track of their position with the help of GPS, the satellite-based global positioning system.

Such toll systems are multiplying, particularly in big congested cities, including London and Stockholm. But it is Singapore that leads the pack. The city-state not only charges drivers for using much-travelled roads (driving on an expressway can be S$6, or $4.60); it also adjusts traffic lights to suit the flow of vehicles, uses data collected by taxis to measure average speed and is developing a parking-guidance system, noting that cars looking for somewhere to park are now a big cause of congestion.

Singapore may also become the first city to introduce real-time dynamic pricing on its roads. In 2006 the Land Transport Authority tested a traffic-prediction system built by IBM to set the tolls. And next year it plans to test a satellite-based system that does not require gantries and can charge according to how congested a road is at that particular time.

Another of the island’s infrastructure-management systems has become a model for the world: that for water. At the information centre at the southern tip of the island, next to the Marina Barrage, visitors can literally get a taste of it by picking up a bottle of “NEWater”, waste water that after extensive treatment has become potable again. But most of the treated water is fed back, via a separate distribution system, to Singapore’s factories and power plants—and then treated again.

This closed loop is part of a water-supply system in which “every drop counts,” in the words of Yap Kheng Guan, a director at the island’s Public Utilities Board (PUB). The Marina Barrage is another case in point. It was inaugurated in 2008 and acts as a tidal barrier to keep seawater out, thus turning the island’s most populated district into a water-catchment area and the harbour into a reservoir. When two other reservoirs are opened next year, more than two-thirds of Singapore’s territory will be used to catch rainwater.

The city-state’s desalination plants are also among the world’s most efficient. All this means that the island—smaller than Luxembourg and home to nearly 5m people as well as an economy nearly as big as that of Hong Kong—is able to meet more than 60% of its water needs on its own. But it wants to go even further: 50 years from now it hopes to be self-sufficient.

Sensors play a relatively small part in Singapore’s water management because the infrastructure is so new. On average there is only one leak a day. The PUB puts sensors only in a few key spots, for instance where water leaves the reservoirs. Should the system detect a dangerous contamination, that part of the network can be shut down immediately. And if heavy rainfall in central Singapore threatens to flood the city during high tide, seven huge pumps next to the Marina Barrage start to push water into the sea at 40 cubic metres per second each.

So far Singapore has no smart water meters, and at the moment there is no pressing need. Most
Singaporeans live in multi-storey apartment buildings, which makes it easy to read meters. But if the PUB wants to reach its target of cutting daily domestic water use per person from 155 litres in 2008 to 147 litres by 2020 (about the same as in India, and a quarter of the figure in America, see chart 3), Singapore will have to become smarter still—and set yet another example.
A special report on smart systems

Living on a platform

For cities to become truly smart, everything must be connected

Nov 4th 2010

IN SINGAPORE conversations about water quickly turn political. The city-state no longer wants to depend on water from Malaysia when the current water-supply agreement between the two countries expires in 2061. More than once the neighbour to the north, of which Singapore was part before an acrimonious split in 1965, has threatened to increase prices or even cut off supplies.

Yet politics is not the only reason for Singapore’s advanced water system. The information centre at the Marina Barrage features pictures of floods and droughts. “We have either too much water or too little,” explains Yap Kheng Guan, a director of Singapore’s PUB. Even today, despite a sophisticated system of ditches and tunnels, floods can suddenly strike. In July parts of the main shopping district were under water after heavy rainfalls.

The problems of scarcity and excess are in evidence on the city-state’s roads too. Singaporeans, who are among the world’s richest people, love to drive, but space for roads is severely limited. When in the early 1970s the central area became too congested, the government introduced the world’s first manual urban road-pricing system. In 1998 it became the first to be automated. “Singapore proves that necessity is the mother of invention,” says Teo Lay Lim, who heads the local office of Accenture.

Now the city wants to become a “living laboratory” for smart urban technologies of all kinds—not just water and transport systems but green buildings, clean energy and city management too. Both local and foreign firms in these sectors will be able to develop and show off their products on the island before selling them elsewhere, explains Goh Chee Kiong, who is in charge of the clean-energy cluster at Singapore’s Economic Development Board.

There is strong demand for making cities smarter, not just in China and other rapidly urbanising countries but throughout the Western world. Resources like water, space, energy and clean air are scarce in urban areas, which makes them the natural place to start saving, says Mark Spelman, Accenture’s global head of strategy.

“Smart-city” projects have been multiplying around the world. Some of them are not as new as their labels suggest, and in any case what exactly constitutes a smart city is hard to define. But they all have one thing in common: they aim to integrate the recent efforts to introduce smart features in a variety of sectors and use this “system of systems”, as IBM calls it, to manage the urban environment better.

The best-known smart city is Masdar, a brand-new development in Abu Dhabi that recently welcomed its first residents and will eventually become home to 40,000 people. It is being built entirely on a raised platform, which makes maintenance and the installation of new gear much easier. Below the platform sits the smart infrastructure, including water pipes with sensors and a fibre-optic network. Above it is to be a showcase for all kinds of green technology: energy-efficient buildings, small pods that will zoom around on paths (no cars will be allowed) and
systems that catch dew as well as rainwater.

Yet experts see Masdar mostly as a property project: hardware in search of a purpose. What really matters to a city’s smartness, they argue, is the software that runs on it and the network that connects its parts. “It is the common infrastructure for all the smart systems,” says Wim Elfrink, who heads the “Smart+Connected Communities” initiative of Cisco, the networking-equipment maker.

**Getting it together**

Cisco is trying to demonstrate that point in Songdo City near Seoul, where the firm provides all the digital plumbing. Sitting on reclaimed land, Songdo is perhaps the most ambitious smart-city project so far. It is expected to cost $35 billion and will be home to 65,000 people. Like Masdar, it will boast all the latest green technologies. But its main claim to fame is that everything in the city is wired up.

Residents of “First World”, the first completed apartment complex, already enjoy the benefits of this all-embracing connectivity. Smartphones unlock front doors. Air-conditioning, blinds and security systems are controlled by displays all over the apartment which can also be used to access all kinds of online services. With a few clicks or touches users are able set up a videoconference with a doctor, do business with the local government or find out how best get to work.

What Cisco sees as the most important application for running a smart city was shown at the World Expo in Shanghai this year. In its pavilion the firm built a command centre to keep tabs on an imaginary smart city. A huge video screen displayed everything from traffic maps and energy use to weather information and pictures from security cameras. Visitors were given a demonstration of how city managers would react to an accident on a city-centre bridge: cameras zoom in, an ambulance is dispatched, traffic is rerouted to other bridges—all automatically, within seconds.

The world’s smartest city, however, may soon rise in an unexpected place: near Porto in Portugal. PlanIT Valley, designed for an eventual population of 150,000, is an ambitious attempt to “combine technology and urban development”, in the words of Steve Lewis, co-founder of Living PlanIT, the start-up behind the project, who used to work at Microsoft.

His experience at the software giant proved an excellent preparation for the job. Microsoft is the very model of a platform company, providing technology to connect things (such as printers and PCs) and a foundation for the products made by others (such as browsers and media players). When he was at Microsoft in the early 2000s, Mr Lewis also oversaw the relaunch of a strategy called .Net—an early example of what geeks like to call “service-oriented architecture”. The idea is to build programs as a combination of loosely-coupled electronic services that can be redeployed elsewhere.

After Mr Lewis left Microsoft in 2005, he tried to introduce the concept of re-usable components to the construction industry, which seemed ripe for it. Designs are often used only once, most buildings are not energy-efficient, the industry produces a lot of waste, and many materials are simply thrown away. All this amounts to around 30% of the cost of construction, according to a case study on Living PlanIT by the Harvard Business School.

But instead of selling products to construction companies, Mr Lewis ended up applying his ideas to an entire city. Even before the first concrete is cast, PlanIT Valley has already been built—in a simulation program that also allows detailed planning of the construction. Much of the city, which is to cost about $10 billion, will rely on prefabricated parts; its foundation, for instance, will be made of concrete blocks that come with all the gear for smart infrastructures pre-installed. Eventually the entire city and its buildings will be run by an “urban operating system” that
integrates all parts and combines them into all kinds of services, such as traffic management and better use of energy.

Living PlanIT has a clear idea of who will live and work in its city: the employees of the companies that form its "ecosystem", another concept taken from the software industry. The start-up has enrolled a number of partners, among them Cisco, Accenture and McLaren Electronic Systems, a sister company of the eponymous Formula One brand, which will provide sensor technologies. The idea is that these firms will operate research facilities in PlanIT Valley, jointly improve the concept, develop applications and build similar projects elsewhere.

Such grand designs are possible only when building a city from scratch. But entrepreneurs like Mr Lewis and the planners of similar projects have other advantages. For a start they generally have government backing. Portugal granted the PlanIT Valley project "potential national importance" status, which among other things means cheap land and generous tax breaks. Songdo was launched by the South Korean government. And new cities are free from the constraints of having to deal with an established population, old infrastructure and bureaucracy.

**Something old, something new**

Making an existing city smart is a different problem altogether, as demonstrated by Amsterdam, the Netherlands' biggest city. Amsterdam Innovation Motor (AIM), a public-private joint venture created for this purpose, is not intended to come up with some master plan but to identify interesting "smart" projects, work with local firms and other stakeholders and find ways to make projects worthwhile for everybody.

So far AIM has launched a dozen projects, ranging from installing smart meters in some households to connecting ships to the electricity grid so that they no longer have to use diesel generators when berthed in the city's port. The most ambitious effort so far is something called "Climate Street", which aims to reduce the energy use of an entire shopping street.

Most existing cities, at least in the West, will go for such a step-by-step approach, predicts Carlo Ratti, an architect and engineer who heads the SENSEable City Lab at the Massachusetts Institute of Technology (MIT). He and his colleagues have come up with a number of smart urban projects of their own. In one, called "TrashTrack", they asked volunteers to attach small electronic tracking devices to hundreds of pieces of rubbish to see where they would end up in order to improve waste logistics. More recently they introduced the "Copenhagen Wheel", a bicycle wheel whose red hub can not only give the rider a boost but also measure environmental conditions, such as pollution and noise levels.

Yet many such projects will need a common platform that streamlines data gathering and supports all kinds of applications, says Mr Ratti. That would also enable him to realise his ultimate vision: turning the city into a "control system" that makes use of data from a variety of sources, from mobile phones to smart meters and sensors in buildings. The data could be mined to improve public transport and security.

So far Mr Ratti and his collaborators have mainly used data from mobile phones for their projects. In "WikiCity", implemented in Rome, such data allowed people to see visualisations of how they moved through the Italian capital. However, a new mayor elected in 2008 proved much less interested in Mr Ratti's projects than his environmentalist predecessor, so the team has gone off to Singapore.

But it will be not just governments, cities and utilities that will make the world smart. Private companies will also play their part, particularly start-ups.
A special report on smart systems

Augmented business

Smart systems will disrupt lots of industries, and perhaps the entire economy

Nov 4th 2010

CALL it the democratisation of sensors. Pachube (pronounced “patch-bay”), a start-up based in London, offers a service that lets anybody make sensor data available to anyone else so they can use them to build smart services. One tinkerer has Pachube’s computers control the fan in his office, guided by temperature readings uploaded from a thermometer on his desk.

Such experiments are free, but those who develop more serious applications and do not want them to be available to anyone else have to pay. Usman Haque, Pachube’s boss, hopes that more and more firms will do so as sensors multiply.

Pachube’s business model is one of the more interesting attempts to make money from the convergence of the physical and the digital worlds, but there are plenty of other firms trying to cash in on smart systems. Many will fail, but those that succeed will disrupt more than one industry and perhaps the economy as a whole.

But what is most exciting about smart systems is the plethora of new services and business models that they will make possible. “The internet of things will allow for an explosion in the diversity of business models,” says Roger Roberts, a principal at McKinsey and one of the authors of a recent study on the industry.

It is not just utilities that will benefit from smart systems but other sectors too. The chemical industry, for instance, has already installed legions of sensors and actuators to increase its efficiency. Others are just starting. In the paper industry, according to the McKinsey study, one company achieved a 5% increase in its production by automatically adjusting the shape and intensity of the flames that heat the kilns for the lime used to coat paper. FoodLogiQ, a start-up, allows food suppliers to tag and trace their wares all along the supply chain—and consumers to check where they come from. Sparked, another start-up, implants sensors in the ears of cattle, which lets farmers monitor their health, track their movements and find out a lot of other things about their animals that they never realised they wanted to know. On average, each cow generates about 200 megabytes of information a year.

Thanks to detailed digital maps, maintaining such things as roads and equipment will also become much more efficient. Asfinag, an Austrian firm, used aeroplanes equipped with special cameras to map the country’s highways. Its employees can now fly over them digitally and even see what is underground. San Francisco’s Public Utilities Commission knows the exact coordinates of every waste-water pump, its maintenance history and the likelihood of it failing. “Firms can now send out maintenance crews before things actually break,” says Steve Mills, who heads IBM’s software business. “Making the old stuff run better will be the most important benefit of such systems in the short run.”

Moreover, smart systems make new forms of outsourcing possible, some of it to unexpected places. Pacific Control is not exactly a household name, but the company, based in Dubai, claims (with some justice) that it is the “world leader in automation solutions”. Its global command
centre remotely monitors buildings, airports and hotels, keeping an eye on such things as energy use, security and equipment. For the moment most of the firm’s customers are in Dubai itself, but it should find more than a few abroad.

Significantly, once devices are connected and their use can be metered, there is no longer any need to buy them. Already some makers of expensive and complex equipment no longer sell their wares but charge for their use. Rolls-Royce, for instance, which makes pricey aircraft engines, rents them out to airlines, billing them for the time that they run. Makers of blood-testing equipment have taken to charging only if the device actually produces usable data. And Joy Mining Machinery, a maker of mining equipment, charges for support by the tonne.

Some firms are using metering in innovative ways. Zipcar and other car-sharing firms, for instance, put wireless devices with sensors into their vehicles so that customers can hire them by the hour. And insurance firms, among them Progressive in America and Coverbox in Britain, ask customers to install equipment in their cars that can measure for how long, how fast and even where a car is driven. Premiums can then be based on individual drivers’ behaviour rather than on such proxies as age and sex.

Michael Chui, a co-author of McKinsey’s report on the internet of things, says that such applications will allow companies to “have a much more dynamic interaction with customers”. In Japan, for instance, vending machines can recognise a customer’s age and sex and change the message they display accordingly.

The more data that firms collect in their core business, the more they are able to offer new types of services. By continuously assessing the performance of its jet engines around the world, Rolls-Royce is able to predict when engines become more likely to fail so that customers can schedule engine changes. Heidelberger Druckmaschinen, whose huge presses come with more than 1,000 sensors, has started offering services based on the data it collects, including a website that allows customers to compare their productivity with others. “Many companies will suddenly discover that their main business is data,” says Paul Saffo, a Silicon Valley technology forecaster who wrote a widely noted essay on the impact of ubiquitous sensors back in 1997.

Hewlett-Packard is a prime candidate for such a Saffo moment—if its plans to scatter millions of sensors around the world come to fruition. It is doing this to increase demand for its hardware, but it also hopes to offer services based on networks of sensors. For instance, a few thousand of them would make it possible to assess the state of health of the Golden Gate bridge in San Francisco, says Stanley Williams, who leads the development of the sensors at HP. “Eventually”, he predicts, “everything will become a service.”

Apple, though it prides itself on its fancy hardware, is already well on its way towards transforming itself into a service and data business thanks to the success of its iPhone. When the computer-maker launched the device in June 2007, it did not expect “apps”, the applications that run on smartphones, to become such a big deal. The “App Store”, where users can download
these pieces of software, was launched a year after the first iPhone was shipped. But the App Store now sells more than 250,000 apps that have been downloaded over 6.5 billion times. And with its new platform for mobile advertising, called iAd, Apple has started to make money from all the data it collects.

Some firms will make a living based entirely on mining “data exhaust”, the bits and bytes produced by other activities. One example is Google’s PowerMeter, which not only lets users check their use of electricity online but gives Google access to lots of data to analyse and, not least, sell advertisements against.

Conventional services, too, can be metered. Those supplied by governments may not be the first to spring to mind but, as a study by the Dutch economics ministry asks, why not use sensors for taxing things like pollution? That might be uncontroversial, but analytics software could also be put to more manipulative uses by fine-tuning charges for public goods to get citizens to behave in certain ways.

Much of the innovation in this field may come not from incumbents but from newcomers, and it may happen fastest on such platforms as Pachube. In a way it is a cross of YouTube and Windows. What made the video-sharing site so popular was the way it converted all videos to a common format. Pachube is doing the same for data feeds from sensors. And like Microsoft’s operating system for applications, it provides basic features for smart services, such as alerts, data storage and visualisation tools.

This spring at Where 2.0, a technology conference in Silicon Valley, the star of the show was Skyhook Wireless, a firm that offers geographical-location information as a service. It recently launched a new offering called SpotRank. Drawing on all the data it has collected in recent years from apps using its services, the firm can predict the density of people in specific urban areas—anywhere, any day and at any hour. “This will give us great insights into human behaviour,” says Brady Forrest, the chairman of the conference.

Another hit at the conference was a service called Wikitude. Its “World Browser”, a smartphone app, checks the device’s location as well as the direction in which its camera is pointing and then overlays virtual sticky notes other users have left about things like local landmarks. So far Wikitude and similar services are mostly used as travel guides. But in principle users could collaboratively annotate the entire physical world—and even other people. TAT, another start-up, already experiments with something called “Augmented ID”, which uses facial recognition to display information about a person shown on a smartphone’s screen.

It is difficult to say what effect all this will have on business and the economy. But three trends stand out. First, since smart systems provide better information, they should lead to improved pricing and allocation of resources. Second, the integration of the virtual and the real will speed up the shift from physical goods to services that has been going on for some time. This also means that more and more things will be hired instead of bought. Third, economic value, having migrated from goods to services, will now increasingly move to data and the algorithms used to analyse them. In fact, data, and the knowledge extracted from them, may even be on their way to becoming a factor of production in their own right, just like land, labour and capital. That will make companies and governments increasingly protective of their data assets.

In short, we may be moving towards a “Weightless World”, the title of a 1997 book by Diane Coyle about a future in which bytes are the only currency and the things that shape our lives have literally no weight. But for now, gravity has not quite been repealed yet.
A special report on smart systems

The IT paydirt
Who will clean up?
Nov 4th 2010

CONTRARY to what might be expected, the industry that will see the least change is information technology. For most IT firms smart systems simply mean more business. This will drive a new wave of technology investment, predicts Andrew Bartels of Forrester Research. By 2017, he says, “smart computing technologies” will represent about half the spending on IT equipment and software in America (see chart 4).

Clearly some parts of the IT industry stand to benefit more than others. Harbor Research estimates that internet-enabled devices alone will net more than $10 billion worldwide in 2014, compared with $4.3 billion in 2009. And wireless sensors are growing exponentially. Last year a mere 10m radio chips for such sensors were sold, according to ABI Research. If it has its calculations right, that total will rise to 645m by 2015.

Since all the data gathered by sensors have to be kept somewhere, storage is hot, too. That explains the recent bidding war between Dell and HP over 3Par, a data-storag e company. HP won by offering $2.35 billion for a firm with only 650 employees and $194m in revenues. Forecasts from IDC, another market-research firm, throw light on why HP is willing to pay so much. IDC expects the capacity shipped to increase by 50% plus this year.

Vendors of programs that sift through data are also likely to do well. In recent years IBM has invested billions of dollars in buying firms that make business analytics software. In September, for instance, it gave $1.7 billion for Netezza, a vendor of data warehouses (specialised computer systems that quickly crunch through huge amounts of data). It is the biggest bet IBM has made in any area, says Ambuj Goyal, the firm’s global head of development and manufacturing. If it comes good, IBM should be richly rewarded. The global market for analytics programs, for instance, will grow from $25.5 billion this year to $34 billion in 2014, according to IDC.

This technology wave will almost certainly produce new software champions too. SAP came of age when mainframes were dethroned by smaller computer systems that allowed companies to streamline many more of their business processes. Similarly, experts predict that new programs will be needed to manage a firm’s interactions with the physical world. Already, there is a plethora of start-ups offering to help businesses cut greenhouse gases.

Platforms to integrate the data streams from all kinds of sensors are another new market. Examples include Pachube, a start-up, and Palantiri Systems, best described as a “Facebook for sensors”. The service allows devices to have their own “page” on corporate social networks, so their readings are shown in the form of newsfeeds and people can ask questions about them. “Devices thus become part of the conversation,” says John Canosa, Palantiri’s boss.

As usual, most money will be made from IT services, in particular to set up smart systems in cities. China alone will need to add the equivalent of one New York every year to accommodate the number of people expected to migrate to urban areas by 2025, according to McKinsey. Big IT firms are chasing all over the country to get a piece of this huge pie. Cisco is already helping to
build a Chinese replica of Songdo, the smart-city project in South Korea. IBM, for its part, hopes to help develop an entire network of smart cities and has started to collaborate with several of them.
“MIRROR WORLDS” is only one of David Gelernter’s big ideas. Another is “lifestreams”—in essence, vast electronic diaries. “Every document you create and every document other people send you is stored in your lifestream,” he wrote in the mid-1990s together with Eric Freeman, who produced a doctoral thesis on the topic. Putting electronic documents in chronological order, they said, would make it easier for people to manage all their digital output and experiences.

Lifestreams have not yet replaced the desktop on personal computers, as Mr Gelernter had hoped. Indeed, a software start-up to implement the idea folded in 2004. But today something quite similar can be found all over the web in many different forms. Blogs are essentially electronic diaries. Personal newsfeeds are at the heart of Facebook and other social networks. A torrent of short text messages appears on Twitter.

Certain individuals are going even further than Mr Gelernter expected. Some are digitising their entire office, including pictures, bills and correspondence. Others record their whole life. Gordon Bell, a researcher at Microsoft, puts everything he has accumulated, written, photographed and presented in his “local cyberspace”. Yet others “log” every aspect of their lives with wearable cameras.

The latest trend is “life-tracking”. Practitioners keep meticulous digital records of things they do: how much coffee they drink, how much work they do each day, what books they are reading, and so on. Much of this is done manually by putting the data into a PC or, increasingly, a smartphone. But people are also using sensors, mainly to keep track of their vital signs, for instance to see how well they sleep or how fast they run.

The first self-trackers were mostly über-geeks fascinated by numbers. But the more recent converts simply want to learn more about themselves, says Gary Wolf, a technology writer and co-founder of a blog called “The Quantified Self”. They want to use technology to help them identify factors that make them depressed, keep them from sleeping or affect their cognitive performance. One self-tracker learned, for instance, that eating a lot of butter allowed him to solve arithmetic problems faster.

A market for self-tracking devices is already emerging. Fitbit and Greengoose, two start-ups, are selling wireless accelerometers that can track a user’s physical activity. Zeo, another start-up,
has developed an alarm clock that comes with a headband to measure people’s brainwave activity at night and chart their sleep on the web.

As people create more such self-tracking data, firms will start to mine them and offer services based on the result. Xobni, for example, analyses people’s inboxes (“xobni” spelled backwards) to help them manage their e-mail and contacts. It lists them according to the intensity of the electronic relationship rather than in alphabetical order. Users are sometimes surprised by the results, says Jeff Bonforte, the firm’s boss: “They think it’s creepy when we list other people before their girlfriend or wife.”
A special report on smart systems
Sensors and sensibilities
A smarter world faces many hurdles
Nov 4th 2010

THERE is not much to see in the city of Bakersfield, north of Los Angeles, but recent events have put it on the global electricity-industry map. As in many other Californian communities, Pacific Gas & Electric (PG&E), the local power utility, had installed smart meters in most households. Soon afterwards customers started complaining about rocketing power bills. For some people they almost trebled. Predictably, this caused a political storm. Local politicians and consumer groups jumped on the issue. Enterprising lawyers launched a class-action suit. PG&E admitted that some of its meters had technical problems, but the higher bills were clearly due to a combination of exceptionally hot weather, increased charges and changes in the rate structure.

An independent auditor found nothing wrong with the smart meters, and California’s regulators did not stop PG&E from installing more of them. But utilities and regulators elsewhere, spooked by the incident, have become much more careful before embracing the technology. “Bakersfield is likely to slow down the installation of smart meters—not just in the United States but worldwide,” says Ahmad Faruqui of the Brattle Group, a consultancy. Bakersfield also demonstrates that a smarter world will meet with resistance. The reasons are part technical, part institutional.

A list as long as your arm

Technology is a good place to start. Sensors are getting ever cheaper, but for many applications they are still much too expensive. HP, for instance, likes to point out that its super-sensitive accelerometers are made in the same factories as its printer cartridges. But the firm’s sensors are still too pricey to use them for anything but high-value applications, such as oil exploration. RFID tags are a cautionary tale. They were supposed to revolutionise retailing but the readers, software and other gear needed to make them useful is still not cheap enough to be universally adopted.

Equally important, standards for such things as smart meters need to be sorted out. Setting them too early would hamper innovation, but in their absence utilities will hold back from investing, worried that they might bet on the wrong technology. Standards could also become a weapon of industrial policy, in particular in countries that see clean technology as an engine of growth. When China’s State Grid Corporation, which operates most of the country’s power network, announced its smart-grid plans in June, it also released the standards it intends to implement. Some say this was a move to protect Chinese firms.

The internet-address system is a worry as well. For a computer or any other device to be part of the internet, it needs a unique identifier—currently a long number called an internet-protocol (IP) address. Because of the network’s rapid growth in recent years, these numbers could run out as early as the middle of next year. If the IT industry keeps dragging its feet on moving to IPv6, a new address system that uses many more numbers, the growth of the internet of things will be
stymied.

Space is also bound to get tight in the ether. A few wireless sensors and devices do not make a difference, but as their numbers grow they will need an ever bigger chunk of the available radio spectrum. The number of wireless subscriptions has now reached 5 billion worldwide, earlier than expected, not least because so many SIM cards now sit in machines that communicate with other machines.

And then there are security concerns, particularly after the Stuxnet worm made the rounds in September. The malicious program quickly found its way into computers controlling industrial processes the world over, demonstrating how vulnerable control systems are to such attacks. But even before Stuxnet struck, security consultants had shown how large numbers of smart power meters could be hacked and shut down.

**Turf, ego and power**

Yet all these technical issues pale by comparison with the institutional barriers. For a city to offer smart services and save money, its departments have to work closely together, share their data and use a common IT infrastructure. London, for instance, has different payment systems for public transport, bicycle hire and toll roads. Such fragmentation is costly and makes it more difficult to come up with new offers (say, reducing the congestion charge for those who often hire a bicycle). But getting a city’s islands of bureaucracy to work together tends to be difficult, says Mark Cleverley of IBM, who helps governments and cities develop plans for smart systems.

The problem is not just that departments often jealously protect their data, something experts call TEP, as in “turf, ego and power”. Officials also lack a common language or generally agreed criteria for a smart city—which is a big issue, too, for the many companies that are usually involved in a project. “It’s hard to build a business case if people don’t understand each other,” says Simon Giles, in charge of strategy for smart technologies at Accenture.

Things are easier in Singapore. Ministries and agencies compete for reputation and resources, but they also co-operate closely on implementing master plans such as “A Lively and Liveable Singapore: Strategies for Sustainable Growth”, the city-state’s roadmap to becoming smart. That helps to explain why Singapore will probably be the first city to combine its various smart systems into a single one.

More generally, Asian countries seem to have an advantage in building smart systems because governments are often less democratic and administrations more hierarchical. China’s State Grid Corporation intends to have its smart grid fully built by 2020. The country’s government has also made the implementation of IPv6 a central part of its five-year plan to build the “China Next Generation Internet”. It showed off its efforts at the 2008 Olympic games in Beijing, where everything that was connected—cameras, taxis, security systems—used IPv6.

In the West it will often take a crisis to get there. When Thames Water in 2006 failed to meet targets set by the regulator to reduce leaks and was subsequently sold, the new leadership went on to organise things differently. Today, at the utility’s operating centre in Reading, the workers who monitor the network, take calls from customers and schedule work crews all sit in one open-plan office, allowing them to communicate much more easily across departmental boundaries.

Similarly, when Bill Ritter became Colorado’s governor in 2007, he made the consolidation of the state’s chaotic IT systems a priority and named a state chief information officer who is also a member of his cabinet. Since then Colorado has made great progress in achieving one prerequisite for becoming a smart state: a common IT infrastructure capable of delivering new services.

Amsterdam, being the capital of a highly pluralistic country, had to take a different approach. Instead of relying on the municipal administration to become a smart city, it created Amsterdam
Innovation Motor (AIM), a public-private joint venture in charge of coming up with projects and mediating between the parties involved. “Being a translator and making sure that a project is worthwhile for everybody are our main jobs,” explains Ger Baron, AIM’s project manager. If these three examples are any guide, smart systems may well change the way that local governments, in particular, are organised. Instead of being a collection of departmental silos, they could come to resemble computing platforms. Most services, from payment systems to traffic information, would be provided in only one version and used by all departments—or by private firms that want to offer their own urban applications.

Some cities, such as London, San Francisco and Washington, DC, have already opened their data vaults. IBM, among many other companies, has already built a web-based application called City Forward that takes in data from 50 cities. Yet others are not that generous with their data, which is the third barrier. More openness should be good for innovation, not just in terms of the information itself but how it is handled. But firms with lots of data—be they power utilities or makers of medical equipment—will be loth to give them up, says Glen Allmendinger, president of Harbor Research.

At the same time, Mr Allmendinger predicts, some firms will be forced to give up control of their data. Hospitals, for instance, will hardly put up with dozens of dashboards that monitor the activities of different types of equipment: they will want a unified view. And some clever start-ups and IT firms will find ways around data monopolies. Nobody can stop consumers from giving data about their power usage to non-utilities, for instance. Some private meters, attached to a sensor clamped around the main power line, can now send the data they have gathered to web-based energy-monitoring services, such as Google’s PowerMeter and Microsoft’s Hohm.

Data are a problem for governments too. Li Yizhong, China’s minister of industry and information technology, has expressed concerns about IBM’s Smarter Planet initiative. “The US tries to use its information network technology for things as small as controlling one computer or one generator and as large as controlling a whole industry, to control every country’s economy,” he is reported to have said. “We must be enlightened and vigorously develop strategic emerging industries, but also must raise our vigilance and cannot fall under the control of anyone.”

China’s concerns with IBM’s Smarter Planet (called “wise Earth” in Mandarin) point to the fourth set of barriers: government regulation—or the lack thereof. Privacy legislation tops the list. New laws will multiply in response to an increasingly smart world. Germany’s government plans to strengthen its rules to deal with Google’s Street View, an online service that lets users pan through photos of streets. Among other things, the new bill is likely to enshrine in law what Google has already agreed to do under pressure from data-protection officials: giving people the option to have their house blurred on Street View. Nearly a quarter of a million have done so.

The regulation of smart grids is a murkier area. Some countries push utilities to reduce energy demand, but out-of-date rules encourage them to sell more, says Accenture’s Mr Giles. Elsewhere, ill-conceived deregulation of the power market is holding things up. Since the grid now has more than one owner, it is often hard to know who will bear the risks and who will garner the rewards.

A host of new legal questions will also have to be answered. Who is liable if an autonomous system, such as an autopilot that governs the movement of cars on a motorway, causes an accident? What if a single company manages to dominate data from certain types of sensors or control the information about where sensors can be found and which of them are active? And can private surveillance still be restricted when cameras and other sensors make it ubiquitous? “The sensor revolution will challenge hidden assumptions in a bewildering array of doctrinal fields,” writes Kevin Werbach, of the Wharton School of the University of Pennsylvania, in a paper entitled “Sensors and Sensibilities”.

Lastly, consumers may not play ball. PG&E’s woes in Bakersfield are not the only example. In
Boulder, Colorado, the showcase for smart grids, customers of Xcel Energy, the local utility, are becoming increasingly cross because they will have to pay much of the project’s costs. In the Netherlands the government backed down from making smart meters mandatory because of concerns that the data collected could be used to see whether properties are empty or expensive new gadgets have been purchased. Consumers also dislike feeling that they are being squeezed dry, particularly in America, which makes dynamic pricing hard to bring in. Even simple rate plans where the price of electricity depends on the time of day have had to be abandoned after customer protests.

Nor is such resistance limited to smart meters. The smooth introduction of Stockholm’s toll system was the exception rather than the rule. In many countries politicians do not even try. Germany, for instance, charges lorries for using its motorways, but only a suicidal government would attempt to extend the system to cars in a country where even buckling up was long opposed by motoring clubs as interfering with drivers’ freedom.

Make it attractive

It is odd, then, that everybody loves mobile devices, which are not that different from smart meters or on-board units. In particular, smartphones and the applications that run on them generally keep a close watch on what users do. Even so, nearly 270m of these devices will be sold this year, 55% more than in 2009, says IDC.

The difference is that Apple and other smartphone makers have made it their business to find out what consumers want—traditionally not the forte of utilities and government agencies. For example, it took that flurry of protests to prompt PG&E to open a dedicated call centre for questions about smart meters. Yet communicating with customers should be one of the first things for firms to do when introducing smart meters, says Mr Giles.

Another lesson is that utilities should not try to achieve too many things at once, says Mr Giles, who recently surveyed smart-grid projects worldwide for a study on how to speed up their introduction. Some utilities brought in smart meters and new pricing schemes at the same time, thus overwhelming consumers and obscuring the reasons for higher bills.

To avoid such problems, Amsterdam is trying “co-creation”, in the words of AIM’s Mr Baron. “We did not just put in smart meters and ask consumers to pay for them,” he says. Instead 500 households in the district of Geuzenveld were invited to make suggestions on how to save energy and monitor consumption.

Yet utilities may have to resort to social engineering to get customers more engaged. Opower, a start-up, lets them see not only their own consumption figures but numbers for their neighbours too (anonymised to preserve privacy), and offers them tips on saving power. Peer pressure, the company claims, persuades people to reach for the switches much more often. Given enough time, all these barriers to building smart systems can probably be overcome. But how smart does the world really want to be?
A special report on smart systems

Horror worlds
Concerns about smart systems are justified and must be dealt with

Nov 4th 2010

“IT IS not possible to make a lasting compromise between technology and freedom, because technology is by far the more powerful social force and continually encroaches on freedom through repeated compromises.” Thus wrote the Unabomber, also known as Ted Kaczynski, in his manifesto, published in 1995 by the New York Times and the Washington Post in the hope that he might end his terror campaign or somebody might recognise his style of writing and unmask him.

Mr Kaczynski’s methods were abhorrent. His bombs killed three people and injured 23 over nearly 20 years. He was arrested in 1996 and is currently serving a life sentence. But his concern that technology will slowly but surely undermine human freedom is shared by quite a few mainstream thinkers. As this special report has argued, smart systems will improve efficiency and could help solve many environmental problems, in particular global warming. Yet if those systems seriously impinge on people’s freedom, many people will balk. The protests against smart meters in Bakersfield and elsewhere may be only the start.

Smart systems are rekindling old fears. Top of the list are loss of privacy and government surveillance. Internet users have only recently begun to realise that every single thing they do online leaves a digital trace. With smart systems the same thing will increasingly apply to the offline world; Google’s Street View is only the beginning.

Even the champions of a smarter planet admit as much. “Some citizens have expressed discomfort at living in not a safer society but a ‘surveillance society’,” said Sam Palmisano, the boss of IBM, in a speech earlier this year. He cited a newspaper article recounting that there are now 32 closed-circuit cameras within 200 yards of the London flat in which George Orwell wrote his book “1984”.

Hopes and fears

Mr Palmisano would be in the wrong job, however, had he not gone on to say that such concerns have to be rethought and to stress the economic and social benefits of smart systems. Others point out less obvious advantages. “All this technology actually strengthens the human side of cities,” says Carlo Ratti, director of MIT’s SENSEable City Lab. People who are always connected, he argues, can work wherever they like. And Mr Haque, the boss of Pachube, claims that “sensors
empower people because measuring the environment allows them to make decisions in real time.”

On the other hand smart systems are also undeniably useful as an instrument of control. Singapore has made an impressive job of smartening up its physical infrastructure, but its network of security cameras could also be used for enforcing rules more objectionable than a ban on chewing gum. Similarly, the operations centres and dashboards for local governments in China being built by Cisco, IBM and others beg the question whether their only purpose is to make these cities smarter.

Other deep fears brought on by smart systems is that machines could be hacked, spin out of control and even take over the world, as they did in the film “The Matrix”. As the Stuxnet worm and the May “flash crash” on Wall Street have shown, the first two are already real possibilities, even if the third still seems somewhat remote—although well-known computer scientists, artificial-intelligence researchers and roboticists met in California a couple of years ago to discuss that risk.

And there is a more subtle danger too: that people will come to rely too much on smart systems. Because humans cannot cope with the huge amounts of data produced by machines, the machines themselves will increasingly make the decisions, cautions Frank Schirrmacher of the German daily Frankfurter Allgemeine Zeitung in his recent book “Payback”. Similarly, Nicholas Carr, an American commentator on the digital revolution, in his book “The Shallows” claims that the internet, the mother of all smart systems, is on its way to smothering creativity and profound thinking.

A further worry is that smart technology will ultimately lead to greater inequality—and not just because it could create an “information priesthood”, in the words of Mr Gelernter. Paul Saffo, a noted Silicon Valley technology forecaster, expects ubiquitous sensors to give a huge boost to productivity—at the expense of human monitors. “We are likely to see more jobless recoveries,” he says.

Whether computers will indeed start to eliminate more jobs than they create remains to be seen. But smart systems certainly represent a conceptual change. So far IT has been used to automate and optimise processes within firms and other organisations as well as the dealings between them. Now it will increasingly be used to automate and optimise interactions with the physical environment.

Some of the concerns raised will be hard to deal with. For instance, there would be little point in passing laws that would give individuals the right to decide whether their data can be used by smart systems if cameras and other sensors are already ubiquitous. And building in circuit-breakers to keep automation from going too far could defeat the purpose of smart systems and stifle innovation.

Still, technological progress is not some force of nature that cannot be guided. “We can and we should exercise control—by democratic consensus,” says Mr Gelernter. Yet for a consensus to be reached, there must be openness. The biggest risk is that smart systems become black boxes, closed even to citizens who have the skills to understand them. Smart systems will make the world more transparent only if they themselves are transparent.

Special reports
Sources and acknowledgments

Nov 4th 2010

Besides those cited in the text, the author would like to thank many others for their time, ideas and kindness during the preparation of this report. They include Bruno Berthon of Accenture, Eric Clementi of IBM, Tom Davenport of Babson College, Peter Elliott of PA Consulting Group, Scott Gnau of Teradata, Jeanne Harris of Accenture, Chris King of eMeter, Michael Liard of ABI Research, Michael LoCascio of Lux Research, Edzard Overbeek of Cisco, Joachim Schaper of SAP and Elisabeth Zornes of Cisco.
A special report on smart systems

Offer to readers

Nov 4th 2010

Buy a PDF of this complete special report, including all graphics, for saving or one-click printing.

*The Economist* can supply standard or customised reprints of special reports. For more information and to place an order online, please visit our Rights and Syndication website.
Snipping off the shackles
The red tape that ties down businesses is being modestly pruned around the world. But there is still an awful lot left to cut

Nov 4th 2010 | LAGOS AND MEXICO CITY

The streets outside are searingly hot, noisy and pot-holed. But Tunde Oyekunle’s air-conditioned office is an oasis of calm. Mr Oyekunle runs a property consultancy in Lagos, Nigeria’s business capital. He is also setting up a company to make window-frames and other fittings. “You’re expected to keep jumping through the obstacle course—and to enjoy it,” he says of the constant frustrations of being an entrepreneur in such a chaotic country.

Nigeria’s population and oil reserves—both, at 150m people and 37 billion barrels, the largest in sub-Saharan Africa—should make it an attractive place to do business. But these advantages are offset by misgovernment, rampant corruption and dismal infrastructure. Each year since 2003 the World Bank has published a “Doing Business” survey of how countries compare on some of the most important factors in opening, running and closing a firm. From a very low base, Nigeria has been among the fastest improvers, and Mr Oyekunle confirms that things have indeed got a bit less terrible. But in the bank’s latest report, out this week, Nigeria slips three places to 137th out of 183 countries surveyed. It stood still over the past year as many other countries, rich and poor, kept reforming.

The report does not try to assess broader questions of governance, such as macroeconomic policy or overall levels of corruption, even though these have a big effect on how easy it is to do business. What it does measure are the petty bureaucracy and onerous rules that can make life a nightmare for firms. But the findings correlate well with those of wider studies of national competitiveness, such as those by the OECD and the World Economic Forum. Familiar names lead the “Doing Business” league: Singapore, Hong Kong, New Zealand. At the bottom are the usual sub-Saharan suspects, plus Venezuela, whose socialist leader, Hugo Chávez, has continued to harry private industry.

Since the World Bank’s studies began, businesspeople globally have experienced a slight loosening of the red tape. The top reformer over the past year was Kazakhstan, which leapt 15 places to 59th after making it quicker and cheaper to start a firm, and simplifying construction permits. But for most businesspeople in most developing countries (and a few rich ones), trying to keep a firm going and provide jobs and economic growth is still a soul-destroying task. The bank notes that whereas the most dynamic and fastest-growing countries continually improve and update their regulatory systems, the poorest ones plod along.
under business rules dating from the late 19th century. While they do, they will stay poor.

The remaining differences between the most and least efficient countries on each measure are so extreme that there can be no justification for them. In New Zealand it takes one day to create a new company; in Suriname it takes almost two years. The charge for registering a change of property ownership in Syria amounts to more than a quarter of the building’s entire value. Despite Kazakhstan’s other improvements, it still takes ten documents and 81 days to export goods from there, compared with three documents and five days in Estonia.

Mr Oyekunle says he has no problem in principle with having to register his companies, apply for permits and so on. It is just that the rules are executed painfully slowly. Everyone knows that having “an ally in the ministry” can speed things along, he says; it may be that the fees he pays to lawyers to push through his paperwork include backhanders to such “allies”—though he doesn’t ask.

This is a common phenomenon in business-unfriendly countries. In Mexico, the proliferation of trámites, as pettifogging rules and paperwork are collectively known, has spawned a breed of middlemen called tramitadores, who deal with greasy-palmed bureaucrats on behalf of harassed businesspeople. Brazil’s equivalents, despachantes, also get official documents pushed through suspiciously quickly, for a fee. It is an extra cost, but at least it gets things done.

Bonfire of the inanities

In recent years Mexico has staged a bonfire of the trámites. In the bank’s latest report, it has overtaken Colombia to become the most straightforward country in Latin America in which to do business, and the 35th easiest in the world, up from 41st last year. That puts it far ahead of its much-hyped rival, Brazil, which slipped three places to 127th. It has taken a global financial crisis to get some countries to revamp their bankruptcy laws, but Mexico did so ten years ago. As a result, creditors of bust firms there typically get back 67 cents on the dollar, close to the rich-country average. Brazil’s cumbersome insolvency system consumes much of a failed business’s assets in costs, typically leaving just 17 cents on the dollar.

According to Dahlia Khalifa, one of the World Bank report’s authors, an important way in which Mexico and other reformers have cut the burden on business is to shift bureaucratic tasks online. Mexican firms can file their taxes on the web, which is still impossible in most Latin American countries. This, along with a drastic reduction in the number of annual payments needed, has cut the time spent grappling with the taxman by 148 hours per year compared with 2004. In Brazil this still takes an astonishing 2,600 hours (see chart on previous page). Beatriz González, who runs Rojo Bistro, a busy French restaurant in Mexico City, confirms that online filing has made her life far easier. Businesses such as hers now make just six payments a year, one of the fewest in the world (in Ukraine, for example, firms must make 135).

India is another country where businesses can increasingly circumvent bothersome bureaucrats by filing their taxes and conducting other official procedures online. The birthplace of the supposedly abolished “Licence Raj” still has a lowly 134th position in the “Doing Business” league, well behind China (79th). But its national average disguises a huge variation between states. Ms Khalifa says that if all the best practices seen in various parts of India were adopted across the whole country, it would leap 55 places in the league. Even India’s poorest state, Bihar, is now making a great play of its efforts to become business-friendly, though its talk is still ahead of reality (see article).

Big regional variations are common in other developing countries. Surveys by Marco Escotto and
colleagues at the IPADE Business School in Mexico City have found that the time taken to open a new business varies from six days in Culiacán to more than 60 in Guadalajara. Likewise, Nigeria’s streamlined building code, passed in 2006, has been adopted by some states but others are still dithering.

Wherever the red tape is thickest, the result is widespread informality. Many small firms operate under the radar of officialdom, dodging taxes and ignoring rules to survive. But they have to stay small, and thus contribute much less than they might otherwise do to a country’s prosperity. The bank believes that by making politicians concerned about improving their country’s position in the league, it is slowly helping to make it possible for informal businesses to go legit, thereby giving governments more scope to raise revenues.

The state of Lagos (in which Lagos city is situated) has been improving its tax collection. Mr Oyekunle says this has encouraged formerly chaotic companies to keep proper accounts, which in turn makes it easier for them to do business with each other. The extra tax revenue is being used to improve services such as public transport, which among other benefits makes it a better place to do business.

**A good game**

The World Bank’s report has spawned a whole industry of academic studies on how its indicators correlate with countries’ social and economic progress. More than 650 have already been published, with a further 2,000 or so still being worked on. So far, this research has found that making it easier and cheaper to start businesses does indeed reduce the informal sector, create jobs, improve productivity and reduce corruption. A study conducted as Mexico rolled out a new online company-registration service found that each city that adopted it typically enjoyed a 5% increase in the total number of registered firms and a 2.8% rise in employment in the types of business affected.

The remarkable leaps that a few countries have made in the league table have led to suspicions that some governments are gaming the system by passing paper reforms designed to bump up their score without making much difference to the ease of doing business in that country. An obvious outlier, for example, would seem to be Saudi Arabia, which is now 11th in the league, ahead even of Japan and Germany. Really? Ms Khalifa insists that the bank is careful to choose areas of regulation that, if reformed, cannot fail to have a positive effect on businesses—so she believes there is little scope for working the system. However, she points out that the study is claiming only that, say, Saudi Arabia is better than Germany and Japan on a range of measures to do with opening, running and closing a firm, and not that it has a better overall economic climate.

Despite such worries, the bank’s report has succeeded in putting the issue of business red tape on the international political agenda. A recent summit of Asia-Pacific countries, which have become the most enthusiastic reformers, agreed on five priority areas, from simplifying business start-up procedures to better enforcement of contracts. Passing such reforms often means overcoming resistance, especially from bureaucrats. But in an era of tight budgets and high unemployment, they make even more sense as a way to create jobs and boost growth while costing governments little or nothing.
Bihar's pro-business reforms

Paper tiger
There is more talk about reform than action in India’s poorest state

Nov 4th 2010 | PATNA

IT IS surely no coincidence that Bihar, besides being India’s poorest state, has also been its least inviting for entrepreneurs. That is supposed to be changing. Nitish Kumar, Bihar’s chief minister, has spent his five years in office fixing the roads and other infrastructure. Crime has fallen, so the bright and wealthy are no longer frightened off by the threat of kidnapping, extortion and murder. Stability has allowed local trade to flourish. A state official reels off an impressive-sounding list of 398 approved investment proposals—from sugar mills to power plants—worth $4.8 billion. That all sounds rosy, until you look for success on the ground. India’s tycoons have visited, and left. There is not one example of a big industrial investment to show for it.

Perhaps local officials are failing to spot the brightest entrepreneurs—those deft enough to avoid the bureaucrats. Take the case of Husk Power Systems, formed in 2007 by three young Biharis and an American friend. It runs 50 micro power plants in rural areas fired by burning otherwise useless rice husks. Now employing more than 250 people, the firm sells cheap electricity to 200,000 rural folk, who previously relied on kerosene lamps or candles.

Each power plant turns a profit in a few months, and Husk plans to build hundreds more in the next two years. But that is no thanks to Bihar’s pen-pushers. Scientific advisers in Delhi were “very helpful” with permits and business contacts. But the entrepreneurs try to avoid contact with the Bihar government as much as possible. An early brush-off from one of Mr Kumar’s deputies set the standard for their treatment.

Ratnesh Yadav, one of Husk’s founders, describes constant struggles with local corruption. A village policeman grabbed a bundle of cables for one of the first plants, demanding a bribe: the company refused, opting to bore him into submission instead. When Husk started building a centre to train its workers near the state capital, Patna, a neighbourhood tough-guy demanded 100,000 rupees ($2,250) in protection money. This was refused, so the builders were threatened, then beaten, and a mob flattened the construction site.

A Bihari property developer, while accepting that official corruption is a fact of life, laments how crooked officials in his state prefer “taxing” inputs—the first investments made—to demanding a share in the output of an enterprise, a practice he says is more common in Bengal. Bengal-style graft at least means officials have a long-term interest in seeing the business thrive. The state government talks some fine talk about having made things easier for businesses, such as creating a “one-stop window” for them to submit all their paperwork. But half a dozen businessmen, asked about the window, hoot with laughter. It is nothing more than a postbox, says one; the papers are simply shuffled on to the same old unresponsive departments. An investor with political clout can get things done in perhaps four visits. Otherwise, it’s a long wait.

Business
Japanese bosses
From Walkman to hollow men
Japan’s lack of bold business leaders

Nov 4th 2010 | TOKYO

THE Walkman changed the way people listened to music, especially on the go. Introduced by Sony in 1979, the portable cassette-tape player is finally being discontinued in the Japanese market. The device will remain in production in China and sold in some other places, although Sony will not say how many it still sells or why it bothers to make Walkmans at all in the age of the iPod and smartphone.

Whoever buys them, the numbers are unlikely to add much to the more than 220m Walkman cassette-players already sold. Yet this pioneering product was almost never made in the first place. Sony’s co-founder, Akio Morita, had to battle with his own engineers and executives who argued that a tape-player without a recording function would never work. “Everybody gave me a hard time,” Morita wrote in his memoirs in 1986. In the end, though, the boss had his way.

Such determination from a business leader is unlikely in today’s Japan. Founder-presidents like Morita, who died in 1999, hold immense power. But their successors, called salaryman-shacho (or “hired-hand presidents”), do not. This makes it difficult for Japanese bosses to be leaders rather than just figureheads.

“The salaryman-shacho is one of the biggest reasons why the Japanese economy went down. They don’t take responsibility,” thunders Tadashi Yanai, the founder and boss of Fast Retailing, Japan’s largest clothing retailer and operator of the Uniqlo chain of stores. Mr Yanai, who is reckoned to be Japan’s richest man, worth around $9 billion, is not alone in his view. Japanese managers lack “assertiveness, vigour, energy and resolve”, says Kazuo Inamori, the 78-year-old founder of Kyocera, one of the country’s biggest producers of electronics parts.

One problem is that in a consensus-based culture—with the ideal of lifetime employment, and promotions and compensation based more on seniority than performance—few bosses have a free hand, or even an interest, in forging a brash path. Such bosses are implicitly expected to keep things as they are and owe their position to so many internal colleagues that thorough corporate overhauls are almost impossible. Hence, when Toyota needed to take radical steps to rejuvenate the company in 2009, it named the founder’s grandson as president, hoping it would put a bold pair of hands on the steering wheel.

The leadership deficit translates into poor corporate performance. Japanese firms’ return on equity has long been less than half that of American and European companies. Since 1996 the number of Japanese companies among the world’s leading 50 firms by sales in sectors like manufacturing, retail, banking and health care has fallen by half or more. If the leaders of Japanese firms were able to make just basic improvements—increasing average sales growth from 2% to 5%, lifting earnings from 4.5% to 7% and boosting capital efficiency by 10%—the capitalisation of Japan’s sickly stockmarket could triple from its current level, says Bain.
consultancy, in a recent study.

Yet bold leadership is rarely appreciated. In June Naoto Kan, Japan’s prime minister, scolded Carlos Ghosn, the boss of the Renault-Nissan alliance, for firing workers—even though Mr Ghosn rescued Nissan from bankruptcy and transformed the company. It also took an outsider to push through change at Sony, where Sir Howard Stringer, a British-born businessman, became boss in 2005. It has taken him years to shoulder stodgy executives aside. This year Sony returned to making money and in the three months to September 30th reported net profits of ¥31.1 billion ($385m), having made a net loss of ¥26.3 billion a year earlier. Sony needed shaking up. Despite creating the market for portable music with the Walkman, it largely missed the shift to digital music-players.
The defence industry

War on new fronts

Different tactics are needed to profit from a slowdown in defence spending

Nov 4th 2010

AS DEFENCE budgets come under fire, defence companies are deploying new tactics to protect their profits. Britain is cutting military spending by 8% over four years and Germany has similar ideas. And after growing by more than 10% in recent years, America’s annual budget of some $700 billion—nearly half the world’s total—is unlikely to rise after 2011. It might even fall. Robert Gates, America’s defence secretary, said in May that “the gusher has been turned off,” and recently announced that $100 billion would be cut over five years from “overheads” at his department.

Defence companies have to cope not only with reduced budgets but with a shift in policy and technology, which will also mean fewer orders for expensive pieces of kit. Last year Mr Gates cut some badly performing big projects. And America may yet change from “cost plus” contracts, in which the government shares the risk of financing big projects, to more fixed-price awards, like the deal for a new airborne refuelling tanker, shortly to be awarded to either Boeing or Europe’s EADS.

Some big programmes are still going strong. The F-35 multi-role fighter jet is worth over $380 billion in America and should contribute around 15% of the profits of Lockheed Martin, its main contractor. But such projects are exceptions. So defence companies will be looking harder abroad for military budgets that are still growing. Many of those budgets will belong to countries with deep pockets and neighbours to fear. A restive Iran and plenty of petrodollars should ensure that the Gulf states continue to buy lots of weapons. The Obama administration has been seeking congressional authority for Boeing to sell Saudi Arabia $60 billion-worth of jets, including F-15 fighters. Boeing, which makes the F-15, wants to increase its overall export sales from 16% of its defence business to 25%. The military budgets of India, Japan and South Korea are tempting, too. Brazil is also keen to bring its armed forces up to date. But Harry Nourse of HSBC, a bank, points out that as more firms head abroad the competition will get hotter.

There will be some opportunities in the shifting priorities of defence budgets closer to home, especially when the supplanting of older weapons systems is being deferred. Britain’s decision to delay replacing its ageing nuclear submarines, for instance, means more cash will go into keeping them going. BAE Systems, Britain’s biggest defence contractor, already earns half its revenues from support services, such as maintenance and upgrading, and sees them growing in importance as more defence services are outsourced.

Newer threats to national security also hold out the hope of fresh sources of profit. Defence companies, using technological know-how gathered from work in communications, surveillance and reconnaissance, are moving rapidly into security services, where budgets are rising. Cybersecurity is the area with most promise. David Strauss, an analyst with UBS, another bank, reckons increased spending on cybersecurity will mean reduced defence spending in other areas. Nevertheless, firms specialising in security software believe the business will boom as the rest of
the rich world attempts to catch up with Britain and America in cybersecurity. But that race will attract plenty of competition from civilian software giants with more developed distribution networks and vast sales forces. The defence companies are banking on their high levels of security clearance and experience of dealing with defence departments to keep ahead.

Companies will buy or sell assets as they adjust to the new requirements. Northrop Grumman is considering a sale of its low-margin shipbuilding unit. And Boeing and EADS are looking to buy smaller firms in areas like cybersecurity and robotics.

More collaborative programmes are likely too. Before a summit in London this week between David Cameron, Britain’s prime minister, and Nicolas Sarkozy, the French president, BAE Systems and France’s Dassault urged the two leaders to support collaboration on developing a new generation of combat aircraft and unmanned surveillance drones, which are increasingly replacing some helicopters and aircraft because they are much cheaper to buy and to operate. Britain and France are already planning to share aircraft carriers.

Yet the mega-mergers that defined previous defence cuts, like Boeing’s takeover in 1997 of McDonnell Douglas, are unlikely to be seen again. Governments may be looking for a greater bang for their buck, but none will want to reduce competition by blessing a grand alliance among the half-a-dozen or so big defence contractors left in the world which are capable of handling large weapons programmes. The defence chiefs will always have some big-ticket items on their shopping lists.

Business
Oracle v SAP
Maintaining fees
A lawsuit against SAP is about more than illegal downloads
Nov 4th 2010

SOMETIMES a tackle says much about a match and even the entire season. This is the case with a trial that opened on November 1st, pitting the world’s two biggest makers of corporate software, Oracle and SAP, against each other. The dispute goes back to SAP’s purchase in 2005 of TomorrowNow, which provided maintenance services for some of Oracle’s software. Its aim was to poach customers. But in 2007 Oracle sued SAP, alleging that TomorrowNow had made illegal downloads from its website.

SAP has since admitted that TomorrowNow had done wrong and closed it down. It will not even contest allegations that it was aware of the copyright infringement and has reportedly agreed to pay $120m in legal fees to Oracle. This essentially leaves only two questions open: the damages—SAP thinks $40m is enough; Oracle wants about $2 billion—and whether Léo Apotheker, SAP’s former boss and now head of Hewlett-Packard (HP), will appear in court.

As a result, it will be up to another trial to answer the underlying question: what are the rules for third-party maintenance? In January Oracle sued another maintenance firm, Rimini Street. It has since countersued, accusing Oracle of anticompetitive behaviour.

The issue is the same as with independent car-repair shops: what access to the intellectual property of the original vendor should they have? If the court favours Rimini Street and others, their business could take off. A growing number of firms are thinking about defecting from Oracle and SAP, even though they would no longer get regular updates. They are happy with their existing applications and could cut their maintenance costs in half.

If many customers jump ship, this would weigh heavily on the results of Oracle and SAP. Maintenance fees, usually 22% of a program’s price per year, have become a bigger part of firms’ technology budgets and of software vendors’ income. For both firms, maintenance generates twice as much revenue as software sales—and all of the profits.

Yet if the TomorrowNow trial has attracted so much attention, it is also because of a new epic rivalry in the industry. It started when Oracle bought Sun Microsystems last year, becoming a direct rival to HP. Things got worse in September when Oracle hired HP’s ex-boss, Mark Hurd, who had been pushed out the previous month. The relationship became downright hostile when HP then appointed Mr Apotheker as successor and installed as chairman, of all people, Ray Lane, who left Oracle in 2000 after falling out with its flamboyant boss, Larry Ellison.

Mr Ellison, who has shown restraint in recent years, has since rediscovered his previous more belligerent form. He compared HP’s board to “idiots” when they forced Mr Hurd out. He spoke of “madness” after Mr Apotheker’s appointment. Later he accused HP’s new boss, who started his new job on the first day of the trial, of having “overseen an industrial-espionage scheme”.

All this has entertainment value. And it may impress Wall Street. But it is unlikely to make firms buy more of Oracle’s products. Nor will it do anything to counter the growing anger among customers of Oracle (and of SAP, for that matter) over how much they pay in maintenance fees, with so little in return.
Face value: Martin Sorrell

King of the Mad Men

As the advertising giant he built celebrates its 25th birthday, Sir Martin Sorrell is once again full of optimism

Nov 4th 2010 | NEW YORK

ONLY someone who spends as much time on aeroplanes as Martin Sorrell could possibly find in “Up In the Air”, George Clooney’s film about the emptiness of long-distance travel, a reason to be optimistic about America. As the film makes clear, Americans suffer the same pain and psychological damage when they lose their jobs as Europeans do, says Sir Martin, the boss of WPP, the world’s biggest advertising and marketing group. But America downsizes fast when the economy falters, whereas in Europe restructuring takes years. It was fierce job-cutting in 2009 that may help explain why American firms have been able to increase their ad spending sharply in 2010, says Sir Martin. “It is truly remarkable America has been so strong this year.”

America is behaving more like an emerging market than a mature one for advertising, WPP said on October 29th when it reported that third-quarter revenues there were up by 9.9% on the same period a year earlier, contributing mightily to like-for-like global revenue growth of 7.5%. It was a perfect birthday gift to ensure high spirits at the staff parties Sir Martin has been hosting on both sides of the Atlantic to celebrate WPP’s 25th anniversary. The firm began with his purchase of a shell company, Wire and Plastic Products, with money borrowed against shares in Saatchi & Saatchi, the advertising agency where he was finance director. In its most recent financial year WPP had pre-tax profits of $1.3 billion on revenues of $14 billion. Its market capitalisation is now $15 billion.

The firm had little option but to grow by acquisition, says Sir Martin. His first big deal was the purchase in 1987 of J Walter Thompson, then 13 times bigger than WPP, which led Advertising Age to feature him under the headline, “The Man Who Would Be King”. Two years later he bought Ogilvy—which gave WPP a “near-death experience” during the debt crisis of 1991 because of what Sir Martin regards as his biggest mistake: using convertible paper to part-finance the deal. Other big purchases included Young & Rubicam and Grey.

WPP today is a fusion of hundreds of companies—and an exception to the general rule that most mergers fail. Sir Martin attributes this success to “only buying good businesses”, taking time to get to know the firms, insisting on (typically) five-year lock-in deals of the talent, and a decent
amount of “luck”.

Sir Martin is now focused on smaller acquisitions, of which the company typically makes around 30 a year. In one recent deal, WPP bought a $5m stake in Buddy Media, a company which specialises in advertising on Facebook.

WPP’s boss is sometimes put down by critics as a finance-obsessed “bean counter”, but he delegates a lot and has placed some astute bets, such as deciding that the advertising industry would become increasingly driven by technology. He says he started investing in digital businesses in the mid-1990s. He was also an early proponent of the enormous potential of China.

So the irony that WPP’s strength this year owes much to an ad boom in America rather than in emerging economies, and in conventional media, with television advertising making a strong comeback, does not escape him. But Sir Martin explains this is happening because a lot of clients are building their brands and feel this sort of advertising is better done with traditional media whereas “online is more about price and offering a deal.” Nonetheless, if he were starting WPP today he says it would concentrate on Asia, Latin America, the Middle East and central Europe, and on acquiring and analysing customer data, as well as more digital activities.

In the long run, WPP seems to be well placed in many of the world’s fastest-growing economies, including Africa, where it has been hired to rebrand Zain, a mobile-phone company. Only around one-third of WPP’s revenue now comes from the sort of work most people associate with advertising; the rest is generated by a broader range of marketing activities, such as consumer research, digital marketing, public relations, and media planning and buying. It is a world away from the 1960s Madison Avenue advertising agency featured in “Mad Men”, a hit television drama. Sir Martin watches that too, and admits it shows that some things remain the same in adland: “The egos, turf wars and political incorrectness.”

**Correction:** one of the advertising groups bought by WPP was Grey, not Gray as we originally wrote. This was corrected on November 4th 2010.
Barack Obama thinks that the rise of India will be good for American jobs. There is another side to the story

ON THE eve of the 2008 New Hampshire primary Bill Clinton finally gave vent to his fury with the Obama campaign. He dismissed Barack Obama’s message as “the biggest fairy tale” he had ever heard. (“Give...me...a...break,” he roared at the startled crowd.) And he denounced underhand tactics, particularly a description of Hillary Clinton as “the senator from Punjab”.

On November 5th Mr Obama, fresh from his humiliation in the mid-term elections, flies to India accompanied by an entourage of almost 250 businesspeople. His message for the folks back home will be that India could be a goldmine for American jobs. And he will clinch a succession of huge business deals with India—not least a $5.8 billion aircraft sale by Boeing.

Mr Obama’s win-win rhetoric is plausible enough. India is growing at about 8% a year at a time when America can barely manage 2%. It is also set to add 240m people to its working population by 2030. And America produces all sorts of things that Indians crave, from iPads to MBAs to fighter planes.

Yet the rise of new economic powers always brings problems as well as opportunities for incumbents. New companies displace old ones. New business models disrupt established ones. Comfortable workers in the rich world are forced to compete with hungrier ones in the poor world.

India is producing a legion of new global giants that are competing head-to-head with established American companies. Look at Arcelor Mittal and Tata Steel in steelmaking; Bharat Forge and Sundram Fasteners in car parts; Hindalco in aluminium rolling; and a host of companies, including Infosys, Tata Consulting Services (TCS), Cognizant and HCL Technologies, in information services. Twenty years ago India had no global companies worth mentioning. Today the Tata group earns 60% of its revenues abroad, and Indian companies ranging from natural-resource firms, such as Reliance Industries, to health-care companies, such as Piramal Healthcare, have been snapping up American brands.

American companies are also setting up shop in India. Bangalore and Hyderabad have “electronic cities” crowded with America’s leading companies. In Bangalore Cisco spent $1 billion on its Globalisation Centre East and General Electric (GE) opened a swanky research centre. IBM
employs more people in India than in the United States.

For American workers the most worrying thing about all this is the flight of brain-intensive jobs to India. Americans reconciled themselves to the loss of manufacturing jobs with the thought that they would keep the smart jobs. But they reckoned without two things: the power of the internet and the hunger of emerging-market companies.

India has long since turned itself into the world’s back-office—subjecting paper-processing hubs such as Kansas City to the same forces of competition that devastated former industrial cities such as Gary, Indiana. Now Indian-based companies are moving into an wider range of services: reading CT-scans and X-rays, processing legal documents and helping with animation. They are also moving into sophisticated niches. TCS and Infosys compete directly with IBM and Accenture in consulting. American companies are adding to the trend by moving more of their important operations to India: John Chambers, Cisco’s boss, has decreed that 20% of the firm’s leadership should be in Bangalore.

Companies in India are challenging American ones in an area that they have long considered their own—innovation. The Boston Consulting Group’s 2010 survey of innovation notes that the number of American companies on its list of top innovators is declining while the number of Indian companies is rising. It also points out that the Indian firms place a higher value on innovation than the American companies.

Most strikingly, Indian companies have produced a new type of innovation, variously dubbed “frugal”, “reverse” and “Gandhian”. The essence is to reduce the price of a product or service by a breathtaking amount—80% rather than 10%—by removing unnecessary bells and whistles. Tata Motors is selling its “people’s car” for $3,000; GE’s Indian arm offers a medical ECG machine for $400; Bharat Biotech sells a single dose of its hepatitis B vaccine for 20 cents and Bharti Airtel provides one of the cheapest wireless telephone services in the world. These frugal products are likely to disrupt established Western companies (including GE itself) by forcing them to engage in a bloody price war.

**Luring them back**

To add to this general turbulence Indian-based companies are also on a hiring binge. For decades America has gorged itself on a seemingly limitless supply of brilliant Indian PhD students and entrepreneurs. Half of Silicon Valley’s start-ups were either founded or co-founded by Indians. But these paragons are now returning en masse to the mother country (just as America makes life more difficult for immigrants). Why work for a sluggardly American firm when Infosys is growing at double digits? Why live in a flimsy bungalow in the Valley when an Indian company will provide you with a villa in a gated community, membership of a country club and a chauffeur-driven car?

There is an upside to these downsides. Frugal products will be a godsend for America’s pinched consumers. They may even prevent the American economy from being crushed by the health-care Godzilla. But Americans need to get back on the treadmill. In a recent speech Mr Obama told schoolchildren in Philadelphia that: “When students around the world in Bangalore or Beijing are working harder than ever, and doing better than ever, your success in school is not just going to determine your success, it is going to determine America’s success in the 21st century.” That is not a bad theme for the next two years of his presidency.
WHEN the leaders of the Group of Twenty (G20) countries meet in Seoul on November 11th and 12th, there will be plenty of backstage finger-pointing about the world’s currency tensions. American officials blame China’s refusal to allow the yuan to rise faster. The Chinese retort that the biggest source of distortion in the global economy is America’s ultra-loose monetary policy—reinforced by the Federal Reserve’s decision on November 3rd to restart “quantitative easing”, or printing money to buy government bonds (see article). Other emerging economies cry that they are innocent victims, as their currencies are forced up by foreign capital flooding into their markets and away from low yields elsewhere.

These quarrels signify a problem that is more than superficial. The underlying truth is that no one is happy with today’s international monetary system—the set of rules, norms and institutions that govern the world’s currencies and the flow of capital across borders.

There are three broad complaints. The first concerns the dominance of the dollar as a reserve currency and America’s management of it. The bulk of foreign-exchange transactions and reserves are in dollars, even though the United States accounts for only 24% of global GDP (see chart 1). A disproportionate share of world trade is conducted in dollars. To many people the supremacy of the greenback in commerce, commodity pricing and official reserves cannot be sensible. Not only does it fail to reflect the realities of the world economy; it leaves others vulnerable to America’s domestic monetary policy.

The second criticism is that the system has fostered the creation of vast foreign-exchange reserves, particularly by emerging economies. Global reserves have risen from $1.3 trillion (5% of world GDP) in 1995 to $8.4 trillion (14%) today. Emerging economies hold two-thirds of the total. Most of their hoard has been accumulated in the past ten years (see chart 2).

These huge reserves offend economic logic, since they mean poor countries, which should have abundant investment opportunities of their own, are lending cheaply to richer ones, mainly America. Such lending helped precipitate the financial crisis by...
pushing down America’s long-term interest rates. Today, with Americans saving rather than spending, they represent additional thrift at a time when the world needs more demand.

The third complaint is about the scale and volatility of capital flows. Financial crises have become more frequent in the past three decades. Many politicians argue that a financial system in which emerging economies can suffer floods of foreign capital (as now) or sudden droughts (as in 1997-98 and 2008) cannot be the best basis for long-term growth.

France, which assumes the chairmanship of the G20 after the Seoul summit, thinks the world can do better. Nicolas Sarkozy, the country’s president, wants to put international monetary reform at the top of the group’s agenda for the next year. He wants a debate “without taboos” on how to improve an outdated system.

Such a debate has in fact been going on sporadically for decades. Ever since the post-war Bretton Woods system of fixed but adjustable exchange rates fell apart in the 1970s, academics have offered Utopian blueprints for a new version. The question is: what improvements are feasible?

The shape of any monetary system is constrained by what is often called the “trilemma” of international economics. If capital can flow across borders, countries must choose between fixing their currencies and controlling their domestic monetary conditions. They cannot do both. Under the classical 19th-century gold standard, capital flows were mostly unfettered and currencies were tied to gold. The system collapsed largely because it allowed governments no domestic monetary flexibility. In the Bretton Woods regime currencies were pegged to the dollar, which in turn was tied to gold. Capital mobility was limited, so that countries had control over their own monetary conditions. The system collapsed in 1971, mainly because America would not subordinate its domestic policies to the gold link.

Today’s system has no tie to gold or any other anchor, and contains a variety of exchange-rate regimes and capital controls. Most rich countries’ currencies float more or less freely—although the creation of the euro was plainly a step in the opposite direction. Capital controls were lifted three decades ago and financial markets are highly integrated.

Broadly, emerging economies are also seeing a freer flow of capital, thanks to globalisation as much as to the removal of restrictions. Net private flows to these economies are likely to reach $340 billion this year, up from $81 billion a decade ago. On paper, their currency regimes are also becoming more flexible. About 40% of them officially float their currencies, up from less than 20% 15 years ago. But most of these floats are heavily managed. Countries are loth to let their currencies move freely. When capital pours in, central banks buy foreign exchange to stem their rise.

They do this in part because governments do not want their exchange rates to soar suddenly, crippling exporters. Many of them are worried about level as well as speed: they want export-led growth—and an undervalued currency to encourage it.

Just as important are the scars left by the financial crises of the late 1990s. Foreign money fled, setting off deep recessions. Governments in many emerging economies concluded that in an era of financial globalisation safety lay in piling up huge reserves. That logic was reinforced in the crisis of 2008, when countries with lots of reserves, such as China or Brazil, fared better than those with less in hand. Even with reserves worth 25% of GDP, South Korea had to turn to the Fed for an emergency liquidity line of dollars.

This experience is forcing a rethink of what makes a “safe” level of reserves. Economists used to argue that developing countries needed foreign exchange mainly for emergency imports and short-term debt payments. A popular rule of thumb in the 1990s was that countries should be able to cover a year’s worth of debt obligations. Today’s total far exceeds that.
Among emerging economies, China plays by far the most influential role in the global monetary system. It is the biggest of them, and its currency is in effect tied to the dollar. The yuan is widely held to be undervalued, though it has risen faster in real than in nominal terms (see article). And because China limits capital flows more extensively and successfully than others, it has been able to keep the yuan cheap without stoking consumer-price inflation.

China alone explains a large fraction of the global build-up of reserves (see chart 3). Its behaviour also affects others. Many other emerging economies, especially in Asia, are reluctant to risk their competitiveness by letting their currencies rise by much. As a result many of the world’s most vibrant economies in effect shadow the dollar, in an arrangement that has been dubbed “Bretton Woods 2”.

History lessons

The similarities between this quasi-dollar standard and the original Bretton Woods system mean that many of today’s problems have historical parallels. Barry Eichengreen of the University of California, Berkeley, explores these in “Exorbitant Privilege”, a forthcoming book about the past and future of the international monetary system.

Consider, for instance, the tension between emerging economies’ demand for reserves and their fear that the main reserve currency, the dollar, may lose value—a dilemma first noted in 1947 by Robert Triffin, a Belgian economist. When the world relies on a single reserve currency, Triffin argued, that currency’s home country must issue lots of assets (usually government bonds) to lubricate global commerce and meet the demand for reserves. But the more bonds it issues, the less likely it will be to honour its debts. In the end, the world’s insatiable demand for the “risk-free” reserve asset will make that asset anything but risk-free. As an illustration of the modern thirst for dollars, the IMF reckons that at the current rate of accumulation global reserves would rise from 60% of American GDP today to 200% in 2020 and nearly 700% in 2035.

If those reserves were, as today, held largely in Treasury bonds, America would struggle to sustain the burden. Unless it offset its Treasury liabilities to the rest of the world by acquiring foreign assets, it would find itself ever deeper in debt to foreigners. Triffin’s suggested solution was to create an artificial reserve asset, tied to a basket of commodities. John Maynard Keynes had made a similar proposal a few years before, calling his asset “Bancor”. Keynes’s idea was squashed by the Americans, who stood to lose from it. Triffin’s was also ignored for 20 years.

But in 1969, as the strains between America’s budget deficit and the dollar’s gold peg emerged, an artificial reserve asset was created: the Special Drawing Right (SDR), run by the IMF. An SDR’s value is based on a basket of the dollar, euro, pound and yen. The IMF’s members agree on periodic allocations of SDRs, which countries can convert into other currencies if need be. However, use of SDRs has never really taken off. They make up less than 5% of global reserves and there are no private securities in SDRs.

Some would like that to change. Zhou Xiaochuan, the governor of China’s central bank, caused a stir in March 2009 when he argued that the SDR should become a true global reserve asset to replace the dollar. Mr Sarkozy seems to think similarly, calling for a multilateral approach to the monetary system. If commodities were priced in SDRs, the argument goes, their prices would be less volatile. And if countries held their reserves in SDRs, they would escape the Triffin dilemma.

For SDRs to play this role, however, they would have to be much more plentiful. The IMF agreed on a $250 billion allocation among measures to fight the financial crisis, but global reserves are rising by about $700 billion a year. Even if there were lots more SDRs it is not clear why governments would want to hold them. The appeal of the dollar is that it is supported by the most liquid capital markets in the world. Few countries are likely to use SDRs much until there are deep private markets in SDR-denominated assets.

Only if the IMF evolved into a global central bank able to issue them at speed could SDRs truly
become a central reserve asset. This is highly unlikely. As Mr Eichengreen writes: “No global government... means no global central bank, which means no global currency. Full stop.”

Nor is it clear that the SDR is really needed as an alternative to the dollar. The euro is a better candidate. This year’s fiscal crises notwithstanding, countries could shift more reserves into euros if America mismanaged its finances or if they feared it would. This could happen fast. Mr Eichengreen points out that the dollar had no international role in 1914 but had overtaken sterling in governments’ reserves by 1925.

Alternatively, China could create a rival to the dollar if it let the yuan be used in transactions abroad. China has taken some baby steps in this direction, for instance by allowing firms to issue yuan-denominated bonds in Hong Kong. However, an international currency would demand far bigger changes. Some observers argue that China’s championing of the SDR is a means to this end: if the yuan, for instance, became part of the SDR basket, foreigners could have exposure to yuan assets.

More likely, China is looking for a way to offload some of the currency risk in its stash of dollars. As the yuan appreciates against the dollar (as it surely will) those reserves will be worth less. If China could swap dollars for SDRs, some exchange-rate risk would be shifted to the other members of the IMF. A similar idea in the 1970s foundered because the IMF’s members could not agree on who would bear the currency risk. America refused then and surely would now.

Rather than try to create a global reserve asset, reformers might achieve more by reducing the demand for reserves. This could be done by improving countries’ access to funds in a crisis. Here the G20 has made a lot of progress under South Korea’s leadership. The IMF’s lending facilities have been overhauled, so that well-governed countries can get unlimited funds for two years.

**Overcome your reserve**

So far only a few emerging economies, such as Mexico and Poland, have signed up, not least because of the stigma attached to any hint of a loan from the IMF. Perhaps others could be persuaded to join (best of all, in a large group). Reviving and institutionalising the swap arrangements between the Fed and emerging economies set up temporarily during the financial crisis might also reduce the demand for reserves as insurance. Also, regional efforts to pool reserves could be strengthened.

However, even if they have access to emergency money, governments will still want to hoard reserves if they are determined to hold their currencies down. That is why many reformers think the international monetary system needs sanctions, imposed by the IMF or the World Trade Organisation (WTO), against countries that “manipulate” their currencies or run persistent surpluses.

This is another idea with a history. Along with Bancor, Keynes wanted countries with excessive surpluses to be fined, not least because of what happened during the Depression, when currency wars and gold-hoarding made the world’s troubles worse. The idea went nowhere because America, then a surplus economy, called the shots at the Bretton Woods conference in 1944. The same forces are evident today—except that America, as a deficit country, is on the other side of the argument. Like America in the 1940s, China would never agree to reforms that penalised surplus countries.

Such rules would probably be unenforceable anyway. Harsh penalties in international economic agreements are rarely effective: remember Europe’s Stability and Growth Pact? Modest co-operation has better prospects. Just as the Plaza Accord in 1985 was designed to weaken the dollar and narrow America’s current-account deficit, so the G20 could develop a plan for rebalancing the world economy, perhaps with target ranges for current-account balances and real exchange rates. These would be supported by peer pressure rather than explicit sanctions.
A rebalancing plan, which included faster real appreciation of the yuan, would remove many of the tensions in the monetary system. But shifting the resources of China and other surplus countries from exports to consumption will take time.

Meanwhile, capital flows into emerging markets are likely to surge much faster. This is partly due to America’s quantitative easing: cheap money will encourage investors to seek higher yields where they can find them. It is also partly due to the growth gap between vibrant emerging economies and stagnant rich ones. And it reflects the under-representation of emerging-market assets in investors’ portfolios.

For the past decade emerging economies have responded to these surges largely by amassing reserves. They need other options. One, adopted by Brazil, South Korea, Thailand and others, and endorsed by the IMF, is to impose or increase taxes and regulations to slow down inflows. Some academics have suggested drawing up a list of permissible devices, much as the WTO has a list of legitimate trade barriers.

This is a sensible plan, but it has its limits. Capital-inflow controls can temporarily stem a flood of foreign cash. However, experience, notably Chile’s in the 1990s, suggests that controls alter the composition but not the amount of foreign capital; and they do not work indefinitely. As trade links become stronger, finance will surely become more integrated too.

Other tools are available. Tighter fiscal policy in emerging economies, for instance, could lessen the chance of overheating. Stricter domestic financial regulation would reduce the chances of a credit binge. Countries from Singapore to Israel have been adding, or tightening, prudential rules such as maximum loan-to-value ratios on mortgages.

But greater currency flexibility will also be needed. The trilemma of international economics dictates it: if capital is mobile, currency rigidity will eventually lead to asset bubbles and inflation. Unless countries are willing to live with such booms—and the busts that follow—Bretton Woods 2 will have to evolve into a system that mirrors the rich world’s, with integrated capital markets and floating currencies.

Although the direction is clear, the pace is not. The pressure of capital flows will depend on the prospects for rich economies, particularly America’s, as well as the actions of the Fed. Emerging economies’ willingness to allow their currencies to move will depend on what China does—and China, because its capital controls are more extensive and effective than others’, can last with a currency peg for longest.

If America’s economy recovers and its medium-term fiscal outlook improves, the pace at which capital shifts to the emerging world will slow. If China makes its currency more flexible and its capital account more open in good time, the international monetary system will be better able to cope with continued financial globalisation and a wide growth gap between rich and emerging markets. But if the world’s biggest economy stagnates and the second-biggest keeps its currency cheap and its capital account closed, a rigid monetary system will eventually buckle.
The Fed's big announcement
Down the slipway
“Quantitative easing” is unloved and unappreciated—but it is working
Nov 4th 2010 | WASHINGTON, DC

EVEN before the Federal Reserve unveiled its second round of quantitative easing (QE) on November 3rd, critics had already denounced it as ineffectual or an invitation to inflation. It cannot be both and it may not be either.

The announcement of “QE2” was hardly breathtaking. The Fed said it will buy $600 billion of Treasuries between now and next June, at about $75 billion a month, although it also said it could adjust the amount and timing if need be. That was about what markets expected but far less than the $1.75 trillion of debt it bought between early 2009 and early 2010 in its first round of QE. Yet QE2 seems already to have exceeded the low expectations it has aroused. Since Ben Bernanke, chairman of the Fed, hinted at it at Jackson Hole on August 27th, markets have all done exactly what they should (see chart).

Under QE the Fed buys long-term bonds with newly created money. This lowers long-term yields and chases investors into riskier, alternative investments. The real yield on ten-year, inflation-indexed Treasury bonds has fallen from 1.05% to 0.5%, a result of relatively flat nominal yields and a rise in expected inflation. The yield on their five-year cousins is negative (see Buttonwood). Share prices are up by 14% in the same period. Lower yields make the dollar less appealing: it has duly fallen by 5% against the Japanese yen, by 9% against the euro and by 5% on a trade-weighted basis. “You can declare QE to be a success already,” says one hedge-fund economist. “Whether this translates into real activity remains a question-mark. But the question of whether the mechanism would work has been answered.”

With a bit of a lag, these easier financial conditions are supposed to boost growth through three channels. First, lower real yields spur borrowing and investment. This channel is bunged up: many households cannot borrow because their homes have fallen in value and because banks are less willing to lend. But the remaining two channels remain open. Higher share prices have raised household wealth by some $1.4 trillion, which will spur some spending. And the lower dollar should help trade. American factory purchasing managers reported a sharp jump in export orders.
in October and a drop in imports.

Macroeconomic Advisers, a consulting firm, reckons that the Fed will eventually buy $1.5 trillion of debt under QE2, and that this will raise growth next year to 3.6% from 3.3% without QE. That’s not exactly overwhelming: the firm thinks the Fed would have to buy $5.25 trillion of bonds to achieve the equivalent of a –4% federal-funds rate, which is what the economy needs. The Fed will not do that for fear of unknown consequences, among them the response of Congress’s newly empowered Republicans. In a Bloomberg poll, 60% of self-identified tea-party supporters favoured overhauling or abolishing the Fed.

Could QE work too well and drive inflation expectations to dangerous levels? “The odds aren’t zero,” says Don Kohn, a former Fed vice-chairman, but they’re small. There’s more risk that expectations could rise once credit loosens up and spending accelerates. That, however, would be a signal that the Fed has succeeded; it can then tighten policy.

Other countries complain that QE is merely bringing them overvalued currencies and bubbly asset markets by pushing investors to seek higher returns elsewhere. But that may be unavoidable given their divergent growth paths. Both India and Australia raised interest rates this week despite rising currencies.

A damaging round of beggar-thy-neighbour currency interventions cannot be ruled out. But the Bank of Japan, after intervening directly to weaken the yen in September, has struck upon a more benign response. It had been scheduled to release details of its own QE at a regular policy meeting in mid-November but moved the date forward to this week. Analysts suspect this was to counteract upward pressure on the yen because of the Fed’s move. If central banks all print money in unison, and don’t mop up excess liquidity, then the result could be a worldwide monetary fillip. QE’s benefits should not be over-egged. Nor should they be dismissed.
Pay at investment banks
Mutiny over the bounty
Investment banks have cut pay a bit but shareholders are still getting a raw deal
Nov 4th 2010

IT IS a year since the investment-banking industry committed reputational suicide by paying bumper bonuses just a few months after the worst financial crisis in living memory. That move helped destroy investment bankers’ credibility with the public and many politicians. Outside finance, even red-blooded capitalists cringed in embarrassment. Bonuses were paid from profits buoyed by public subsidies—either directly through bail-outs or by central-bank interventions and implicit government guarantees. They also were paid at the expense of rebuilding capital buffers. In 2009 the typical firm’s wage bill was equivalent to between a quarter and half of its core capital. Investment banks, it seemed, were not being run in the interests of the economy or even of their owners, but for their staff. It was financial mutiny.

Now banks are once again working out how much they should pay their people. Amazingly since 2009 there have been no political keel-haulings, just a few whips of the lash. Faced with an angry public, some governments have agreed to tax banks’ borrowing to recoup some of the subsidy they get. Britain imposed a one-off tax on bonuses that should raise at least £2.5 billion ($4 billion), more than the £550m originally expected. America restricted pay at firms that still have TARP bail-out funds.

Regulators, meanwhile, have obsessed about the structure of bankers’ pay. In June American supervisors issued guidelines that said bosses should not incentivise employees to blow up their firms—a management insight worthy of the Springfield nuclear-power plant. The European Union is finalising rules that will apply next year.

Banks say they have already changed their ways. A recent report by the Institute of International Finance, a lobbying group, and Oliver Wyman, a consulting firm, found that three-quarters of firms asked said they now took risk into account when calculating bonuses, and that 39% of banks’ aggregate bonus pools was in the form of deferred compensation, not cash.

How useful all this is remains to be seen. Managers at Lehman Brothers and Bear Stearns owned lots of shares, just as the corporate-governance police said they should, yet ran their firms aground. And there is a strong sense that regulators have answered the subordinate question (how should bankers be paid?) while ignoring the one that matters most to people: how much should they be paid?
Policymakers doubtless hoped (again) that banks would show some restraint this year. They also probably guessed that new regulations would squeeze profits, limiting the amount available for traders to spend on provocatively expensive dessert wines. Encouragingly, there is some evidence this has happened. Most observers reckon the industry’s revenue could fall by up to a fifth in 2010 as the exceptional market conditions that followed the bail-outs have faded. Some banks are reacting. Goldman Sachs’s compensation bill in the third quarter was $3.8 billion, down by 28% compared with the same period in 2009.

But the overall picture is less convincing. For five leading firms in America and Europe that have so far reported third-quarter results, overall compensation fell by 17%, to $18 billion, compared with the same quarter in 2009 (see chart).

Some firms that did badly still booked pay costs that pushed their investment-banking units into the red—most notably UBS. Its chief financial officer was brutally honest to analysts. “We are a living example of a bank that experimented with not paying people and it didn’t come off very well in 2008. And as a consequence we know that we are bound to pay people, to some extent, regardless of the performance of the bank.” More marginal firms, including Nomura (which bought bits of Lehman Brothers), seem to struggle to make decent returns in any conditions.

Huw van Steenis, an analyst at Morgan Stanley, says that since investment banks are now relying more on client businesses and less on trading on their own account, revenues have become more volatile. Areas such as interest-rate swaps and foreign-exchange trading incur large fixed costs. Banks with lower market shares may struggle to produce profits during weak quarters, which makes it more important that they can control pay.

The “flow monster” firms with high market shares may be more resilient. Yet even the really big firms are paying staff a lot but barely making acceptable profits on their newly enlarged capital bases—Goldman’s return on equity (ROE) was 10% in the third quarter. Deutsche Bank, which has relatively low capital ratios (something that should flatter ROE), managed 13% on an underlying pre-tax basis.

Regulators have got strong grounds to intervene on pay only if banks cannot make enough money, or attract enough new equity, to raise their capital ratios to the required level. Reassuringly, the big firms with lowish market shares (and therefore, perhaps, weaker profits) in fixed income, currencies and commodities trading—Credit Suisse, UBS and Morgan Stanley—are reasonably capitalised.

Yet the industry’s continuing prioritisation of staff over shareholders suggests that banks are still being managed badly. During the boom, banks’ shareholders showed all the resistance of a doormat on pay. But now they have lots of capital tied up in a mature, even declining, industry that cannot control its costs properly, it is time for them to take command.

Finance and Economics
The yuan-dollar exchange rate
Nominally cheap or really dear?
China’s exchange rate has risen faster than you think. Really
Nov 4th 2010 | HONG KONG

AMERICAN manufacturers complain that China undervalues its exchange rate. But which one? The nominal exchange rate is now 6.67 yuan to the dollar, having strengthened by almost 2% since September 5th (when Larry Summers, an adviser to President Barack Obama, flew to Beijing to complain about the currency in person) and by 24% since 2005.

But China’s real exchange rate with America has strengthened by almost 50% since 2005, according to calculations by The Economist (see chart). A real exchange rate takes account of price movements in each country. If prices rise faster in China than in America, China’s real exchange rate goes up, even if its nominal exchange rate stays the same. That’s because higher prices at home make China’s firms less competitive abroad, just as if their currency had gone up.

To calculate the real exchange rate, you need a gauge of prices in each country. Many economists use the consumer-price index (CPI). But the CPI contains lots of goods and services (such as housing rents) that cannot be traded across borders. Our measure of the real exchange rate, which we will regularly update, offers a more direct measure of competitiveness by looking instead at unit labour costs: the price of labour per widget. These costs go up when wages rise or productivity (widgets per worker) falls. In American manufacturing, unit labour costs have risen by less than 4% since the first quarter of 2005, according to the Bureau of Labour Statistics. In Chinese industry they have risen by 25% over that period, according to our sums.

Those estimates are rough and ready. There are no official statistics on China’s unit labour costs. Our calculations are based on the value-added in industry (which extends beyond manufacturing) and the wage bill of urban factories, which does not count the town and village enterprises that employ over two-thirds of China’s metal-bashers. But the urban plants probably churn out a big share of the goodies that America buys.

The combination of a 24% rise in the yuan against the dollar and a 21% increase in Chinese unit labour costs, relative to America’s, explains the steep appreciation shown in the chart. The yuan may well still be undervalued but our index suggests American manufacturing should have less to fear from Chinese competition than it did five years ago. Until June 2009 appreciation was largely because of the stronger yuan. Since then it is largely because China’s unit labour costs have grown much faster than America’s. Employers in China’s coastal factories have suffered labour shortages and strikes. America’s factories have reported strong productivity gains as they have wrung more out of the workers that survived the recession (although those gains will be hard to repeat).

Of course, China and America do not trade only with each other. China’s big surpluses and America’s big deficits depend on the real exchange rate between them and all of their trading partners. But calculating that would require timely estimates of unit labour costs for all of China’s trading partners. That is a bit too laborious.
Europe’s new regulatory architecture is transferring power in profound ways

Nov 4th 2010 | BRUSSELS

THE subtle gravitational influence of the moon is imperceptible to humans yet is able to move oceans. Discreet changes to the rules governing European finance may in time have profound effects on the tides of capital that wash its shores.

On January 1st three new European regulators will begin for the first time to exert centralised control over large swaths of Europe’s financial markets—including the City of London, the world’s biggest international capital market. The new bodies succeed three committees that previously tried to co-ordinate the supervision of European banks, insurers, pension funds and securities. Yet unlike their predecessors, these are no mere talking-shops.

The new rules will bring things such as credit derivatives and credit-rating agencies into the regulatory net. Officials concede that a lack of rules did not lead to the last crisis, yet they fret about the next one. “We are trying not only to fight the last war, but also to anticipate the sources of the next one,” says one senior Eurocrat.

From January, for instance, the European Securities and Markets Authority (ESMA) will directly supervise ratings agencies. Proposals currently being debated may also allow it to intervene directly in markets by, for instance, temporarily banning naked short-selling (the sale of securities that investors do not yet have in their possession). A European Commission discussion paper seen by The Economist asks whether ESMA should be given the power to ensure the “appropriate timing” of the publication of sovereign-credit ratings. Some fret that might be shorthand for suppressing cuts to the ratings of wobbly European states.

The new rules also centralise authority that is now exercised (in theory) by national supervisors. “We see [the new agencies] as being the supervisors of the supervisors,” says one official. “Some national supervisory authorities failed dramatically. We know that in Ireland there was almost no supervision of the large banks.”

Quite how this will work is not entirely clear, partly because the rules are still being written. But considerable power will be given to the new authorities to write “binding technical standards” which national regulators will then have to enforce. “We have very little residual rule-making capacity,” says one regulator.

Many national supervisors, including those in Britain, which has in the past opposed any European encroachment on how the City is run, are reasonably sanguine about these developments. Although there is some anxiety about the erosion of sovereignty Europe’s new financial landscape entails, the rules are widely seen as likely to make the whole financial system safer. Many large insurers and banks, in London and elsewhere, also stand to benefit from common rules across Europe’s borders.

Yet there are two big concerns. The first is that the new rules threaten to politicise issues that were, in most cases, happily looked after at home. The commission “wants to create an ever closer union,” says one person involved in the talks. “That’s in their DNA and the crisis provides a good opportunity.”

This is a particular worry for London. Although Britain has the largest stake in getting the new rules right, it will have no more say in drafting most of them than
countries with far less economic interest in the outcome (see chart). In the tortuous world of Brussels horse-trading, Britain may have to make concessions on all sorts of side-deals to win support for sensible regulation of one of its main industries. "Nonsensical decisions may be taken by majority vote on things that are really about the UK," says Nicolas Véron of Bruegel, a pro-European think-tank, who supports the centralisation of regulation but frets about the new bodies’ governance. Commission officials counter that a collapse of, say, a big hedge fund in Britain could spark contagion throughout the rest of Europe; that gives all countries an equal stake in how the rules are written.

The second big worry is that the new rules exacerbate risk by taking powers away from the authorities that would have to pay the bill if things went awry. In the area of derivatives, for instance, ESMA and its banking counterpart, the European Banking Authority, will write detailed rules over how much capital and margin centralised clearing houses should hold. Yet were a clearing house to blow up, national taxpayers would be the ones bailing it out. That really would make waves.

Finance and Economics
WHAT is the point of investing? For most people the aim is to earn a return that is at least higher than inflation. If you can’t achieve that, you may as well spend your money straight away.

So it seems rather odd, at least on the surface, that the American government was able to sell inflation-linked bonds last month on a negative real yield. Those who bought the bonds were guaranteeing that their investment would lose purchasing power. Why on earth would investors—presumably sane ones—do that?

There have been previous examples of investors earning negative real yields on conventional government bonds, particularly in the 1970s. But they have usually been attributed to a failure to anticipate an inflationary surge, rather than the result of a deliberate decision.

This time round, however, negative real yields arguably reflect optimism that the Federal Reserve, via the policy of quantitative easing, can deliver a good economic outcome and avoid the extremes of deflation or hyperinflation. The bond issue is also good news for the American government. There is no sign yet that investors are panicking over the size of the fiscal deficit or the lack of any medium-term austerity plan.

Inflation-linked bonds promise that both the coupon (interest payment) and the redemption value will keep pace with prices. Take a bond with a 2% real yield maturing in ten years’ time; the bond will pay an initial $20 on a face value of $1,000. If prices double over the decade, it will end up paying $40 on a maturity value of $2,000. The latest bond had a five-year maturity and a yield of 0.5%. Investors bought the issue at 105% of par, locking in a yield of 0.55% below inflation.

The best way of looking at these bonds is that investors trade inflation protection for a lower starting yield. The difference between conventional and index-linked bond yields of the same maturity is roughly equal to expected inflation.

The negative yield on inflation-linked bonds is just a corollary of the very low yields on conventional debt. If five-year Treasury bonds are yielding 1.25%, as they were on November 2nd, then a negative 0.55% real yield on inflation-linked bonds implies an expected inflation rate of 1.8%. This suggests that the Fed has been successful at forcing inflation expectations modestly higher. In late 2008, after the collapse of Lehman Brothers, the market was pricing in deflation (see chart).

The easy-money policy of the Fed explains why inflation-linked bonds may not be a bad deal for investors. Mark Capleton of Société Générale says yields reflect the expectation that the Fed will hold short-term rates below inflation for the foreseeable future. If inflation averages 1.5% over the next two years, and the Fed keeps short rates at 0.5% or less, then the real yield on cash will be -1%. In that light, a negative yield of 0.55% on index-linked bonds seems a good investment. Short-dated conventional bonds have such low yields (the two-year Treasury pays just 0.34%) that investors in them are almost certain to lose money in real terms, too. And buyers of index-linked bonds have protection against deflation, since they
will always be redeemed at their face value or higher.

This situation is not unique to America. The British inflation-linked gilt that is due to mature in 2016 trades on a negative real yield. Even long-dated yields are less than 1% in real terms, thanks to demand from pension funds.

Are these low real yields a sign that investors are desperate to protect themselves against inflation? Some believe that quantitative easing is setting the economy up for an inflationary surge in the long term. Bill Gross of PIMCO, a fund-management group, wrote recently that: “Cheque-writing in the trillions is not a bondholder’s friend; it is in fact inflationary and, if truth be told, somewhat of a Ponzi scheme.”

But there is little sign that other bond-market investors agree with him. If you compare the yield on conventional bonds with the yield on the index-linked Treasury bond that matures in 2028, the result is an implied inflation rate of 2.4%. That hardly sounds like the Weimar Republic.

So why is gold, a classic anti-inflation hedge, still doing so well? The answer to this enduring puzzle may lie in the level of real interest rates. As Chris Watling of Longview Economics points out, gold’s last great bull run was in the 1970s, when real yields were negative. Positive real rates in the 1980s and 1990s had bullion trading sideways for 20 years. In a world of negative yields, owning gold has no opportunity cost.
Ambac's fall
And then there was one
The bond-insurance industry struggles for survival
Nov 4th 2010

AMERICA’S municipal-bond market is worth around $2.8 trillion. But “monoline” insurers, which
insure municipal bonds issued by American cities and counties, are barely breathing. On
November 1st the industry edged closer to extinction when one of the largest bond insurers,
Ambac, announced that it would skip an interest payment. The company could file for bankruptcy
by the end of the month.

It didn’t need an oracle to predict Ambac’s demise. Earlier this year a state regulator siphoned off
some of Ambac’s most toxic assets and put them into “rehabilitation”. Ambac has over $1.6
billion in debt, but only $76m in cash and short-term securities. One of its most coveted assets is
its $7 billion “net operating loss tax carry forward”, which could translate into $2.5 billion in tax
savings if it ever manages to turn a profit. Rob Haines of CreditSights, a research firm, does not
think it will: “Ambac is a dying company with a finite life.”

The prospects for other monoline insurers look equally bleak. The industry got going in the 1970s
and at first provided insurance only for municipal-bond issuers, which rarely defaulted. Over the
past decade, however, the industry has branched out into structured products, such as risky
mortgage-backed securities and collateralised-debt obligations. Big mistake. When subprime
mortgages soured, bond insurers such as Ambac and MBIA, another embattled monoline, were on
the hook to pay up. Their credit ratings dropped, which meant issuers were less willing to buy
insurance from them.

In 2005 bond insurers covered around 57% of new bond issuance, but now they cover a mere
7% or so. Only one monoline remains active: Assured Guaranty, which sat out most of the
structured stampede. All its pre-crisis peers are either being restructured, face litigation or are
out of business. Even Warren Buffett, who entered the bond-insurance market in 2008, has
pulled back. “We’re like an only child,” says Dominic Frederico, the boss of Assured Guaranty.
“We don’t have anybody to play with but all the toys are ours.” Still, life isn’t all fun and games.

Some still believe there is hope for the industry. The National League of Cities, a non-profit
organisation, thinks there should be a mutual insurance company owned and operated by local
governments. But monolines will have to embrace a new model to succeed. Stanislas Rouyer of
Moody’s, another ratings agency, says monolines need to emphasise that they provide not just
insurance but also monitoring and surveillance capabilities. This would enable them to sell their
wares directly to retail investors, who account for 36% of the buyer base for municipal bonds.

There are other hurdles to jump first. The shaky finances of some municipalities could put what’s
left of the industry to another huge test. Fragile issuers and nervous investors ought to be a boon
to insurers. But mass defaults by cities and counties could be the final blow for Assured Guaranty
and its zombie peers.

Finance and Economics
Microfinance in India

Discredited

A string of suicides puts microlending under the spotlight

Nov 4th 2010

THIS was meant to be the year when Indian microfinance came of age, thanks to the listing in August of SKS, the country’s biggest microfinance institution (MFI). Optimists hoped that an infusion of private capital would spur even greater growth in credit to India’s rural poor, nearly 27m of whom are already microfinance clients.

Two months and a messy collision with the realities of local politics later, Indian MFIs are reduced to talking about something more basic: survival. Politicians from the state of Andhra Pradesh (AP), where microfinance has made the deepest inroads and where SKS has its headquarters, have held microlenders responsible for the suicides of 57 people. It is alleged that they were hounded to their deaths by lenders’ coercive recovery practices. MFIs deny wrongdoing. Vikram Akula, SKS’s founder, says that although 17 of the 57 women who killed themselves were SKS clients, none was in default so there was “no scope for putting any pressure”.

Despite this, the state government passed an executive order on October 15th imposing curbs on MFIs. The order stopped short of capping interest rates, as many had feared, though a subsequent statement by a senior bureaucrat suggested that this remains an option. SKS has voluntarily shaved two percentage points off its loan rates in AP, where it has 2.2m borrowers. But it is barely functioning in the state anyway. A series of arrests of field workers has led the company to keep 6,000 staffers idle. It has made no collections in swathes of AP for three weeks.

Does microfinance have a case to answer? Interest rates of 20-30% may seem high but so are recovery and loan-servicing costs in remote villages. According to Mary Ellen Iskenderian of Women’s World Banking, a network of MFIs, a more pressing problem is likely to be overindebtedness, fuelled by rapid growth in a sector with no formal credit bureaus. Big Indian MFIs are now sharing information, pledging not to lend to a person who has already borrowed from three others and to keep total lending to a limit. But smaller lenders have fewer qualms.

This immediate crisis may well pass. India’s central bank says it will not intervene before all the facts are clear. The country’s main commercial banks also said on November 1st that they would continue to lend to MFIs. And the trouble is so far limited to AP. But the MFIs’ problems may have deeper roots. The growth of microfinance has reduced local politicians’ ability to use rural credit...
as a tool of patronage. That puts MFIs in the firing line.
DESpite its deserved reputation as a nation of thrift and fiscal discipline, Germany has a habit of making bond markets nervous. At a European Union summit last month Germany won agreement to rewrite EU treaties to allow for a permanent scheme to deal with stricken euro-zone borrowers—including, it hopes, a mechanism for an orderly sovereign default. At that summit Jean-Claude Trichet, the head of the European Central Bank, warned EU leaders that talk of debt restructuring was likely to unsettle bond markets and drive up the borrowing costs of troubled euro-zone countries. So it proved. The gaps between the ten-year bond yield of Germany and those of Greece, Portugal and Ireland jumped sharply this week.

The desire for an agreed set of procedures for a public-debt default is not new. In 2001 Argentina defaulted on its foreign debts after huge bail-outs that went wrong. That failure sparked a quest, led by the IMF, for international rules to govern sovereign-debt restructuring. Then, as now, it was hoped that making default less messy would prevent costly bail-outs that served only to rescue a few lucky private creditors. It would also strengthen bond-market discipline.

The hard part is designing a system that enables a speedy agreement from creditors on how big a loss they are prepared to accept. After more than a year of deliberation the IMF produced a blueprint for a sovereign-debt restructuring mechanism (SDRM), which would be written into the treaty that governs the fund’s operations. But the proposals failed to get enough support from the IMF’s membership. America was reluctant to cede any legal power to a supranational authority. For their part, some emerging-market members feared that the SDRM would make their access to credit more expensive because it appeared to make default more likely.

Yet unless default is a realistic threat, there is little incentive for markets to distinguish between the bonds of disciplined countries like Germany and lax ones like Greece. And in a forthcoming paper, Jeromin Zettelmeyer of the EBRD argues that an SDRM-type scheme has a better chance of survival in Europe, where the practice of ceding some national legal powers to a larger entity is long established (and where spillovers from one country’s troubles to others are large). The fallout from Greece has been a much bigger shock to the euro zone than Argentina’s default was to the IMF’s wider membership. This sense of acute crisis means radical measures have more chance of being adopted.

A first challenge is to be clear about just how “orderly” a default can reasonably be. Any default
or restructuring implies a reduction in debt: creditors do not get all their money back (at least when they expected to). All creditors would be hit. A default could not, for instance, spare banks from trouble: they cannot be treated differently both for reasons of fairness and because to shield them from the full effects of a default would only encourage them to load up on risky bonds in the first place. One way to protect banks from the fallout, and to discourage them from holding iffy bonds, would be to force them to set aside more capital against the bonds of countries with larger-than-average debts.

The best that can be hoped for is a process that is predictable; that takes place as soon as it becomes obvious that the debt burden is unsustainable (to stop good money being thrown after bad); and that is not held up by small groups of creditors seeking to achieve better terms than most would settle for. Just as a drawn-out bankruptcy dissipates the value of a firm’s assets, a default in which a country faces legal battles with squabbling groups of creditors weakens its capacity to repay debt.

To meet these requirements, an ideal sovereign-default scheme would have three main features. First, it would require someone to judge that the debt position is unsustainable. Second, it would need a supranational institution, such as the IMF or the European Commission, to oversee creditors’ claims and co-ordinate agreement on a settlement. This institution would need legal tools to bind all creditors to a deal agreed upon by a qualified majority (say, 75%) of them and to protect the debtor from legal challenges while that settlement was negotiated. A third element would be a mechanism to allow fresh credit to keep the defaulting country running. These funds would be senior to existing debts to shield them from the restructuring.

Opening chapter

The trickiest part of all this is the decision to start proceedings. Defaults are damaging and costly: banks are crippled, governments fall, populations suffer and countries are frozen out of capital markets. Often a defaulting country suffers lost years of economic progress, says Robert Koenigsberger of Gramercy, an emerging-markets investment manager. Debt-ridden countries will seek to delay the inevitable; their rescuers frequently will, too. One way to avoid delay is for the IMF or the EU to promise not to bail out countries whose debts go beyond a specific threshold, forcing them to seek a restructuring. A rules-based approach would have the benefit of clarity. But if the bar is set too high it would temporarily reprieve countries that are going to end up broke anyway; if set too low, it could force sound sovereigns into bankruptcy. A form of “constrained discretion” might work best, if the criteria used to make the judgment are known by all.

One aspect of default that could not be set by a rule is the size of the “haircut”—ie, how big a loss creditors have to bear. That would need case-by-case negotiation. But deals have been struck in the past, suggesting there is usually a decent sense of what a country can afford. Debtors may wish to drive a hard bargain but that risks delaying a settlement. The desire to move on is what leads countries to strike a deal (Argentina is a big exception). Haircuts range widely but are typically between a third and a half of the value of debts. Hence this week’s jitters.
Correction: Buttonwood
Nov 4th 2010

On October 9th Buttonwood said that there were only four quarters since 1980 (prior to the third quarter of 2010) when gold, the S&P 500 and Treasury bonds had all risen. We should have said there were only four quarters when they had all risen by 4% or more.

Finance and Economics
Geoengineering

Lift-off

Research into the possibility of engineering a better climate is progressing at an impressive rate—and meeting strong opposition

Nov 4th 2010

AS A way of saying you’ve arrived, being the subject of some carefully contrived paragraphs in the proceedings of a United Nations conference is not as dramatic as playing Wembley or holding a million-man march. But for geoengineering, those paragraphs from the recent conference of the parties to the Convention on Biological Diversity (CBD) in Nagoya, Japan, marked a definite coming of age.

Geoengineering is shorthand for the idea of fixing the problem of man-made climate change once the greenhouse gases that cause it have already been emitted into the atmosphere, rather than trying to stop those emissions happening in the first place. Ideas for such fixes include smogging up the air to reflect more sunlight back into space, sucking in excess carbon dioxide using plants or chemistry, and locking up the glaciers of the world’s ice caps so that they cannot fall into the ocean and cause sea levels to rise.

Many people think such ideas immoral, or a distraction from the business of haranguing people to produce less carbon dioxide, or both—and certain to provoke unintended consequences, to boot. It was the strength of that opposition which drove the subject onto the agenda at Nagoya. But that strength is also a reflection of the fact that many scientists now take the idea of geoengineering seriously. Over the past few years research in the field has boomed. What is sometimes called Plan B seems to be taking shape on the laboratory bench—and seeking to escape outside.

Stratospheric thinking

The most widely discussed way of cooling the Earth is to imitate a volcano. Volcanoes inject sulphur dioxide into the stratosphere, where it eventually forms small particles of sulphate that reflect sunlight back into space. Volcanoes, though, do this on a one-off basis. Geoengineers would need to leave the cloud up for a long time, which could get tricky. If you put sulphur dioxide into air that already has a haze of particles in it, the gas will glom onto those particles, making them bigger, rather than forming new small particles of its own. Since what is needed for cooling is a lot of small particles rather than a few big ones, this approach would face problems.

David Keith, of the University of Calgary, and his colleagues recently came up with a way of
keeping the particles small: use sulphuric acid rather than sulphur dioxide. Released as a vapour at high altitude it should produce a screen of properly sized particles, even in a sky that is already hazed. And the fleet of aircraft needed to keep that screen in being turns out to be surprisingly small. A study that Dr Keith commissioned from Aurora Flight Sciences, a Virginia-based company that makes high-altitude drones, concludes that it could be done by an operation smaller than an airline like Jet Blue, operating from a few bases around the world.

That airline would, however, do best with a fleet of newly designed aircraft. The most straightforward option, according to the report, would be to develop a vehicle capable of flying at altitudes of 20-25km (about 65,000-80,000 feet), distributing ten tonnes of acid a flight. Such craft might look like slightly portly U-2 spy planes, or possibly like the White Knight mother ship developed to launch Virgin Galactic’s tourist spaceships. About 80 such planes would allow the delivery to the stratosphere of a million tonnes of acid every year at a cost of one or two billion dollars over an operational life of 20 years.

A more intriguing idea suggested in the study would be to use a sort of hybrid plane-blimp along the lines of Lockheed’s experimental P-791 (pictured above), which generates lift through both buoyancy and aerodynamics. Lift is a problem in the rarefied air of the stratosphere, and it seems such a design can help. The study dismisses another blimpish idea, though: that of pumping sulphurous chemicals up a long pipe held aloft by a large tethered balloon. It also rejects the use of rockets and guns, both of which have also been proposed as ways of getting sulphur into the stratosphere (see chart).

On the face of it Aurora’s study is extraordinary. Given that a few million tonnes of sulphur a year might be enough to cool the Earth by a degree or two, the report seems to confirm what Scott Barrett, a political scientist at Columbia University, has called the “incredible economics” of geoengineering. The thought that a couple of billion dollars a year spent on sulphur could offset warming as effectively as hundreds of billions of dollars of investment in low-carbon energy suggests there is a real bargain to be had here. Maybe. But opponents of the idea are inclined to insert the word “Faustian” first.

The smog of war

One reason for rejecting sulphate hazing out of hand might be the damage it could do to the ozone layer. Ozone-destroying reactions happen faster on surfaces, such as those provided by sulphate particles, than they do in the open air. It is therefore likely that the addition of sulphate to the stratosphere would result in a loss of ozone, and thus in more ultraviolet radiation getting through. Indeed, the eruption of Mount Pinatubo in 1991 led to just such a loss, even as it cooled the climate.

Current research suggests, though, that any risk to the ozone layer is probably not sufficient reason to abandon the idea. The Montreal protocol, which banned various ozone-depleting chemicals, has left the ozone layer’s long-term prospects looking quite bonny. Sulphate-based geoengineering would certainly slow down its recovery, but would not send it into reverse. The climatic gains might thus be worth the ultraviolet losses.

Might. But that, too, is an area that would bear investigation. For another risk lies in the subtle distinction between “global warming” and “climate change”. Double the amount of carbon dioxide in the atmosphere and the average global temperature will go up. Add the right amount of stratospheric sulphur and the temperature will come back down to where it began. There will, in other words, be no net global warming. But though the average temperature is unchanged, the climate is not. Modelling suggests that a world where additional greenhouse warming has been cancelled out this way will still be warmer at the poles and cooler at the tropics. Moreover—and
more worryingly—it will have less rainfall.

Every computer model of a stratospheric haze shows some decrease in rainfall, though the details vary. The more carbon dioxide that gets put into the atmosphere and the more sunshine that is removed from the sky, the greater the drying becomes. And that drying is worse in some places than in others. One recent study, for example, suggested that engineered cooling of this sort would lead to a much bigger loss of rainfall in China than in India. That might have political ramifications—even though both countries come closer to their original climates with the other’s optimal level of geoengineering than with no geoengineering at all.

Understanding the mechanism and implication of these effects is another crucial research step, and a difficult one to take at the moment because it is hard to assess the results from one paper on geoengineering in the light of another. That is because they all start from different assumptions, something that Alan Robock of Rutgers University hopes to overcome. Dr Robock, who carries out geoengineering research while taking an avowedly hostile approach to any suggestion of deploying the technology, has teamed up with climate modellers at other institutions to produce a set of options that could be run on a range of computer models.

This grand intercomparison, which may involve ten or more modelling teams, should allow researchers to get a better grip on what is really happening, and to see which of their results might be dependent on the vagaries of a particular piece of software. Considering that, a few years ago, it was rare to get the computer time needed to do even a single geoengineering simulation with a state-of-the-art climate model, this investment of time and effort marks a big step forward.

Whatever the models reveal about the pattern, impacts and nature of the loss of rainfall, it is hard to imagine that it will not be bad news of some sort. This is one of the reasons why most in the geoengineering field reject the notion that the “incredible economics” offer a real bargain. Hazy cooling and greenhouse warming cannot be traded one for the other; simply adding more and more sulphate to counterbalance more and more carbon dioxide would be dessicatory and dangerous. Cooling might take the edge off the peak of a planetary fever, or perhaps buy time as emissions cuts begin to have the desired effects. But hazing is a complementary medicine, not an alternative one.

Screening sunlight from the sky with sulphates is not, though, the only suggestion around. Various entrepreneurial researchers are looking at ways of extracting carbon dioxide from the atmosphere and stashing it out of harm’s way.

**Suck it and see**

Nature already provides one method: photosynthesis. Using political and financial tools to encourage the growth of forests, and chemical ones to encourage the growth of photosynthetic plankton, are both possibilities—though both, especially the chemical approach, have their sceptics. Planet hackers of an industrial bent, however, propose proper bent-metal engineering: so-called “direct air capture” technology that would chemically scrub carbon dioxide out of the air, then release it from those scrubbers in a concentrated form that could be sequestered underground. Various companies, including one started by Dr Keith, are trying to produce demonstrators for such technologies. One way is to use arrays of fans to pass air in large volumes through cleverly contrived surfaces along which an absorbing fluid flows.

An alternative approach is to use the ocean as your absorber. Among those investigating this possibility is Tim Kruger, fellow and currently sole employee of the newly founded Oxford Geoengineering Programme at the eponymous university. Mr Kruger proposes dumping quicklime—calcium oxide—into the sea. That change in ocean chemistry would encourage carbon dioxide dissolved in the water to turn into ions of carbonate and bicarbonate, freeing chemical “space” into which carbon dioxide from the atmosphere could flow.
The chemically literate will spot a potential snag. Calcium oxide is made by heating up limestone (calcium carbonate). This drives off carbon dioxide. Generating the heat is also likely to involve the release of that gas. All this carbon dioxide will have to be squirreled away in the same way carbon dioxide scrubbed from the air (or a power station’s chimney) would. But that might not be too hard. The gas will already be concentrated and pure if the kilns work the right way.

![An airscrubber, from an artist’s imagination](image)

The idea of liming is a comparatively old one, first mooted by Haroon Kheshgi, a researcher at ExxonMobil, in the mid-1990s. Dr Kruger’s work, meanwhile, was recently supported by a grant from another oil company, Shell, through what it calls its GameChanger programme. Cynics may smile at the oil companies’ involvement, and at the intellectual property and plans for profit that companies trying to pull carbon out of the atmosphere all rely on. But money is needed. Shell’s money, for instance, paid for a panel of researchers to look into Mr Kruger’s plans. They concluded that if put to use they might lock up carbon dioxide for $40 a tonne—which seems almost embarrassingly cheap, and which, as a preliminary figure, Mr Kruger is keen not to hype. Dr Keith thinks his air capture might, with luck, manage $100 a tonne. People further from the technology, but with less of a direct interest in its success, think prices will be higher.

Nor is Mr Kruger’s esprit untypical. Other fields of research are being drawn, blinking, into the light by geoengineering’s new-found popularity. “Cloud whitening” provides a nice example. Until 2006 work on the idea of cooling the planet with the help of a fine mist of sea salt sprayed into low layers of maritime cloud, to make them whiter, was the province of two semi-retired British academics. A mere four years later John Latham, the cloud physicist who thought up the idea, and Stephen Salter, a marine engineer who designed systems that might embody it, have been joined by 23 other authors from seven different institutions on a paper outlining current work on the matter. This paper looks not only at the cooling effects such a scheme might have on the climate and the practicalities of creating such a spray from boats at sea, but also at the possibilities of a field trial and what might be learned from such a trial about the way clouds work—a problem that climate scientists, limited to observations and models without the help of direct intervention, have yet to answer.

Whitening some clouds has a certain aesthetic appeal; it is certainly hard to see as an environmental threat in itself. Perhaps the most benign-sounding idea of all, though—and one that brings a Herculean sense of effort that messing around with the air and oceans cannot match—is Slawek Tulaczyk’s nascent proposal to lock the world’s ice caps in place.

Dr Tulaczyk, a specialist in glacial flow who works at the University of California, Santa Cruz, observes that one of the most catastrophic consequences of climate change could be a rise in sea level. The risk is not so much that the ice caps of Greenland and Antarctica will melt, but that enough meltwater will get under them to lubricate their journey from the land into the sea. At a meeting held at his university last month he outlined ideas he has been developing which might slow that process down, either by pumping the meltwater out, or by refreezing it in situ using liquid nitrogen. What makes this scheme merely ambitious, rather than totally crazy, is that you
might need do it in only a few places. A large fraction of the ice coming off Greenland, for example, flows down just three glaciers. Work out how to slow or stop those glaciers and you may have dealt with a big problem.

The Devil and the details

Polluting the stratosphere. Liming the oceans. Locking Greenland’s glaciers to its icy mountains. It is easy to see why sceptics balk at geoengineering. And if viewed as a substitute for curbing greenhouse-gas emissions, a cover for business-as-usual into the indefinite future, then it might indeed prove a Faustian bargain. But that is probably the wrong way of looking at it. Better to use it as a means of smoothing the path to a low-carbon world. Most of the researchers working in the area of stratospheric hazing, for example, think that its best use might be reducing the peak temperatures the Earth would otherwise face at a time in the future when greenhouse-gas emissions have started falling but atmospheric levels are still going up.

To see whether any form of geoengineering could work, though, small-scale experiments need to be carried out. Fertilising the ocean with iron has already been tried—admittedly without much success, but also without perceptible harm being done. Such experiments are, however, regulated by an international body, the London Convention on maritime dumping, which the CBD approves of. But what of other experiments? The CBD’s decision at Nagoya allows small-scale experimentation. But small by what standard? That of a laboratory or that of a planet? And small by whose? That of an enthusiast or that of an opponent?

Take hazing experiments. Such experiments could start fairly soon, were money available. One could easily imagine releasing sulphuric acid from a high-altitude aircraft and studying the chemistry going on in its wake using another aircraft. NASA, America’s aerospace agency, is already equipped with a modified U-2 that would do the job well.

Experiments of this sort would not be harmless. But they would do a lot less harm to the stratosphere than Concorde or the space shuttle, devices that were accepted by most people. The harm done by stopping geoengineering experiments is that the good which might come from them will never be known.

Yet even some enthusiastic researchers worry about undue haste. Dr Keith, long an advocate of more research, says he unexpectedly finds himself thinking that things are moving, if anything, faster than he would want. “Taking a few years to have some of the debate happen is healthier than rushing ahead with an experiment. There are lots of experiments you might do which would tell you lots and would themselves have trivial environmental impact: but they have non-trivial implications.” Geoengineering’s growth spurt will need to be matched by some grown-up questioning. Who benefits? Who decides? Who faces the risk?
DHIRUBHAI AMBANI grew up in a two-room home with an earthen floor in the Indian state of Gujarat, close to the Arabian Sea. Later this month his eldest son, Mukesh (pictured above, right), head of Reliance Industries and the world’s fourth richest man, will throw a party to show off his new home in Mumbai, a towering vertical palace with six floors of parking space, three helipads and a hanging garden.

The story of how the Ambanis moved from dusty provinces to city skyscrapers is a tale of pluck, guile and vaulting ambition. But telling it also requires courage and tenacity. Hamish McDonald, an Australian journalist who was posted to Delhi in the 1990s, brought out his first book on Ambani, “The Polyester Prince”, in 1998. Publication in India was scrapped after Reliance set its heart on legal action, but the book became required reading for anyone interested in Indian industry. In his new work, ”Mahabharata in Polyester”, Mr McDonald brings the story up to date, adding chapters about Dhirubhai’s death in 2002 and the subsequent feud between his two sons, Mukesh and Anil.

The young Dhirubhai lacked money, but not charisma. He raised his first 100,000 rupees (now $2,250) from a second cousin’s father and was introduced to yarn trading by a nephew. His first ventures into textile-making were run by Gujaratis back from Yemen, where Dhirubhai had worked for a petrol company during the day while trading rice, sugar and other commodities in the souk after hours.

Indians complain that social connections trump hard work. But no one worked harder than Dhirubhai at forging connections. “His philosophy was to cultivate everybody from the doorkeeper up,” Mr McDonald remarks. With the help of these relationships, Reliance set about making the most of India’s famous “Licence Raj”.

At that time the government took a suffocating interest in a firm’s imports and output. In 1987, for instance, the Customs Directorate alleged that Reliance’s yarn factory had more than twice its permitted capacity and that it had evaded over 1 billion rupees of duty on imported machinery. Reliance denied breaking the rules and the charges were subsequently dropped. But the rules
themselves were strangling Indian industry. In exceeding these limits, Reliance made the case for their removal, according to Arun Shourie, a journalist, former minister and one-time critic of Reliance who later made his peace with the company.

Some of those restrictions also worked to Reliance’s benefit. In 1982, for example, the government raised duties on imported yarn to over 650%, which allowed Reliance to charge high prices for its homespun polyester yarn. Later in the decade import restrictions on paraxylene, a petrochemical, forced India’s other big polyester-maker to buy the crucial ingredient from Reliance, its bitterest rival. Clumsy curbs on trade are bad for the economy, but they are not always bad for individual businesses.

Dhirubhai Ambani knew how to appeal to the people as well as the powerful. By the late 1980s, Reliance Industries boasted the widest shareholding in the world. Dhirubhai held annual meetings in football stadiums and scattered subscription forms for one debenture from a helicopter. His roguish side only added to his appeal. Like India’s most popular Bollywood stars, Dhirubhai was an anti-hero, cocking a snook at complacent and hypocritical guardians of privilege.

By the time Dhirubhai died, Reliance was one of India’s biggest companies. But it was not big enough for both his sons, who soon fell to squabbling. Their mother brokered a split of the family’s assets in 2005. Mukesh got the heavy industry (hydrocarbons, petrochemicals and polyester) with the rich cashflows. Anil got the weightless businesses (telecommunications and financial services) with their rich share valuations. Both had inherited a driving ambition from a father who did not let them rest on their laurels. Within hours of his final MBA exam, Anil left Wharton (where, among other things, he learned to cook and iron his clothes) to look after a textiles factory in Gujarat. Mukesh returned to set up a polyester factory even before completing his MBA at Stanford. Their father told them they could either “command respect” through their efforts, or be left vainly to “demand respect” from people who badmouthed them behind their backs.

Outsiders rarely have the patience to dig through the details of India’s corporate life. Mr McDonald is an exception. His book puts the reader in the thick of the sweatiest corporate wrestling matches. He cannot quite sustain that intensity in the later chapters, in part because they were written from a distance long after he left India, but also because less is at stake. Dhirubhai Ambani’s rise symbolised a struggle for the heart and soul of India. His sons’ squabbles seem petty by comparison, even if the sums involved are huge.

Mukesh’s new palace is in the same neighbourhood he lived in as a youngster. In the intervening years this middle-class address has become an exclusive neighbourhood for Mumbai’s rich and famous. Reliance has grown, but India has grown with it. The Ambani brothers are big fish—and swimming in a much bigger pond.

Books and Arts
Bringing history to life

Ages of imagination
A new story of the world

Nov 4th 2010

**A History of the World in 100 Objects.** By Neil MacGregor. *Allen Lane; 707 pages, £30.* Buy from [Amazon.co.uk](http://Amazon.co.uk)

FOR some listeners it was the Japanese bronze mirror, for others the “Admonitions Scroll” from China, the silver Hoxne pepper pot—or, simply, Neil MacGregor’s velvety voice. Fans of the landmark BBC radio series, “A History of the World in 100 Objects”, felt lost when the programmes came to a finish and their days were no longer book-ended by the British Museum (BM) director’s gentle wit and erudition in describing the history, significance and beauty of 100 objects from the BM’s collection.

None could have imagined quite how the series would permeate the national consciousness. Well over 12.5m podcasts have been downloaded since the first programme on January 21st and more than 550 museums around Britain have launched similar series featuring the local history around them.

When Britain’s new coalition government threatened cuts to public services, the museum world turned to Mr MacGregor. The sage of Bloomsbury lobbied hard to persuade fresh-faced ministers of the importance of museums as national guardians for the future of the past. Where other arts institutions have had their budgets reduced by 30% or more over the next four years, public funding for museums was cut by just 15%.

Among Mr MacGregor’s earliest objects is the Swiss Army knife of the Stone Age, a 1.2m-year-old handaxe found in Tanzania in the 1930s. Discovering how to chip stones to make a tool that would cut flesh was the moment man learned how to be an opportunist. The tool was carried from East Africa to Libya, Israel, India, Korea and even to a gravel pit near Heathrow airport where one was buried 600,000 years ago.

Mr MacGregor went on to tell stories about objects of record, worship, trade, food and veneration. Now another course is being served up with the publication of the book of the series. Radio or television tie-ins are usually just a cheap way of cashing in on a craze. This one is an exception. Allen Lane, which bought the book at competitive auction, has done Mr MacGregor proud. At £30 ($48) the final product is pricier than most, but the BM and the BBC were right to go for a publisher that wanted to avoid doing the job on the cheap. Who wouldn’t want one under their Christmas tree?

The objects have been beautifully photographed, Mr MacGregor’s voice comes through as distinctively as it did on radio and his arguments about the interconnectedness of disparate societies through the ages are all the stronger for the detail afforded by extra space. A book to savour and start over.

Books and Arts
The rise of Asia
At America's expense
India, China and the rest
Nov 4th 2010

Asia Alone: The Dangerous Post-Crisis Divide From America. By Simon Tay. Wiley; 206 pages; $24.95 and £16.99. Buy from Amazon.com, buy from Amazon.co.uk

STYLING himself “America’s first Pacific president”, Barack Obama in Tokyo last year promised to “strengthen and sustain our leadership in this vitally important part of the world.” On November 5th he was due to begin a visit to India, Indonesia and South Korea, and to return to Tokyo to attend the summit of the Asia-Pacific Economic Co-operation forum. President Obama still has to counter a common perception in Asia that America has lost strategic ground to a rising China—partly through its own focus elsewhere after the September 11th attacks, and partly because of the impact of the global financial crisis.

In “Asia Alone”, Simon Tay, chairman of the Singapore Institute of International Affairs, a non-government think-tank, frets that this rift might turn into a permanent divide. America’s “political will to engage with Asia and its influence”, he writes, seem to be waning. Meanwhile “Asia is rising and developing a stronger sense of regionalism.” His timely and readable book makes the case for continued American engagement.

Perhaps because of his Singaporean perspective, Mr Tay may overstate the dangers. South-East Asia in general, and Singapore in particular, have been very successful in placing themselves at the centre of regional diplomacy. An unspoken fear behind his argument is that South-East Asia itself risks losing influence. After all, as Mr Tay notes, the previous administration, of George Bush, was very active in managing its relations with China and India. Yet he accuses it of overlooking the “wider picture of Asia”. An Asia minus India and China is perhaps only wider if you live in the bits in between.

Also, as Mr Tay concedes, Asian “regionalism” is “a mess”, a bewildering plethora of ineffectual talking-shops that only keep going by refusing to tackle head-on any of the potential conflicts they are designed to defuse. And since the region is riven by any number of intractable disputes—the Koreas, Taiwan, Kashmir and the South China Sea are just a few—meaningful integration seems a very long way off. He is right, however, that Asia’s rise is bringing a greater interest in the topic, and that the West’s neglect could lead to its exclusion from the debate about the future.

Another historic burden Mr Obama carries in Asia is the arrogance of American officials during the Asian financial crisis of 1997-98. That caused resentment, helped burnish China’s image and inspired some scarcely concealed glee at America’s comeuppance a decade later. But China’s rise provokes fear as much as admiration in the region. Its recent assertiveness over territorial claims in its near-abroad has seen the region’s smaller countries scurry for American reassurance of support. The difficulty they face is in reconciling China to their need for an American comfort blanket.

This is a symptom of a broader problem: the belief, common on both sides, that China can rise only at America’s expense. Rather, Mr Tay argues, “it is possible and indeed desirable for China to rise and the United States to remain powerful and influential in Asia.” The hope must be that he is right. But mutual suspicions of each other’s intentions have become deep-rooted. America and China still often play Asia as a zero-sum game.
Cancer

With hope, farewell fear
The long struggle to understand cancer

Nov 4th 2010

The Emperor of All Maladies: A Biography of Cancer. By Siddhartha Mukherjee. Scribner; 541 pages; $30. To be published in Britain by Fourth Estate in January; £25. Buy from Amazon.co.uk

IT IS said that when the good burghers of Amsterdam were first presented with a rhinoceros—armoured, horned, three-toed, with aprehensile lip—spectators shook their heads in disbelief. Cancer provokes a similar bafflement. So protean are its forms and so varied its features that even specialist prognoses of aggressiveness, invasion and response to treatment have typically generated more exceptions than rules. Apparently identical cancers in two patients may behave so unlike as to appear utterly different diseases. Siddhartha Mukherjee’s “The Emperor of All Maladies” tells of the search for a “unifying theory” of cancer, the common attribute of all types of malignant cell growth that might reveal its cure.

The arc of this rich and engrossing book matches Mr Mukherjee’s personal evolution as an oncologist, beginning on the first day of his hospital residency. It seems that the diversity of this implacable, shape-shifting foe will defeat him. He is faced with dead-end discoveries, therapeutic disasters and revelations that lead only to more mysteries. But with the perceptiveness and patience of a true scientist he begins to weave these individual threads into a coherent and engrossing narrative.

The earliest references to cancer, in 2600BC or so by Imhotep, an ancient Egyptian physician, then by Hippocrates and Galen, were simple clinical descriptions: swelling, ulceration, death. These were attributed to “humours” or blockages of bile. In the mid-19th century, a pioneering German pathologist, Rudolf Virchow, identified one feature of cancers: that they represent an uncontrolled proliferation of cells. The cause may still have been a mystery, but the search began for cures.

Surgeons brandished the knife, cutting ever wider and deeper, but recurrence of the disease suggested that the operations had been too conservative, that even more extensive procedures stood more chance of cure. As the science of pathology advanced and leukaemias and lymphomas became recognised as cancers of blood cells, it became clear that the entire bone marrow or lymphatic system could not be extirpated (although some physicians tried). Chemotherapeutic drugs were used, singly and then in increasingly lethal combinations to try to destroy all abnormal cells. X-rays and other forms of radiation were known to kill cells and these were aimed at lymph glands near and distant, on sites of secondary cancer spread in bone and lung and brain.

Practitioners in each field claimed advances. Individual lives were saved. Scientific optimism after the second world war led a leading American oncologist, Sidney Farber, to talk in 1962 of the underlying “Singularity” of cancer, and to postulate a “universal cure”. Screening programmes for breast and cervical cancer promised detection at an earlier stage, with improved outcomes. In Here’s how they look in the lymph
1985 American epidemiologists conducted a review of the benefits of these advances in diagnosis and treatment. In the previous year there had been 211 deaths and 448 new cancer cases diagnosed for every 100,000 Americans. When these were compared with the figures for 1962, it was evident that this war was not being won; cancer-related deaths had increased by 8.7%. Much of this could be traced back to the lung-cancer epidemic that had followed the surge in smoking in the 1950s, but the message was clear. More needed to be understood about cancer’s causes before true advances could be made on the curative front.

Scientists had not been idle, but the significance of their labours remained obscure. A virus had been found to cause a cancer in chickens. A rare eye tumour sometimes manifested itself in members of the same family. Certain occupations seemed to breed malignancy; chimney sweeps historically got cancer of the scrotum, dye manufacturers bladder cancer and wartime shipyard workers handling asbestos died from aggressive tumours of the membrane lining the chest. Radium, that source of X-rays used to treat some cancers, had induced fatal malignancies in Marie Curie and her fellow researchers. There was the explicit association between cigarettes and lung cancer, while the newest disease, AIDS, sometimes appeared as multiple malignant tumours called Kaposi’s sarcoma. What common process could be understood from these apparently unconnectable discoveries?

It was time to return to fundamentals. Instead of replicating to an organised plan and forming normal tissue, cancer cells multiply madly. They secrete compounds that induce a proliferation of blood vessels that feed their growth and allow them to infiltrate the walls of adjacent organs. These attributes are genetically programmed functions of normal cells that are intended to combat infection or repair injury. They are controlled by molecular triggers that switch on and off on demand. The common aspect of the apparently disparate causes of cancer is that they induced genetic damage, locking these switches full on. Chaotically multiplying, the abnormal cells mutate, evolving myriad new characteristics: resistance to chemotherapy or an ability to establish colonies in distant parts of the body. The unifying theory had been found.

No longer is the topography of cancer formless flesh, unbridled and invading, but a complex scaffold of cancer DNA that affords binding sites for molecular therapies to block or reset aberrant cellular switches. Twenty-four new drugs are already in use, targeting specific mutations of lung, breast, colon, prostate and blood-cell malignancies. Researchers have hundreds of others in trial. Surgery, radiotherapy and chemotherapy treatments advance constantly.

Cancer’s endless mutability, its ruthless adaptation to survive, is being matched by resourcefulness. The epitaph of the emperor of maladies has not been written quite yet, but his all-conquering domain is in perceptible retreat.
GIUSEPPE ESKENAZI takes the long view. Ten years ago he decided that he would celebrate the 50th anniversary of his London gallery in 2010 with a landmark exhibition. He carefully began putting aside the best examples of what he buys and sells, including porcelain, bronzes and sculpture. Mr Eskenazi is regarded as one of the most important dealers in oriental art in the world. Each of the 12 Chinese objects he has selected is a rarity among rarities. This is a dazzling show.

The kneeling figure of a shaman proffering a shallow dish is just ten centimetres high, yet hugely compelling. Dating from the Han period, around 2,000 years ago, it is probably unique. Four closely related figures exist, but they are all bronze. Mr Eskenazi’s is the only one made of gold. Almost certainly unique too is the elegant, pear-shaped Qing-dynasty vase, decorated in the Imperial palace in Beijing with two writhing claw-footed dragons. The only other comparable piece was in a Japanese collection and probably destroyed during the second world war. Mr Eskenazi’s vase was made to order for the emperor and is mentioned in the imperial records.

The exhibition catalogue, too, is excellent. Its lead essay, by a young scholar, Wang Tu, is a “biography” of the show’s archaic bronze wine vessel that dates back 3,000 years. The essay is a model of lucidity, combining detailed information about the vessel and its decoration with illustrated stories about its previous Chinese and Japanese owners. The bronze, which the uninitiated might otherwise have found opaque, comes alive.

Mr Eskenazi works at the very top end of the market, selling to museums and ambitious collectors. He is closely watched in the auction rooms. At a Christie’s sale in London in 2005 he paid £15.6m for a rare, cobalt blue and white 14th-century jar (pictured right) that had been consigned by a Dutch collector. It was bought on behalf of Bruno Eberli, a Swiss-born financier based in New York and one of the most fearless bidders in the West. The price, a world auction record for an oriental work of art, has never been broken despite the surge in the market over the past five years.

Mr Eskenazi was born in 1939 in Istanbul to a Sephardic Jewish family. His father, Isaac, later moved to Milan where he joined the family antiques business. Isaac, a passionate anglophile, sent the 13-year-old boy to England to be educated. Mr Eskenazi speaks six languages. It is his
Italian wife, however, who is fluent in Mandarin.

In 1960 father and son opened a London office, buying in England for the Milan gallery. Milanese taste tended towards Chinese export wares and other decorative pieces. The younger Eskenazi was far more attracted to earlier objects. He began buying what he liked as well as what the Milanese wanted. Soon his exceptional eye and increasing knowledge of early Chinese objects attracted two major collectors, Hans Popper and Ezekial Schloss, European émigrés based in New York. He became a bold bidder for both, occasionally spending more than they told him they would pay.

A pattern was established early on; buy only what you like, go for the very best and, if possible, spend what it takes to get it. There are other principles too. Mr Eskenazi, who “is not shy of making a profit”, does not advise clients to collect as an investment, though some do. In 1979 he sold an exceptional Tang horse to the British Rail Pension Fund for $125,000. (He spent a week having to justify its price.) Ten years later, the fund sold it at auction for £3.74m. The Tang market, though, can be turbulent. In the slump of the 1990s, the same horse was sold for half that price and it is now on offer again—this time for $10m.

Mr Eskenazi does not collect oriental objects. He feels this would be a conflict of interest. Instead he has bought Western works on paper. In 2007 he sold a rare Cézanne watercolour of a melon at Sotheby’s for $25.5m. (The money went to his grandchildren.) He has kept his collection of David Hockney drawings. He paid no more than £150 for them and says he has no plans to sell.

Mr Eskenazi’s first clients were English and American. Japanese and Hong Kong Chinese followed in the 1970s. Now the mainland Chinese dominate the market. Sellers may be tempted to sell at auction, rather than through private dealers. Mr Eskenazi does not think the bubble is about to burst. What then is his strategy for coping with an ever hotter market?

“We will buy when we can, choosing carefully, not being influenced just by what is selling,” he says. “We will retain our own agenda; our own tempo. We are antiques and art dealers. We have premises and we show our objects. And that is how we go on.” Mr Eskenazi helped found Asian Art in London, a ten-day festival, to attract international collectors. In 1993 his son, Daniel, joined the business and the firm has branched out into representing living artists who specialise in traditional Chinese ink painting, such as Li Huayi and Arnold Chang. He also started the gallery’s annual spring exhibitions during New York’s Asian Art week. Both have been great successes. Eskenazi will doubtless continue as it has done for 50 years.

“Fiftieth Anniversary Exhibition: Twelve Chinese Masterworks” is at Eskenazi in London until November 30th. Asian Art in London is on until November 13th.
WHEN Boris Yeltsin made Viktor Chernomyrdin Russia’s prime minister in December 1992, horror seized Russia’s liberal intelligentsia and many Western governments. The Soviet gas minister, 54, inarticulate, with bushy eyebrows and a Gogolesque name that sounded like “blackface” in Russian, was a clear throwback to the Communist nightmare. The contrast with his predecessor Yegor Gaidar, young, anglophone and smart, made the appointment all the more depressing.

Few discerned that this was one of the shrewdest and, in his own way, most colourful politicians in modern Russian history, a man who eased the country’s switch to capitalism while also defining its flaws. Over the next six years Russia not only got used to him, but grew to like him, with his completely instinctive sense of humour and his untranslatable speeches. People marvelled that the Soviet system had produced such a human figure, and had allowed him to survive.

Tenses and cases rarely agreed when he spoke in public: not because he was illiterate, but because he was trying so hard not to swear. Yet his remarks produced wonderfully crazed summations of Russian life in the struggling transition years of the 1990s, and later. “It has never been like this and now it is exactly the same again,” said Mr Chernomyrdin. And “Whatever organisation we try to create, it always ends up looking like the Communist Party.”

He himself was a simple man (with a working-class background, from south of the Urals) with unusual common sense. More than any other politician, he brought about a smooth transition from the Soviet regime to the Russian one. In fact, Mr Chernomyrdin and his colleagues were the reason why the Soviet Union fell apart and why it did so peacefully; but also why it never became a liberal free-market democracy. The explanation was simple: the Soviet nomenklatura was not prepared to defend the Communist system for the sake of petty privileges when they could actually control the vast property of the Soviet Union in their own interests.

Mr Chernomyrdin understood this quicker than many. As minister for the gas industry and a member of the Central Committee of the Communist Party in the mid-1980s, he was entitled to a large apartment in Moscow and a dacha in the country, holidays in a Crimean sanatorium and jars of black caviar from a special shop. But as the Soviet Union began to crumble, greater opportunities loomed. He persuaded the government to transform the gas ministry into Gazprom, and appoint him as its boss. The move from minister to state company boss seemed baffling to many of his colleagues. But while their ministries vanished, along with the country, Gazprom
became the largest and most powerful firm in Russia, offering privileges no Communist Party could match.

As Russia reeled from market reforms in 1992, Mr Chernomyrdin was an indispensable asset to Yeltsin. On the one hand, his Soviet appearance and style appealed to the voters and helped neutralise the shock of market reforms. On the other hand, his pragmatic instincts fitted with those of the reformers. His ability to compromise kept the country on an even keel as it tried to become “normal”. His lack of ideology was an asset, too.

He stood by Yeltsin in 1993 when the Communists and nationalists rebelled against the reformers. In the early 1990s he resisted the temptation to endlessly print money or to return to a command economy, turning to the IMF instead. Bill Clinton became a friend, and he gained such weight internationally that in 1999 he was Russia’s representative in the Kosovo peace talks.

Talking to Basayev

Perhaps most important, Mr Chernomyrdin provided psychological comfort for a population facing the war in Chechnya, terrorism and economic woes. When in 1995 Chechen terrorists took hundreds of hostages in Budyonnovsk, he appeared on TV talking on the phone to an infamous Chechen rebel. “Shamil Basayev,” he cried, “can you hear me?” Later, he explained that “the country had to understand that the government cared about its people.” His call saved the hostages’ lives, and led to talks that ended the first Chechen war.

When Russia was struck by a severe financial crisis in 1998 Yeltsin turned to him again, though he had sacked him a few months earlier. This time, however, the Communists in Russia’s parliament did not want him to be prime minister. As a consolation prize he became the chairman of Gazprom, the company he had created. He stayed there until Vladimir Putin replaced him, and sent him more or less into exile to be the ambassador to Ukraine. There, although he kept to the official line, he privately deplored the Kremlin’s bullying of Ukraine over energy supplies, believing that it belittled Russia itself.

He resented Mr Putin and the low-ranking spooks who surrounded him, especially when they scorned the 1990s as a wasted decade. “Where would they be today without our reforms?” he asked. In the grey landscape of Russian politics, he was a burst of vitality. Yet he also played his part in the building of state capitalism in Russia, and in its de facto return to a one-party system. Or, in his own words, “We wanted the best, but it turned out like always.”

Obituary
**Overview**

Nov 4th 2010

**America’s** Federal Reserve said it would resume “quantitative easing” by buying $600 billion of Treasury bonds by the middle of 2011. According to a preliminary estimate, GDP grew at a 2% annual rate in the third quarter—a bit faster than in the second quarter but much slower than in the first.

The **euro area’s** inflation rate edged up to 1.9% in October from 1.8% in September. Unemployment in the single-currency zone rose by a shade in September, to 10.1% from 10% in August.

Consumer prices in **Japan** fell by 0.6% in September from a year earlier. This was the country’s 19th consecutive month of negative inflation.

**Thailand’s** inflation rate fell to 2.8% in October from 3% in September.

**South Korea’s** industrial production rose by 3.9% in the year to September. The country’s inflation rate in October, at 4.1%, was the highest since February 2009.

The Reserve Bank of **India** increased both its policy rates by a quarter of a percentage point. The rate at which the central bank lends to banks was raised to 6.25%, and the rate at which it borrows from them was increased to 5.25%. The tightening was India’s sixth this year.

The Reserve Bank of **Australia** also increased its policy rate, to 4.75%, citing fears that the moderation in inflation in the past year was “probably close to ending”.

**Economic and Financial Indicators**
## Output, prices and jobs

Nov 4th 2010

<table>
<thead>
<tr>
<th>Country</th>
<th>Output</th>
<th>Prices</th>
<th>Jobs</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>United States</strong></td>
<td>+2.6%</td>
<td>+2.7%</td>
<td>+1.1%</td>
</tr>
<tr>
<td><strong>Japan</strong></td>
<td>+0.9%</td>
<td>+0.6%</td>
<td>+0.7%</td>
</tr>
<tr>
<td><strong>China</strong></td>
<td>+10.6%</td>
<td>+10.0%</td>
<td>+9.3%</td>
</tr>
<tr>
<td><strong>Britain</strong></td>
<td>+1.5%</td>
<td>+2.1%</td>
<td>+1.3%</td>
</tr>
<tr>
<td><strong>Canada</strong></td>
<td>+2.6%</td>
<td>+2.3%</td>
<td>+1.8%</td>
</tr>
<tr>
<td><strong>Euro area</strong></td>
<td>+1.1%</td>
<td>+1.8%</td>
<td>+1.1%</td>
</tr>
<tr>
<td><strong>Australia</strong></td>
<td>+3.4%</td>
<td>+0.7%</td>
<td>+0.9%</td>
</tr>
<tr>
<td><strong>Belgium</strong></td>
<td>+2.7%</td>
<td>+3.2%</td>
<td>+1.9%</td>
</tr>
<tr>
<td><strong>France</strong></td>
<td>+1.6%</td>
<td>+1.0%</td>
<td>+1.2%</td>
</tr>
<tr>
<td><strong>Germany</strong></td>
<td>+1.0%</td>
<td>+0.9%</td>
<td>+1.1%</td>
</tr>
<tr>
<td><strong>Greece</strong></td>
<td>-2.5%</td>
<td>-0.8%</td>
<td>+1.5%</td>
</tr>
<tr>
<td><strong>Italy</strong></td>
<td>-0.5%</td>
<td>+0.2%</td>
<td>+1.2%</td>
</tr>
<tr>
<td><strong>Netherlands</strong></td>
<td>-0.1%</td>
<td>+0.3%</td>
<td>+1.5%</td>
</tr>
<tr>
<td><strong>Slovakia</strong></td>
<td>+4.5%</td>
<td>-0.7%</td>
<td>+0.6%</td>
</tr>
<tr>
<td><strong>Czech Republic</strong></td>
<td>+2.0%</td>
<td>-0.1%</td>
<td>+0.7%</td>
</tr>
<tr>
<td><strong>Denmark</strong></td>
<td>+3.0%</td>
<td>+0.3%</td>
<td>+1.9%</td>
</tr>
<tr>
<td><strong>Hungary</strong></td>
<td>+3.7%</td>
<td>+0.8%</td>
<td>+2.4%</td>
</tr>
<tr>
<td><strong>Norway</strong></td>
<td>+3.7%</td>
<td>+2.7%</td>
<td>+3.2%</td>
</tr>
<tr>
<td><strong>Poland</strong></td>
<td>+3.8%</td>
<td>+1.0%</td>
<td>+1.7%</td>
</tr>
<tr>
<td><strong>Russia</strong></td>
<td>+4.5%</td>
<td>+2.3%</td>
<td>+3.7%</td>
</tr>
<tr>
<td><strong>Sweden</strong></td>
<td>+4.6%</td>
<td>+1.3%</td>
<td>+0.8%</td>
</tr>
<tr>
<td><strong>Switzerland</strong></td>
<td>+2.6%</td>
<td>+1.4%</td>
<td>+1.4%</td>
</tr>
<tr>
<td><strong>Turkey</strong></td>
<td>+4.9%</td>
<td>-0.6%</td>
<td>+1.7%</td>
</tr>
<tr>
<td><strong>Austria</strong></td>
<td>+4.0%</td>
<td>+0.7%</td>
<td>+1.6%</td>
</tr>
<tr>
<td><strong>Hong Kong</strong></td>
<td>+5.5%</td>
<td>+2.0%</td>
<td>+1.5%</td>
</tr>
<tr>
<td><strong>India</strong></td>
<td>+8.6%</td>
<td>+1.0%</td>
<td>+1.3%</td>
</tr>
<tr>
<td><strong>Indonesia</strong></td>
<td>+5.2%</td>
<td>+2.5%</td>
<td>+1.0%</td>
</tr>
<tr>
<td><strong>Malaysia</strong></td>
<td>+4.8%</td>
<td>+0.7%</td>
<td>+1.4%</td>
</tr>
<tr>
<td><strong>Pakistan</strong></td>
<td>+8.9%</td>
<td>+2.1%</td>
<td>+2.7%</td>
</tr>
<tr>
<td><strong>Singapore</strong></td>
<td>+7.7%</td>
<td>+0.0%</td>
<td>+1.2%</td>
</tr>
<tr>
<td><strong>South Korea</strong></td>
<td>+4.7%</td>
<td>+0.3%</td>
<td>+1.1%</td>
</tr>
<tr>
<td><strong>Taiwan</strong></td>
<td>+12.5%</td>
<td>+0.8%</td>
<td>+1.7%</td>
</tr>
<tr>
<td><strong>Thailand</strong></td>
<td>+2.8%</td>
<td>+0.9%</td>
<td>+1.2%</td>
</tr>
<tr>
<td><strong>Argentina</strong></td>
<td>+3.8%</td>
<td>+0.7%</td>
<td>+1.7%</td>
</tr>
<tr>
<td><strong>Brazil</strong></td>
<td>+0.6%</td>
<td>+0.5%</td>
<td>+0.9%</td>
</tr>
<tr>
<td><strong>Chile</strong></td>
<td>+6.2%</td>
<td>+0.5%</td>
<td>+1.6%</td>
</tr>
<tr>
<td><strong>Colombia</strong></td>
<td>+5.4%</td>
<td>+0.3%</td>
<td>+1.3%</td>
</tr>
<tr>
<td><strong>Mexico</strong></td>
<td>+6.7%</td>
<td>+0.5%</td>
<td>+1.8%</td>
</tr>
<tr>
<td><strong>Venezuela</strong></td>
<td>-5.9%</td>
<td>-0.6%</td>
<td>+1.5%</td>
</tr>
<tr>
<td><strong>Egypt</strong></td>
<td>+5.3%</td>
<td>+0.8%</td>
<td>+1.5%</td>
</tr>
<tr>
<td><strong>Israel</strong></td>
<td>+8.0%</td>
<td>+1.0%</td>
<td>+1.1%</td>
</tr>
<tr>
<td><strong>Saudi Arabia</strong></td>
<td>+3.3%</td>
<td>+0.7%</td>
<td>+1.8%</td>
</tr>
<tr>
<td><strong>South Africa</strong></td>
<td>+3.0%</td>
<td>+0.8%</td>
<td>+1.3%</td>
</tr>
</tbody>
</table>

### MORE COUNTRIES

Data for the countries below are not provided in printed editions of The Economist.

- **Estonia**
- **Finland**
- **Ireland**
- **Ireland**
- **Latvia**
- **Lithuania**
- **Luxembourg**
- **New Zealand**
- **Norway**
- **Philippines**
- **Portugal**
- **Slovakia**
- **Slovenia**
- **Ukraine**
- **Vietnam**

*Note: % change on previous quarter, annual rate. The Economist poll or Economist Intelligence Unit estimate/forecast. National definitions differ. Inflation rate is average annual. Sources: National statistics offices and central banks; Thomson Reuters Centre for Monitoring; British Economy Office; EIU.
## The Economist poll of forecasters, November averages

Nov 4th 2010

### Economic and Financial Indicators

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Real GDP, % change</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Australia</td>
<td>3.0/4.0</td>
<td>2.6/4.1</td>
<td>3.4 (3.1)</td>
<td>5.4 (3.3)</td>
<td>2.9 (2.8)</td>
<td>3.0</td>
<td>-3.0 (-2.6)</td>
<td>-2.9 (-2.7)</td>
</tr>
<tr>
<td>Belgium</td>
<td>1.6/2.1</td>
<td>1.0/2.0</td>
<td>1.8 (1.7)</td>
<td>1.5</td>
<td>2.0</td>
<td>1.9</td>
<td>1.2 (0.3)</td>
<td>1.0 (0.5)</td>
</tr>
<tr>
<td>Britain</td>
<td>1.4/2.8</td>
<td>0.6/2.5</td>
<td>1.7 (1.5)</td>
<td>1.8</td>
<td>3.1 (2.0)</td>
<td>2.7</td>
<td>-1.6 (-1.2)</td>
<td>-1.2 (-1.1)</td>
</tr>
<tr>
<td>Canada</td>
<td>2.7/3.3</td>
<td>2.0/3.2</td>
<td>3.1 (2.0)</td>
<td>2.5 (2.6)</td>
<td>1.7</td>
<td>1.9</td>
<td>-2.0</td>
<td>-2.2 (-2.9)</td>
</tr>
<tr>
<td>France</td>
<td>1.6/1.7</td>
<td>1.0/1.1</td>
<td>1.6</td>
<td>1.4</td>
<td>1.7</td>
<td>1.5</td>
<td>-2.0</td>
<td>-1.9 (-1.9)</td>
</tr>
<tr>
<td>Germany</td>
<td>3.0/3.5</td>
<td>1.3/2.4</td>
<td>3.3</td>
<td>2.0 (1.9)</td>
<td>1.1</td>
<td>1.3</td>
<td>5.2</td>
<td>5.3 (5.5)</td>
</tr>
<tr>
<td>Italy</td>
<td>0.5/1.2</td>
<td>0.5/1.6</td>
<td>1.1 (1.0)</td>
<td>1.0</td>
<td>1.6</td>
<td>1.7</td>
<td>-3.1 (-3.0)</td>
<td>-2.7</td>
</tr>
<tr>
<td>Japan</td>
<td>2.4/3.2</td>
<td>0.1/2.2</td>
<td>2.9</td>
<td>1.3 (1.2)</td>
<td>-0.9</td>
<td>-0.3</td>
<td>3.3</td>
<td>3.3</td>
</tr>
<tr>
<td>Netherlands</td>
<td>1.7/2.6</td>
<td>1.0/2.0</td>
<td>1.9 (1.8)</td>
<td>1.5</td>
<td>1.1 (1.2)</td>
<td>1.5 (1.4)</td>
<td>6.2 (6.3)</td>
<td>6.2 (6.0)</td>
</tr>
<tr>
<td>Spain</td>
<td>-0.5/ml</td>
<td>-0.3/1.1</td>
<td>-0.3</td>
<td>0.4</td>
<td>1.6</td>
<td>1.4</td>
<td>-4.5 (-4.9)</td>
<td>-3.3 (-3.4)</td>
</tr>
<tr>
<td>Sweden</td>
<td>2.7/3.6</td>
<td>2.0/3.4</td>
<td>4.0</td>
<td>2.8</td>
<td>1.2</td>
<td>1.9</td>
<td>6.5 (6.6)</td>
<td>6.6 (6.9)</td>
</tr>
<tr>
<td>Switzerland</td>
<td>2.7/3.1</td>
<td>1.4/2.7</td>
<td>2.9 (2.7)</td>
<td>1.9</td>
<td>6.7 (6.8)</td>
<td>6.7 (6.9)</td>
<td>71.9 (70.7)</td>
<td>30.8 (30.5)</td>
</tr>
<tr>
<td>United States</td>
<td>1.8/2.8</td>
<td>1.5/3.1</td>
<td>3.4</td>
<td>2.3 (2.4)</td>
<td>1.6</td>
<td>1.5</td>
<td>-3.3</td>
<td>-3.5 (-3.2)</td>
</tr>
<tr>
<td>Euro area</td>
<td>1.5/1.8</td>
<td>0.8/1.9</td>
<td>1.6 (1.5)</td>
<td>1.3</td>
<td>1.6 (1.5)</td>
<td>1.6 (1.5)</td>
<td>-0.4 (-0.5)</td>
<td>-0.2 (-0.1)</td>
</tr>
</tbody>
</table>

Sources: IHS Fairtex, Citigroup, Commerzbank, Decision Economics, Deutsche Bank, Economist Intelligence Unit, Goldman Sachs, HSBC Securities, ING, JPMorgan Chase, HSBC, Morgan Stanley, RBC, RBS, Schroders, Societe Generale, UBS

---

This is a table showing the poll of forecasters for November 2010. The table includes data for Real GDP growth, average growth, consumer prices, and current account as a percentage of GDP for various countries. The data is presented in a way that shows the range of forecasts as well as the average forecast for each category.
## The Economist commodity-price index

### Nov 4th 2010

**The Economist commodity-price index**

2005=100

<table>
<thead>
<tr>
<th></th>
<th>Oct 26th</th>
<th>Nov 2nd*</th>
<th>% change on one month</th>
<th>% change on one year</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Dollar Index</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>All items</td>
<td>195.1</td>
<td>196.9</td>
<td>+9.5</td>
<td>+31.8</td>
</tr>
<tr>
<td><strong>Food</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>All</td>
<td>201.9</td>
<td>201.7</td>
<td>+1.4</td>
<td>+23.3</td>
</tr>
<tr>
<td><strong>Industrials</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>All</td>
<td>188.0</td>
<td>189.8</td>
<td>+8.5</td>
<td>+22.8</td>
</tr>
<tr>
<td>Metals</td>
<td>209.5</td>
<td>218.4</td>
<td>+8.4</td>
<td>+75.9</td>
</tr>
<tr>
<td><strong>Sterling Index</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>All items</td>
<td>223.6</td>
<td>223.6</td>
<td>+8.9</td>
<td>+34.9</td>
</tr>
<tr>
<td><strong>Euro Index</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>All items</td>
<td>174.9</td>
<td>174.5</td>
<td>+8.0</td>
<td>+37.9</td>
</tr>
<tr>
<td><strong>Gold</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$ per oz</td>
<td>1,334.00</td>
<td>1,354.74</td>
<td>+1.2</td>
<td>+27.9</td>
</tr>
<tr>
<td><strong>West Texas Intermediate</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$ per barrel</td>
<td>82.54</td>
<td>83.87</td>
<td>+1.4</td>
<td>+5.7</td>
</tr>
</tbody>
</table>

*Provisional. †Non-food ag/cultural.
### Trade, exchange rates, budget balances and interest rates

**Nov 4th 2010**

#### Trade balances, budget balances and interest rates

<table>
<thead>
<tr>
<th>Country</th>
<th>Trade balance*</th>
<th>Current-account balance</th>
<th>Budget balance</th>
<th>Interest rates</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Latest 12 months, $bn</td>
<td>Latest 12 months, % of GDP</td>
<td>Latest 12 months, % of GDP</td>
<td>Latest 12 months, % of GDP</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>United States</td>
<td>-621.4</td>
<td>-60.9 7%</td>
<td>-3.3</td>
<td>-9.0</td>
</tr>
<tr>
<td>Japan</td>
<td>+85.8 6%</td>
<td>+180.9 7%</td>
<td>+5.3</td>
<td>+7.0</td>
</tr>
<tr>
<td>China</td>
<td>+182.9 7%</td>
<td>+289.7 7%</td>
<td>+4.9</td>
<td>+6.0</td>
</tr>
<tr>
<td>Britain</td>
<td>-130.8 7%</td>
<td>-234.5 7%</td>
<td>-1.8</td>
<td>-10.1</td>
</tr>
<tr>
<td>Canada</td>
<td>+8.1 7%</td>
<td>+81.2 7%</td>
<td>+2.5</td>
<td>+1.0</td>
</tr>
<tr>
<td>Euro area</td>
<td>+16.4 7%</td>
<td>+76.7 7%</td>
<td>-0.4</td>
<td>-0.5</td>
</tr>
<tr>
<td>Austria</td>
<td>+17.4 7%</td>
<td>+107.1 7%</td>
<td>+1.0</td>
<td>+0.5</td>
</tr>
<tr>
<td>Belgium</td>
<td>+15.8 7%</td>
<td>+173.6 7%</td>
<td>+1.2</td>
<td>+0.4</td>
</tr>
<tr>
<td>France</td>
<td>-87.2 7%</td>
<td>-51.3 7%</td>
<td>-2.0</td>
<td>-7.8</td>
</tr>
<tr>
<td>Germany</td>
<td>+205.8 7%</td>
<td>+278.8 7%</td>
<td>+5.2</td>
<td>+3.7</td>
</tr>
<tr>
<td>Greece</td>
<td>-62.0 7%</td>
<td>-358.6 7%</td>
<td>-5.8</td>
<td>-7.9</td>
</tr>
<tr>
<td>Italy</td>
<td>-24.4 7%</td>
<td>-73.5 7%</td>
<td>-3.1</td>
<td>-5.0</td>
</tr>
<tr>
<td>Netherlands</td>
<td>+51.0 7%</td>
<td>+425.2 7%</td>
<td>+5.2</td>
<td>+5.7</td>
</tr>
<tr>
<td>Sweden</td>
<td>-72.9 7%</td>
<td>-74.8 7%</td>
<td>-6.4</td>
<td>-9.6</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>+37.5 7%</td>
<td>+22.3 7%</td>
<td>-3.7</td>
<td>-17.0</td>
</tr>
<tr>
<td>Hungary</td>
<td>-7.0 7%</td>
<td>-112.3 7%</td>
<td>-2.1</td>
<td>-3.7</td>
</tr>
<tr>
<td>Turkey</td>
<td>-50.0 7%</td>
<td>-33.6 7%</td>
<td>-1.4</td>
<td>-0.4</td>
</tr>
<tr>
<td>Australia</td>
<td>+6.5 7%</td>
<td>-49.5 7%</td>
<td>+3.0</td>
<td>+2.4</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>-41.1 7%</td>
<td>+12.5 7%</td>
<td>+8.3</td>
<td>+7.7</td>
</tr>
<tr>
<td>India</td>
<td>-123.1 7%</td>
<td>-47.2 7%</td>
<td>-1.7</td>
<td>-5.5</td>
</tr>
<tr>
<td>Indonesia</td>
<td>+214.1 7%</td>
<td>+47.2 7%</td>
<td>+12.2</td>
<td>+8.9</td>
</tr>
<tr>
<td>Malaysia</td>
<td>+154.2 7%</td>
<td>+167.7 7%</td>
<td>+3.0</td>
<td>+2.3</td>
</tr>
<tr>
<td>Pakistan</td>
<td>-55.9 7%</td>
<td>-125.7 7%</td>
<td>-1.5</td>
<td>+6.3</td>
</tr>
<tr>
<td>Singapore</td>
<td>+35.9 7%</td>
<td>+17.0 7%</td>
<td>+3.5</td>
<td>+0.7</td>
</tr>
<tr>
<td>South Korea</td>
<td>+43.5 7%</td>
<td>+34.5 7%</td>
<td>+3.3</td>
<td>+1.2</td>
</tr>
<tr>
<td>Taiwan</td>
<td>+35.8 7%</td>
<td>+40.5 7%</td>
<td>+9.3</td>
<td>+3.5</td>
</tr>
<tr>
<td>Thailand</td>
<td>+12.7 7%</td>
<td>+10.6 7%</td>
<td>+5.0</td>
<td>+2.2</td>
</tr>
<tr>
<td>Argentina</td>
<td>+18.5 7%</td>
<td>+18.5 7%</td>
<td>-1.0</td>
<td>+4.3</td>
</tr>
<tr>
<td>Brazil</td>
<td>+34.7 7%</td>
<td>+63.7 7%</td>
<td>-2.7</td>
<td>+1.7</td>
</tr>
<tr>
<td>Chile</td>
<td>+14.1 7%</td>
<td>+3.2 7%</td>
<td>+0.5</td>
<td>+2.1</td>
</tr>
<tr>
<td>Colombia</td>
<td>+23.2 7%</td>
<td>+2.1 7%</td>
<td>+1.8</td>
<td>+2.0</td>
</tr>
<tr>
<td>Mexico</td>
<td>-1.1 7%</td>
<td>-1.2 7%</td>
<td>+1.1</td>
<td>+3.6</td>
</tr>
<tr>
<td>Venezuela</td>
<td>+31.1 7%</td>
<td>+20.1 7%</td>
<td>+10.9</td>
<td>-6.2</td>
</tr>
<tr>
<td>Egypt</td>
<td>-25.1 7%</td>
<td>-20.3 7%</td>
<td>+0.4</td>
<td>-5.8</td>
</tr>
<tr>
<td>Israel</td>
<td>-1.6 7%</td>
<td>-56.2 7%</td>
<td>+2.9</td>
<td>-4.7</td>
</tr>
<tr>
<td>Jordan</td>
<td>+16.2 7%</td>
<td>+22.8 7%</td>
<td>+1.6</td>
<td>+2.7</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>+105.2 7%</td>
<td>+22.8 7%</td>
<td>+1.6</td>
<td>+2.7</td>
</tr>
<tr>
<td>South Africa</td>
<td>-1.3 7%</td>
<td>-10.9 7%</td>
<td>+4.6</td>
<td>+6.9</td>
</tr>
</tbody>
</table>

**MORE COUNTRIES**

**Data for the countries below are not provided in printed editions of The Economist**

- Estonia
- Finland
- Iceland
- Ireland
- Latvia
- Lithuania
- Luxembourg
- New Zealand
- Peru
- Philippines
- Portugal
- Slovakia
- Slovenia
- Ukraine
- Bangladesh

**Mechanised trade only. The Economist papal and Economist Intelligence Unit estimates. Dollar commentary bonds. News series. Sources: National statistics offices and central banks; Bloomberg; Thomson Reuters; Bank Leumi Le-Israel; Centre for Monitoring Indian Economy; Hong Kong Monetary Authority; JPMorgan Standard Bank Group; OECD Reports.**

---

**Economic and Financial Indicators**

About The Economist online | About The Economist | Media directory | Staff books | Career opportunities | Contact us | Subscribe | [+ Site feedback](#)
### Markets

**Economic and Financial Indicators**

---

**Markets**

<table>
<thead>
<tr>
<th>Index Nov 3rd</th>
<th>Index Dec 31 2009</th>
<th>% change on</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States (DJIA)</td>
<td>11,215.1</td>
<td>+0.8</td>
</tr>
<tr>
<td>United States (S&amp;P 500)</td>
<td>1,198.8</td>
<td>+1.3</td>
</tr>
<tr>
<td>United States (NASDAQ)</td>
<td>2,550.3</td>
<td>+1.5</td>
</tr>
<tr>
<td>Japan (Nikkei 225)</td>
<td>9,160.0</td>
<td>+6.1</td>
</tr>
<tr>
<td>Japan (Toyo's)</td>
<td>803.1</td>
<td>+0.6</td>
</tr>
<tr>
<td>China (SSA)</td>
<td>3,175.4</td>
<td>+1.1</td>
</tr>
<tr>
<td>China (SSB, S terms)</td>
<td>296.9</td>
<td>+2.6</td>
</tr>
<tr>
<td>Britain (FTSE 100)</td>
<td>5,749.0</td>
<td>+1.8</td>
</tr>
<tr>
<td>Canada (S&amp;P/TSX)</td>
<td>12,671.1</td>
<td>+0.8</td>
</tr>
<tr>
<td>Euro area (FTSE Euro 100)</td>
<td>897.8</td>
<td>+0.8</td>
</tr>
<tr>
<td>Euro area (STOXX SE)</td>
<td>2,850.4</td>
<td>+0.6</td>
</tr>
<tr>
<td>Austria (ATX)</td>
<td>2,673.3</td>
<td>+1.0</td>
</tr>
<tr>
<td>Belgium (BE2)</td>
<td>2,658.8</td>
<td>-0.3</td>
</tr>
<tr>
<td>France (CAC 40)</td>
<td>3,842.9</td>
<td>+0.7</td>
</tr>
<tr>
<td>Germany (DAX)</td>
<td>6,637.8</td>
<td>+0.8</td>
</tr>
<tr>
<td>Greece (Athex 20)</td>
<td>1,571.9</td>
<td>+0.8</td>
</tr>
<tr>
<td>Italy (BIT 50)</td>
<td>21,100.8</td>
<td>-3.3</td>
</tr>
<tr>
<td>Netherlands (AEX)</td>
<td>2,991.0</td>
<td>+0.3</td>
</tr>
<tr>
<td>Spain (SIBE)</td>
<td>1,083.8</td>
<td>-1.5</td>
</tr>
<tr>
<td>Czech Republic (PX)</td>
<td>1,168.3</td>
<td>+0.4</td>
</tr>
<tr>
<td>Denmark (OMX)</td>
<td>398.6</td>
<td>+1.1</td>
</tr>
<tr>
<td>Hungary (BUX)</td>
<td>23,075.3</td>
<td>+0.3</td>
</tr>
<tr>
<td>Norway (OSEAX)</td>
<td>464.0</td>
<td>+0.7</td>
</tr>
<tr>
<td>Poland (WIG)</td>
<td>46,168.8</td>
<td>+0.8</td>
</tr>
<tr>
<td>Russia (RTS, S terms)</td>
<td>1,602.5</td>
<td>+1.2</td>
</tr>
<tr>
<td>Sweden (OMXSE)</td>
<td>1,089.5</td>
<td>-1.3</td>
</tr>
<tr>
<td>Switzerland (SMI)</td>
<td>6,513.0</td>
<td>+0.5</td>
</tr>
<tr>
<td>Turkey (ISEQ)</td>
<td>58,684.6</td>
<td>-0.8</td>
</tr>
<tr>
<td>Australia (All Ord)</td>
<td>4,780.8</td>
<td>+0.6</td>
</tr>
<tr>
<td>Hong Kong (Hang Seng)</td>
<td>26,165.7</td>
<td>+0.2</td>
</tr>
<tr>
<td>India (BSE)</td>
<td>24,706.7</td>
<td>+2.3</td>
</tr>
<tr>
<td>Indonesia (CSX)</td>
<td>3,605.7</td>
<td>+0.5</td>
</tr>
<tr>
<td>Malaysia (KLCI)</td>
<td>1,507.6</td>
<td>+0.6</td>
</tr>
<tr>
<td>Pakistan (KSE)</td>
<td>10,617.9</td>
<td>-0.4</td>
</tr>
<tr>
<td>Singapore (SSE)</td>
<td>3,252.6</td>
<td>+3.2</td>
</tr>
<tr>
<td>South Korea (KSPI)</td>
<td>1,950.9</td>
<td>+1.4</td>
</tr>
<tr>
<td>Taiwan (TWI)</td>
<td>8,423.9</td>
<td>+0.2</td>
</tr>
<tr>
<td>Thailand (SET)</td>
<td>1,014.2</td>
<td>+1.1</td>
</tr>
<tr>
<td>Argentina (MSE)</td>
<td>3,205.8</td>
<td>+0.8</td>
</tr>
<tr>
<td>Brazil (Bovespa)</td>
<td>71,904.8</td>
<td>+1.9</td>
</tr>
<tr>
<td>Chile (CPA)</td>
<td>22,077.2</td>
<td>+1.5</td>
</tr>
<tr>
<td>Colombia (BOCI)</td>
<td>16,927.0</td>
<td>+0.4</td>
</tr>
<tr>
<td>Mexico (IPC)</td>
<td>35,843.8</td>
<td>+1.8</td>
</tr>
<tr>
<td>Venezuela (IBC)</td>
<td>67,729.9</td>
<td>+0.4</td>
</tr>
<tr>
<td>Egypt (Cegy 30)</td>
<td>6,714.0</td>
<td>+0.3</td>
</tr>
<tr>
<td>Israel (TA-100)</td>
<td>1,164.4</td>
<td>+0.4</td>
</tr>
<tr>
<td>South Africa (JSE All)</td>
<td>87,040.8</td>
<td>+0.8</td>
</tr>
<tr>
<td>South Africa (JSE All)</td>
<td>87,040.8</td>
<td>+0.8</td>
</tr>
<tr>
<td>Europe (FTSEurofirst 300)</td>
<td>1,088.9</td>
<td>+0.7</td>
</tr>
<tr>
<td>World, ex US (MSCI)</td>
<td>1,233.9</td>
<td>+1.7</td>
</tr>
<tr>
<td>Emerging markets (MSCI)</td>
<td>1,124.4</td>
<td>+3.0</td>
</tr>
<tr>
<td>World, all (MSCI)</td>
<td>319.6</td>
<td>+1.8</td>
</tr>
<tr>
<td>World bonds (Citigroup)</td>
<td>97.9</td>
<td>+1.2</td>
</tr>
<tr>
<td>EMBI+ (JPMorgan)</td>
<td>177.9</td>
<td>+1.0</td>
</tr>
<tr>
<td>Hedge funds (HFRI)</td>
<td>1,196.4</td>
<td>+0.6</td>
</tr>
<tr>
<td>Volatility, US (VIX)</td>
<td>19.6</td>
<td>+0.7</td>
</tr>
<tr>
<td>CDSs, Eur (TRAXX)</td>
<td>80.3</td>
<td>+1.4</td>
</tr>
<tr>
<td>CDSs, N Am (CUST)</td>
<td>89.3</td>
<td>+3.9</td>
</tr>
<tr>
<td>Carbon trading (EU ETS)</td>
<td>14.7</td>
<td>+2.5</td>
</tr>
</tbody>
</table>

*Note: returns, index, currency data updates, base points sources: Standard & Poors, Credit Suisse, central banks and data-exchange providers. Prisons Reuters, WM/Refinitiv, JPMorgan Chase, Bank Credit link Israel; CBOE: CME; Deutsche Bank: EEX, EUREX, Markit; Standard Bank Group; UBS, Westpac.

---

**Economic and Financial Indicators**
Since 1980 Nepal has made the greatest strides in improving human development, according to the UN’s annual Human Development Index (HDI). The index consists of three sub-indices covering wealth, health and education. The countries whose HDI has improved the most since 1980 are mainly in Asia and Africa. China and India have been helped by rapid GDP growth, but even slower-growing countries like Nepal and Bangladesh have fostered human development by making progress in health and education. Adjustments for the unevenness in the distribution of wealth, health and education among a country’s people reduce countries’ HDI score by 22% on average.

Economic and Financial Indicators