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WORLD

Politics this week

Jan 8th 2009

From The Economist print edition

Israel intensified its war on Hamas in the Gaza Strip, sending ground forces to the outskirts of the main urban areas as aircraft attacked suspected Hamas fighters, weapons dumps, rocket-firing positions and arms-smuggling tunnels. After 12 days of fighting, more than 650 **Palestinians** had been killed, many of them women, children and non-combatants, for the loss of seven Israelis. The deaths of more than 30 Palestinians, mostly children, by shells near a UN school, added urgency to diplomacy seeking to bring about a ceasefire. [See article](#)

Getty Images



John Atta Mills was sworn in as **Ghana's** new president after a wafer-thin victory in a run-off against the former ruling party's candidate. The smooth transition after so close a race, in stark contrast to the violence and acrimony last year that disfigured elections in Kenya and Zimbabwe, boosted Ghana's reputation as one of Africa's more successful countries. [See article](#)

Ethiopia began withdrawing its troops from **Somalia** two years after invading it in response to a perceived threat from militant Islamists. But with Somalia's transitional government as weak as ever and a residual force of African Union peacekeepers threatening to leave as well, a power vacuum may be filled again by Islamist militias. [See article](#)

Staying in Santa Fe

Bill Richardson withdrew his nomination as America's commerce secretary, a ripple in Barack Obama's hitherto smooth selection of administration officials. New Mexico's governor is under investigation for awarding a state contract to a political donor, raising questions about why Mr Obama chose him for the job in the first place.

Mr Obama also took some flak for asking **Leon Panetta** to head the CIA. Some intelligence wonks doubted if Mr Panetta, who was chief of staff and budget director under Bill Clinton, has the right background for the job. And Democrats on the Senate intelligence committee said they had been kept in the dark about the nomination. Joe Biden, the vice-president-elect, called this "a mistake".

The convening of the **111th Congress** found Democrats in a tizzy over whether to seat Roland Burris as a senator from Illinois. Mr Burris was sent to Washington by Rod Blagojevich, Illinois's scandal-tainted governor. Mr Blagojevich allegedly tried to sell the seat, made vacant by Barack Obama's election to the presidency. Legal wrangling in Minnesota over spoiled and absent ballots kept one of that state's Senate slots unfilled. [See article](#)

Bloomberg



California's fiscal crisis worsened when negotiations failed between Arnold Schwarzenegger and Democrats in the state Assembly over the budget. The legislators sent a bill to the governor anyway, which he promptly vetoed. [See article](#)

On the (crowded) agenda

Cuba's president, Raúl Castro, said he was willing to talk to Barack Obama, but only on a basis of equals. Mr Castro recently presided over low-key ceremonies to mark the 50th anniversary of the Cuban revolution.

Chile's government unveiled a \$4 billion bundle of measures aimed at creating 100,000 jobs and helping poorer families. In **Mexico**, the government said it would freeze petrol prices and provide cash for struggling industries and the unemployed.

Masked gunmen opened fire and threw a grenade at the studios of Televisa, **Mexico's** largest television company, in the northern city of Monterrey, during the evening news. They left a message warning Televisa to "stop reporting only about us, also report about the narco-officials". At least 5,700 people died in drug-related violence in Mexico last year.

Closing in

After a lengthy and bloody campaign, the **Sri Lankan army** captured the northern town of Kilinochchi, the administrative headquarters of the rebel Liberation Tigers of Tamil Eelam, and said its forces were continuing to advance towards remaining Tiger strongholds. There were three bomb explosions in Colombo, which were blamed on the rebels. [See article](#)

In **Bangladesh**, Sheikh Hasina Wajed of the Awami League was sworn in as prime minister for the second time, following her alliance's landslide victory in an election.

India's prime minister, Manmohan Singh, accused Pakistani state agencies of involvement in the attack on Mumbai last November that killed more than 170 people. India handed over a dossier to Pakistan which it said contained evidence of the involvement of Pakistani terrorist organisations in the attack. Pakistan accused India of point-scoring. [See article](#)

China's government launched a campaign to purge the internet of vulgar and pornographic content. It cited 19 websites, including Google and Baidu, China's leading internet search-engine, for failing to obey requests to block offensive material. There were fears the campaign might also be used by the authorities as an excuse to block online political dissent.

The owner of a **nightclub in Bangkok** was charged with negligence after a fire on New Year's Eve in which at least 64 people died.

In **Cambodia's** capital, Phnom Penh, tens of thousands of people gathered to mark the 30th anniversary of the toppling of the Khmers Rouges by a Vietnamese invasion. As many as 2m people died during the group's four-year rule.

EPA



An unwelcome tradition

The annual gas dispute between **Ukraine** and **Russia** escalated sharply after the Russians decided to shut off all gas supplies. Several countries in south-eastern Europe quickly ran short of gas; even Germany and Italy were hit. A delegation from the European Union flew to Moscow to urge the two sides to reach a deal. [See article](#)

In a sign of growing autocracy, **Azerbaijan** banned foreign companies from broadcasting on national frequencies, shutting off groups such as the BBC and Voice of America.

Turkey arrested at least another 30 people suspected of involvement in a coup plot, including some retired generals and a former police chief. Some 86 people have already been charged.

France's president, Nicolas Sarkozy, proposed sweeping judicial reforms, including the abolition of independent investigating magistrates first brought in by Napoleon. Mr Sarkozy wants the police and state prosecutors to take over the magistrates' role, as in many Anglophone countries.



Business this week

Jan 8th 2009

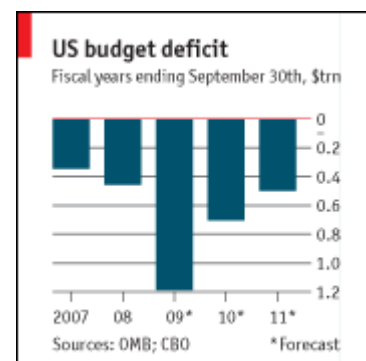
From The Economist print edition

The Congressional Budget Office forecast that America's **budget deficit** for the 2009 fiscal year would reach almost \$1.2 trillion (close to \$4,000 for every man, woman and child). The actual figure will probably be higher if Congress approves a new stimulus package of spending and tax cuts that could top \$800 billion. [See article](#)

The Bank of England sliced its key **interest rate** by half a percentage point to 1.5%, its lowest level since the central bank was founded in 1694. Last month the Federal Reserve lowered its rates near to zero. [See article](#)

Expectations of a cut in rates by the European Central Bank on January 15th were raised when data showed inflation in the **euro zone** falling to a 26-month low in December.

Taiwan made an emergency reduction of half a percentage point in interest rates (the sixth cut since September) amid a slump in exports.



Short circuit

Britain's Financial Services Authority said its ban on **short selling** in financial shares would expire on January 16th (a rule requiring disclosure from those holding short positions will be extended to June 30th). The FSA introduced the ban last September to stop banks from being undermined by waves of selling. In America the Securities and Exchange Commission brought in a similar prohibition, though it was scrapped after a few weeks. Christopher Cox, who plans to step down as the SEC's chairman, now says he regrets introducing the ban.

America's Federal Deposit Insurance Corporation struck a deal to sell what's left of **IndyMac**, a Californian bank which collapsed last summer. The buyers are linked to several big investors, such as George Soros, Christopher Flowers and John Paulson, as well as Michael Dell, a computer magnate. The FDIC and the new owners will share the losses from IndyMac's mortgage portfolio. [See article](#)

Western **banks** raised some much-needed cash by selling the highly prized stakes they had amassed in their Chinese counterparts. Bank of America shaved its holding in China Construction Bank soon after UBS sold its entire stake in Bank of China; Royal Bank of Scotland was said to be considering doing the same. Li Ka-shing, a Hong Kong billionaire, also reduced part of his stake in Bank of China.

Ramalinga ding-dong

India was rocked by a corporate scandal when B. Ramalinga Raju resigned as chairman of **Satyam Computer Services** after admitting he had vastly overstated profits and hid liabilities at the company over several years. Satyam (which means "truth" in Sanskrit) is one of India's biggest technology companies. Its auditing procedures and board of directors are well-regarded and Mr Raju's confession shocked investors. [See article](#)

Steve Jobs revealed that doctors had diagnosed his noticeable weight loss as being caused by a hormonal imbalance, and said he was healthy enough to remain as Apple's chief executive. Mr Jobs has been treated for cancer in the past and investors were worried by how thin he appeared recently, leading to speculation about a successor. [See article](#)

Time Warner said it was heading for an annual loss after booking \$25 billion in charges for the fourth quarter. The conglomerate also reported that advertising had suffered at both its AOL and publishing divisions, as “the economic environment has proved somewhat more challenging” than it expected.

Markets were rattled by a rapid deterioration in the earnings guidance from two big technology companies. **Intel** issued a second warning on fourth-quarter revenue, and **Lenovo**, a Chinese computer-maker which bought IBM’s personal-computer business in 2005, said it expected to record a loss in the quarter and laid off 11% of its workforce.

Alcoa, the world’s largest aluminium producer, announced 15,000 job cuts and a 50% decrease in capital spending because of the downturn. The price of aluminium has fallen by half since July.

Dining out

Waterford Wedgwood called in the administrators. The maker of crystal and ceramics traces its roots to the founding of Josiah Wedgwood’s Staffordshire pottery in 1759 (the company is based in Ireland). It has struggled over the years, despite a revamp of its image away from fancy crockery and towards everyday tableware.

Adolf Merckle, a wealthy German industrialist, committed suicide after making a wrong bet on the direction of Volkswagen’s share price. His death came in a gloomy week for Germany: unemployment in December rose for the first time in nearly three years. The government said it would soon pass a €50 billion (\$68 billion) stimulus package as the country faces perhaps its worse recession in 60 years. [See article](#)

KAL's cartoon

Jan 8th 2009

From The Economist print edition

Illustration by KAL



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OPINION
LEADERS

The Arabs and Israel

The hundred years' war

Jan 8th 2009

From The Economist print edition

How growing rejectionism, the rise of religion, a new military doctrine and a new cold war keep peace at bay

Reuters



WITH luck, the destructive two-week battle between Israel and Hamas may soon draw to an end. But how long before the century-long war between Arabs and Jews in Palestine follows suit? It is hard to believe that this will happen any time soon. Consider: Israel's current operation, "Cast Lead", marks the fourth time Israel has fought its way into Gaza. It almost captured Gaza (behind a pocket containing a young Egyptian army officer called Gamal Abdul Nasser) in 1948, in the war Israelis know as their war of independence. It captured Gaza again in 1956, as part of a secret plan hatched with Britain and France to topple Nasser as Egypt's president and restore British control of the Suez Canal. It invaded a third time during the six-day war of 1967—and stayed there for 38 years, until withdrawing unilaterally three and a half years ago.

Why they fight

And Gaza, remember, is only one item in a mighty catalogue of misery, whose entries are inscribed in tears. The Jews and Arabs of Palestine have been fighting off and on for 100 years. In 1909 the mostly Russian socialist idealists of the Zionist movement set up an armed group, Hashomer, to protect their new farms and villages in Palestine from Arab marauders. Since then has come the dismal march of wars—1948, 1956, 1967, 1973, 1982, 2006 and now 2009—each seared by blood and fire into the conflicting myths and memories of the two sides. The intervals between the wars have not been filled by peace but by bombs, raids, uprisings and atrocities. Israeli settlers in Hebron today still cite, as if it were yesterday, the massacre of Hebron's Jews in 1929. The Arabs of Palestine still remember their desperate revolt in the 1930s against the British mandate and Jewish immigration from Europe, and the massacres of 1948.

The slaughter this week in Gaza, in which on one day alone some 40 civilians, many children, were killed in a

single salvo of Israeli shells, will pour fresh poison into the brimming well of hate (see [article](#)). But a conflict that has lasted 100 years is not susceptible to easy solutions or glib judgments. Those who choose to reduce it to the “terrorism” of one side or the “colonialism” of the other are just stroking their own prejudices. At heart, this is a struggle of two peoples for the same patch of land. It is not the sort of dispute in which enemies push back and forth over a line until they grow tired. It is much less tractable than that, because it is also about the periodic claim of each side that the other is not a people at all—at least not a people deserving sovereign statehood in the Middle East.

That is one reason why this conflict grinds on remorselessly from decade to decade. During eruptions of violence, the mantra of diplomats and editorialists is the need for a two-state solution. It sounds so simple: if two peoples cannot share the land, they must divide it. This seemed obvious to some outsiders even before the Nazi genocide of Europe’s Jews prompted the United Nations in 1947 to call for the creation of separate Jewish and Arab states in Palestine. In 1937 a British royal commission concluded that “an irrepressible conflict has arisen between two national communities within the narrow bounds of one small country.” The answer had to be partition.

The fact that the Arabs rejected the UN’s partition plan of 60 years ago has long given ideological comfort to Israel and its supporters. Abba Eban, an Israeli foreign minister, quipped that the Palestinians “never missed an opportunity to miss an opportunity”. Israel’s story is that the Arabs have muffed at least four chances to have a Palestinian state. They could have said yes to partition in 1947. They could have made peace after the war of 1947-48. They had another chance after Israel routed its neighbours in 1967 (“We are just waiting for a telephone call,” said Moshe Dayan, Israel’s hero of that war). They had yet another in 2000 when Ehud Barak, now Israel’s defence minister and then its prime minister, offered the Palestinians a state at Bill Clinton’s fateful summit at Camp David.

This story of Israeli acceptance and Arab rejection is not just a yarn convenient to Israel’s supporters. It is worth remembering that it was not until 1988, a full 40 years after Israel’s birth, that Yasser Arafat’s Palestine Liberation Organisation (PLO) renounced its goal of liberating the whole of Palestine from the river to the sea. All the same, the truth is much more shaded than the Israeli account allows. There have been missed opportunities, and long periods of rejection, on Israel’s part, too.

Look again at those missed opportunities. At the time of the UN partition resolution, the Jews of Palestine numbered only 600,000 and the Arabs more than twice that number. Most of the Jews were incomers. Although partition might have been the wiser choice for the Palestinians, it did not strike them as remotely fair. In the subsequent war, more than 600,000 of Palestine’s Arabs fled or were put to flight. Afterwards, disinclined either to take them back or return the extra land it had gained in battle, Israel was relieved that the Arab states, traumatised by the rout, made no serious offer of peace. Many of the refugees have been stuck ever since in a sad finger of dunes, the Gaza Strip, pointing at the bright lights of Tel Aviv.

When Israel fell in love

After the ignominious defeat of 1967, the Arab states again rejected the idea of peace with Israel. That was, indeed, a wasted opportunity. But even though the Israel of 1967 discussed how much of the West Bank it was ready to trade for peace, the Likud governments of the late 1970s and 1980s wanted it all. For Israel fell in love with the territories it had occupied.

This was the period of Israeli rejection. Israeli prime ministers such as Menachem Begin and Yitzhak Shamir asserted a God-given right to a “greater Israel” that included the West Bank and Gaza Strip, in which Israeli governments of all stripes continued to plant (illegal) settlements. In some Israeli minds the Palestinians became a non-people, to be fobbed off with self-government under Israeli or perhaps Jordanian supervision. It took an explosion of Palestinian resistance, in the *intifada* (uprising) of the late 1980s and the far more lethal one of 2001-03, to convince Israel that this was an illusion.

Corbis



Building up the iron wall

What bearing does all this history have on the foul events unfolding right now in Gaza? The point is that there have been precious few moments over the past century during which both sides have embraced the idea of two states at the same time. The most promising moment of all came at the beginning of this decade, with Mr Clinton's near-miss at Camp David. But now, with the rise of Hamas and the war in Gaza, the brief period of relative hope is in danger of flickering out.

If rejection of the other side's national claims is one of the things that make this conflict so hard to end, the other is religion. The two are tied together. Hamas is a religious movement, and its formal creed is to reject the possibility of Jewish statehood not only because of Israel's alleged sins but also because there is no place for a Jewish state in a Muslim land.

In Israel's early life Zionism was a mainly secular movement and the dominant force on the other side was a secular Arab nationalism. Since 1967, however, religion, nationalism and hunger for Palestinians' land have fused to create a powerful constituency in Israel dedicated to retaining control of the whole of Jerusalem and Judaism's holy places on the West Bank. Israel's system of proportional voting has given the settlers and zealots a chokehold over politics. Among Arabs secular nationalism is meanwhile waning in the face of a powerful Islamic revival through the region. And a central dogma of the Islamists is that Israel is an implant that must be violently resisted and eventually destroyed.

One far-seeing Zionist, Vladimir Jabotinsky, predicted in the 1930s not only that the Arabs would oppose the swamping of Palestine with Jewish immigrants but also that "if we were Arabs, we would not accept it either". In order to survive, the Jews would have to build an "iron wall" of military power until the Arabs accepted their state's permanence. And this came to pass. Only after several costly wars did Egypt and later the PLO conclude that, since Israel could not be vanquished, they had better cut a deal. In Beirut in 2002 all the Arab states followed suit, offering Israel normal relations in return for its withdrawal from all the occupied territories, an opening which Israel was foolish to neglect.

The depressing thing about the rise of Hamas and the decline of the Fatah wing of the PLO is that it reverses this decades-long trend. Hamas's victory in the Palestinian elections of 2006 had many causes, including a reputation for honesty. Its victory did not prove that Palestinians had been bewitched by Islamist militancy or come to believe again in liberating all of Palestine by force. But if you take seriously what Hamas says in its charter, Hamas itself does believe this. So does Hizbullah, Lebanon's "Party of God"; and so does a rising and soon perhaps nuclear-armed Iran. Some analysts take heart from Hamas's offer of a 30-year truce if Israel returns to its 1967 borders. But it has never offered permanent recognition.

There is worse. On top of the return to rejection and the growing role of religion, a third new obstacle to peace is the apparent crumbling of Jabotinsky's iron wall.

In Lebanon three years ago, and today in Gaza, Hizbullah and Hamas seem to have invented a new military doctrine. Israel has deterred its enemies mainly by relying on a mighty conventional army to react with much greater force to any provocation. But non-state actors are harder to deter. Hizbullah and Hamas, armed by Iran with some modern weapons, can burrow inside the towns and villages of their own people while lobbing rockets

at Israel's. A state that yearns for a semblance of normality between its wars cannot let such attacks become routine. That is why today, as in the 1950s, Israel responds to pinpricks with punitive raids, each of which had the potential to flare into war. Israel's operation in Gaza is designed not only to stop Hamas's rockets but to shore up a doctrine on which Israel thinks its safety must still be based.

At Camp David in 2000 Israel and the Palestinians discovered that even with goodwill it is hard to agree terms. How to share Jerusalem? What to offer the refugees who will never go home? How can Israel trust that the land it vacates is not used, as Gaza has been, as a bridgehead for further struggle? But—and this is the fourth thing that keeps the battle alive—the two sides are seldom left alone to tackle these core issues.

For too long the conflict in Palestine was a hostage to the cold war. America was once neutral: it was Eisenhower who forced Israel out of Gaza (and Britain out of Egypt) after Suez. But America later recruited Israel as an ally, and this suited the Israelis just fine. It gave them the support of a superpower whilst relieving them of a duty to resolve the quarrel with the Palestinians, even though their own long-term well-being must surely depend on solving that conflict.

It may be no coincidence that some of the most promising peacemaking between Israel and the Palestinians took place soon after the cold war ended. But now a new sort of geopolitical confrontation stalks the region, one that sets America against Iran, and the Islamist movements Iran supports against the Arab regimes in America's camp. With Hamas inside Iran's tent and Fatah in America's, the Palestinians are now facing a paralysing schism.

And so to Gaza

Tzipi Livni, Israel's foreign minister, has been saying all week that, although Israel's immediate aim is to stop the rocket fire and not to topple Hamas, there can be no peace, and no free Palestine, while Hamas remains in control. She is right that with Hamas in power in Gaza the Islamists can continue to wreck any agreement Israel negotiates with Mahmoud Abbas, the president of the Fatah-dominated Palestinian Authority on the West Bank. Mr Abbas, along with Egypt's President Hosni Mubarak, may quietly relish Hamas being taken down a peg. Egypt is furious at Hamas's recent refusal to renew talks with Fatah about restoring a Palestinian unity government.

There is a limit, however. Taking Hamas down a peg is one thing. But even in the event of Israel "winning" in Gaza, a hundred years of war suggest that the Palestinians cannot be silenced by brute force. Hamas will survive, and with it that strain in Arab thinking which says that a Jewish state does not belong in the Middle East. To counter that view, Israel must show not only that it is too strong to be swept away but also that it is willing to give up the land—the West Bank, not just Gaza—where the promised Palestinian state must stand. Unless it starts doing that convincingly, at a minimum by freezing new settlement, it is Palestine's zealots who will flourish and its peacemakers who will fall back into silence. All of Israel's friends, including Barack Obama, should be telling it this.

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OPINION

LEADERS

British manufacturing

Coming in from the cold

Jan 8th 2009

From The Economist print edition

Rolls-Royce holds lessons, as the financial crash makes Britain look again at manufacturing

Rex Features



WINSTON CHURCHILL once said he would like to see finance “less proud and industry more content”. At least the first part of his wish has come true. As financial services implode in Britain, all sides are calling for the economy to be “rebalanced” towards manufacturing. Jaguar Land Rover, an Indian-owned carmaker, is surely only the first of many petitioners seeking government aid.

Rather than conduct industrial policy by doling out soft loans to manufacturers, the government needs to get its ideas straight. The fate of manufacturing in Britain, as in much of the industrial world, is no tragedy. Indeed, as Rolls-Royce reveals (see [article](#)), talk of “manufacturing” as a distinct and especially worthy activity now makes very little sense.

How to make a Horlicks

The sorry tale is well-rehearsed. Since the 1970s, manufacturing has fallen from a third to about a tenth of Britain’s economy in one generation, replaced by burger-flipping and minicab driving. Nostalgists mourn GEC, ICI and other industrial names, even as French and German stalwarts churn out high-speed trains, nuclear power stations and the world’s best cars.

But that tale is out of date. Britain’s manufacturing output has grown by a quarter since 1990. According to the Confederation of British Industry, the jobs have been lost not to China, but to improving productivity—which means higher average incomes. Britain is still home to some 150,000 manufacturers turning over some £500 billion (\$750 billion) a year, accounting for 60% of the country’s export earnings.

Rolls-Royce, one of modern Britain’s manufacturing successes, defines the pattern. The aero-engine-maker was once so symptomatic of Britain’s huge, sickly manufacturing sector that a Conservative government felt bound

to save it from collapse by nationalising it in 1971. Since then a privatised Rolls-Royce has transformed itself into a world-class company.

Rolls-Royce has prospered by relentlessly pursuing technical advances and by keeping close to its airline customers. That means large chunks of the work are sent wherever the job can be done best. It is the mirror of the inward investment that keeps factories going in Britain.

The modern Rolls-Royce earns its keep not just by making world-class engines, but by selling “power by the hour”—a complex of services and manufacturing that keeps its customers’ engines burning. If it did not sell services, Rolls-Royce could not earn enough money from selling engines.

In practice, there is no clear line between what counts as a service and what has been made. Look closer and those burger-flippers work on a small assembly line. Rolls-Royce’s designers, salesforce, analysts and financial-support staff are hardly different from their counterparts at ARM, which gets other people to make its microprocessors. The distinction owes more to government statisticians than anything else.

That is why there is no right “balance” between manufacturing and services. The distinction that matters these days is between low-skilled and high-skilled jobs. Just as one threatens impoverishment and drudgery, the other promises a thriving economy. Visiting Rolls-Royce this week, Gordon Brown, Britain’s prime minister, promised government money for new apprenticeships. If that creates skills, fair enough, but, *pace* Churchill, apprenticeships in insurance and actuarial science would be equally justified.

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OPINION
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America's budget

After the recession, the deluge

Jan 8th 2009

From The Economist print edition

Barack Obama must couple short-term stimulus with long-term fiscal reform

FOR all his talk of change, Barack Obama will start his presidency much as George Bush did: with a huge fiscal stimulus aimed at boosting an ailing economy and promoting some pet objectives. The need for stimulus is far greater than in 2001. America is in what could be its deepest recession since the Depression. With interest rates close to zero, the Federal Reserve is out of conventional monetary ammunition, so fiscal policy must do the lion's share.

The problem with this is that higher spending and tax cuts will only make a big budget deficit even bigger. This danger does not justify penny-pinching now: that could merely prompt a bigger collapse in economic activity and even larger deficits. But Mr Obama should do what Mr Bush never did—and link the upcoming splurge to long-term fiscal reform.

The hole in America's balance sheet is clearly partly Mr Bush's fault. Even if you strip out the cyclical economic effects, the 1% surplus he inherited had become a deficit of more than 2% of GDP last year. But other things are at work. The collapse of the credit bubble will reduce tax revenues. The government has taken on big liabilities in its efforts to prop up the banking system. Above all, the first baby-boomers retired last year: as their numbers grow, the cost of the two big retirement programmes, Social Security (pensions) and Medicare, will soar.

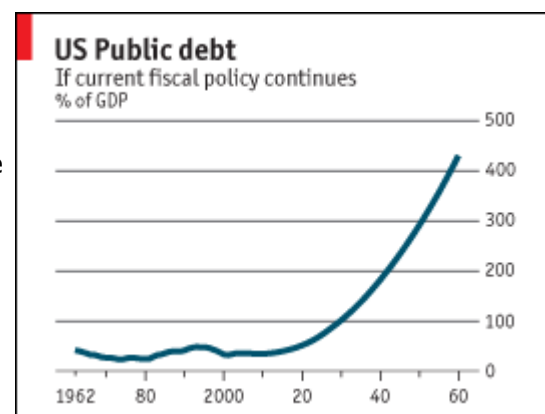
The Congressional Budget Office says that, even without Mr Obama's stimulus plans, America's publicly held debt could rise from a perfectly reasonable 41% of GDP in 2008 to 54% in 2010, a 55-year high (see [article](#)). Under current tax and spending policies it is headed towards 400% by mid-century. Investors, fearing America will have to inflate its way out of such debt, could push the dollar down and interest rates up.

Mr Bush and the Republicans in Congress repeatedly gave voters goodies without paying for them: tax cuts without tax reform, subsidised prescription drugs without Medicare reform, and so on. Mr Obama must not make the same mistake. His stimulus plans may include cherished giveaways such as tax credits for low-paid workers, expanded unemployment insurance benefits, and investments in alternative energy. All have their merits; all will also increase the hole in the books. Despite some earnest waffle about addressing the long-term fiscal challenge, Mr Obama has been short on specifics.

The expiration of Mr Bush's tax cuts at the end of next year imposes a deadline for dealing with the tax code. There is a powerful case for a grand bargain that overhauls the tax system, Social Security and Medicare all at once. The three are interconnected. Subsidised health insurance for the working poor, for example, could be paid for by eliminating the tax deduction for employer-provided insurance. The tax code could be made more progressive by reducing the payroll tax for low-income workers, but that would make it essential to rein in benefits, starting with a higher retirement age. Almost everyone would feel some pain. But in return Americans would get a tax system and budget that would be good for future growth.

Hard but not impossible

If the economics of such a grand bargain are compelling, the politics are daunting. Armies of entrenched



interests ring the tax system, Social Security and Medicare. Yet there may be no time like the present. Mr Obama has political capital and his party comfortably controls both houses of Congress (see [article](#)). He would also find some allies. Kent Conrad and Judd Gregg, the leading Democrat and Republican respectively on the Senate budget panel, have helpfully proposed a bipartisan task-force of congressmen and administration officials. It would come up with a single proposal that Congress could accept or reject but not amend, sidestepping the objections that would surely derail piecemeal reform.

Mr Obama does not need to produce a detailed solution right now. But by committing himself to a process that leads to such a solution, he could reassure investors that the grisly fiscal scenarios painted by the CBO will not come to pass.

Energy in the European Union

Gas wars

Jan 8th 2009

From The Economist print edition

The dispute between Russia and Ukraine shows that Europe must reduce its energy vulnerability

A GAS row between Russia and Ukraine has become a Christmas ritual. That may explain why, until this week, the European Union seemed to pay the latest tiff so little heed. Indeed, the people in Brussels talked of it as a normal bilateral commercial dispute in which the EU should neither interfere nor take sides. Yet Russia's abrupt decision on January 5th to cut off almost all the gas it supplies to EU countries via Ukraine has sharply raised the stakes, inviting the Europeans to intervene more directly. The shutdown should force a rethink of the EU's overall energy policy as well.

Neither side is blameless. Ukraine should be paying higher market prices for its gas; and it should neither have reneged on the gas-transit deal it has with Russia nor pinched gas destined for the EU. But equally Gazprom, Russia's state-controlled energy giant, should not be engaged in overt political bullying just because the Kremlin wants to punish Ukraine's political leaders for leaning towards the West. And both countries should do a lot more to eliminate the shady intermediaries that have made the business of gas supply so opaque—and rife with corruption.

As so often, the two sides' positions have become dangerously entrenched. Even so, precisely because the gas cut-off is damaging the reputations of both Russia and Ukraine, it is unlikely to last long (see [article](#)). Yet it would be wrong to forget quickly the stark reminder, in the depths of a bitterly cold winter, that the EU depends on Russia for a quarter of its gas (some 80% of which flows through pipelines across Ukraine). All EU countries should now urgently look for ways to make themselves less exposed to supply disruptions.

Gazprom, which has been on a charm offensive this week, suggests that the answer is to speed up the building of new pipelines to the north and south of Ukraine, enabling Russia to supply western Europe directly. This appeals particularly to the Germans, the keenest supporters of the planned Nord Stream pipeline. Yet the commercial and strategic case for either pipeline is weak. Worse, they would make it easier for Russia to cut off gas to the eastern European countries through which existing pipelines pass. The real need is for Europe to reduce its dependence on Russia—which would point instead to persisting with Nabucco, a pipeline intended one day to supply gas from Azerbaijan and (perhaps) Central Asia via Turkey, bypassing Russian territory altogether.

Pipelines or pipedreams?

In practice, pipelines are hugely expensive, environmentally risky and take years to construct. So other measures are needed in the meantime. One is to press Russia and Ukraine to sign long-term contracts, with accepted pricing formulae, similar to those that Gazprom already has with most EU countries. The EU must also continue to object forcefully to the gas cut-off, making clear that it undermines Russia's credibility as a reliable energy supplier. And it must stress that it will not allow the Russians to pick off individual EU countries through cosy bilateral deals.

Beyond this, Europe needs to work harder to diversify its sources of energy, something that it must do anyway if it is to meet its ambitious climate-change targets. And it cannot be repeated too often that a fully liberalised energy market, with better linkages between countries, offers all of Europe not only a more efficient energy



future but also a more secure one.

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OPINION
LETTERS

On Gaza, India, Tintin, chilies, William Tyndale, Rod Blagojevich

Jan 8th 2009

From The Economist print edition

Responding to Hamas

SIR – In a leader published in mid-December you advised Israel to allow supplies to enter Gaza for tactical and moral reasons ("[Lift the siege of Gaza](#)", December 20th). But you also stated that if rockets continued to fall on Israelis, a military solution would have to be found. After bowing to world opinion and opening border points to Gaza for supplies, around 80 rockets were fired at Israel by Hamas the very next day.

Since the publication of your leader, the military solution has commenced. No doubt *The Economist* will now join the usual chorus decrying Israel's disproportionate response to the missile barrage. This will only embolden Hamas to continue using civilians as martyrs for its own Islamist glory. Indeed, it is the world's failure to rebuke Hamas after it bombed Israeli civilians that is truly disproportionate. An organisation that refuses to accept Israel's right to exist does not deserve support from any quarter, least of all from *The Economist*.

George Reiss
Paradise Valley, Arizona

SIR – I admire Barack Obama, but am disturbed by his statement last summer that "If somebody was sending rockets into my house where my two daughters sleep at night, I'm going to do everything in my power to stop that" ("[Gaza: the rights and wrongs](#)", January 3rd). Does this include destroying the entire neighbourhood from which the rockets are launched?

Piotr Wandycz
Professor emeritus
Department of History
Yale University
New Haven, Connecticut

An Indian success story

SIR – I was pleasantly surprised by your story on start-ups in India ("[A suitable business](#)", December 20th). To read that the culture of entrepreneurship is spreading across all of India is inspiring. However, you implied that firms managed along the lines of traditional merchant communities such as the Marwari banias are unprofessional or void of meritocracy. I disagree. Marwari-run firms have created wealth for shareholders and succeed because of a determined focus on innovation, customer service and fiscal discipline. The best example of a Marwari entrepreneur is Lakshmi Mittal, who has single-handedly turned around the global steel industry where many before have tried and failed.

Devesh Poddar
East Lansing, Michigan

Comic-book idol

SIR – I was suckled on Tintin along with my mother's milk and I appreciated your article on this fictional Belgian icon ("[A very European hero](#)", December 20th). You provided a balanced analysis of Hergé's ideological equivocations. Yet the author, rather than actively promoting repulsive regimes, took his cue, with a regrettable

lack of critical acumen, from widespread prejudices in European opinion at the time.

Before the second world war many Europeans felt disillusioned at the ineptitude of democratic governments in the West, while the newly established totalitarian regimes of Italy and Germany seemed to herald a national revival. Similarly, most Belgians were convinced that Belgium was in Congo for the sole purpose of educating and uplifting the benighted natives. This in no way excuses Hergé's failure to probe critically the spirit of the time, but Tintin was, in spite of that, a kindly man, who defended the weak against the powerful.

Frédéric Renard
Brussels

SIR – Tintin as we know him was born during the war. Because of the constraints of Nazi censorship, Hergé built a kind of parallel universe away from the duress and lack of freedom of expression. Before the war, Tintin's adventures had a deep political flavour. He travelled to the most exotic and remote places: China under Japanese occupation, the Soviet Union, Belgian Congo, Egypt, India, South America, etc. Under Nazi occupation, Hergé could not indulge in these political manifestos and he sent Tintin literally to the middle of nowhere: the Arctic in "The Shooting Star", the old Inca kingdom in "Prisoners of the Sun". No more politics, just pure and neutral adventures thousands of kilometres away from the nearest human being. Hergé's poetry blossomed during these dark years. After 1940 there was no more politics, but instead a deeper humanist component: the anger of Captain Haddock upon discovering modern-day slavery, the defence of gypsies accused of having stolen an emerald.

Tintin was a very human character, crying in "The Blue Lotus" when he has to part from his friend, Chang, and also in "Tintin in Tibet" when he learns that Chang was in a plane crash (he was saved by a not-so-abominable yeti).

Olivier Rodriguez
Athens

SIR – You chided Tintin for his impotence or unwillingness to address broader political issues and suggest that "Anglo-Saxon audiences" want their fictional heroes to be "imbued with the power to change events and inflict total defeat on the wicked". I would rather stick with gentle, modest and pragmatic Tintin than the testosterone-laden, crusading, musclemen heroes so dear to Anglo-Saxon culture. Tintin may not be able to solve the problems of the world, but he would also never have started the invasion of Iraq.

Louis de Jonghe
Manila

Don't try this at home

SIR – From the capsaicin-endorphin connection to the presence of capsaicin in an ever-wider range of foodstuffs, I devoured your article on chilies ("[Global warming](#)", December 20th). But I was a bit surprised that you thought previous generations would have regarded chili-flavoured chocolate as "preposterous". The Maya knew the concoction since well before the arrival of Columbus. For best results, they used enemas, too, as the colon is much more receptive to the chili delight than the mouth.

Ranko Bon
Motovun, Croatia

More is less

SIR – Regarding your article on William Tyndale, an English martyr burned at the stake, I am not aware that the church has ever formally apologised for his death ("[A hero for the information age](#)", December 20th). Nor for that matter have the successors of King Henry VIII and his agents at home and abroad. Statues of Tyndale and Sir Thomas More, Tyndale's nemesis, stand a mile or so apart along the Thames Embankment. Both men met untimely fates, though More's legacy stands higher in formal circles than that of the man who gave the Bible to countless millions in their own language for the first time, a language that he developed in written form to a higher degree than any until Shakespeare.

Andrew Farran
Beaumaris, Australia

Star reporting

SIR – Thank you for not “starring out” Rod Blagojevich’s expletives when reporting his alleged exploits to sell Barack Obama’s Senate seat (“[The Chicago way](#)”, December 13th). Apart from taking pleasure in being treated as a grown-up (many other newspapers deleted the swearing), I was struck by how much more powerfully the Illinois governor’s seedy, cynical greed was communicated when the obscenities were printed in full. F***ing good decision.

Jonathan King
New York

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WORLD

MIDDLE EAST & AFRICA

The struggle for Gaza

Where will it end?

Jan 8th 2009 | CAIRO AND JERUSALEM
From The Economist print edition



AP

After nearly two weeks of fighting, the outline of a ceasefire may be emerging. But there is no telling where the stumbling diplomacy may lead

DESPAIR quivered in Muhammad al-Majdalawi's voice as he described the Jabaliya refugee camp in the northern Gaza Strip, four days after Israeli troops had entered the territory. "The soldiers are 500 metres from my house," he said. "Three children in my neighbourhood were killed last night. The walls in my house are shaking. Every minute there are explosions, every minute there are martyrs. We can't sleep, we can't move, we have almost no food, no electricity, and it's very cold." He spoke hurriedly, afraid that his mobile phone would run out of power.

The death toll of Palestinians has risen inexorably. Twelve days after the Israeli offensive began, Palestinians put the number at more than 770, with at least 2,500 wounded. Israel claims to have killed more than 130 Hamas fighters. Some medical sources in Gaza say that as many as 40% of the dead are women and children, and that a large majority have been non-combatants. Several entire families have been wiped out. On January 4th Gaza's main vegetable market was hit: five people were killed, 40 wounded. Two days later a school run by the United Nations in the Jabaliya camp was shelled, leaving at least 30 dead. Nearly all were children. Gazans have long felt they lived in an open prison; now they are trapped in a shooting gallery.

The health services are flagging. Eighteen months under siege had already drained hospitals of medicine and working equipment. Now fuel for the generators has nearly run out. Exhausted and demoralised staff struggle to find space for the wounded and the dead.

Since the operation started on December 27th, Israel has hit more than 1,000 targets from sea and air, including roads, government buildings, mosques, police stations, smuggling tunnels, rocket launchers and the Islamic University. Seven Israeli soldiers have been killed, four by errant Israeli tank fire. Hamas attacks on

Israel have been reduced to about 30 rockets a day; four Israeli civilians have died since the start of the war. Israeli forces have so far stayed outside the main urban areas of Gaza. So Hamas may still claim to have won, or at least not lost, the battle.

The Israelis say their strikes have targeted only Hamas; they claim that the university, for instance, housed a Hamas laboratory. There is no doubt, however, that the bombardment has hammered the civilian infrastructure. The sole power plant has been shut down. Of Gaza's 1.5m people, two-thirds lack electricity and nearly half have no running water. Raw sewage is spilling into the streets, risking epidemics. Most of the petrol stations in Gaza are closed. Diesel fuel, which used to be smuggled from Egypt through tunnels that have been bombed, is no longer available on the black market. Cooking gas and heating fuel are scarce. In a cold winter, many families leave their windows open for fear of shattering glass from explosions. People drag mattresses to the middle of their rooms and huddle together to keep warm.

The UN's World Food Programme gives warning of a looming crisis. Flour, rice, sugar, milk, canned food and fresh meat have nearly run out. Another UN agency says that fewer than 20 bakeries are still working. Hundreds of people queue outside those that still sell bread. One man waited for five hours, only to buy one packet of pitta bread to feed his large family for a day. Others are living on stale bread and tea, heated on fires made out of pieces of wood and cartons collected on the street.

When the electricity supply briefly comes back on, people rush for their phone chargers. Once plugged in, they turn on their televisions and, if they are rich enough to have computers, check their e-mails or contact relatives on Skype. For a moment they feel less isolated. But soon there is yet another blackout, and darkness falls again.

What Israel wants

As the casualties mount, Israel is increasingly obliged to justify its tactics. Why, for example, did it shell the UN school, which had been assigned as a temporary refuge, and whose GPS co-ordinates had been given to the Israeli army? Because, officials said, Hamas fighters and a mortar crew had been spotted just outside it, and the building itself was booby-trapped or housed explosives. (The UN hotly denies this.) Israel also leaked intelligence information purporting to show that senior Hamas fighters and politicians were holed up in a warren of underground chambers under Shifa Hospital, the main health-care centre in Gaza City. Israeli spokesmen said Hamas deliberately and cynically operated close to civilians. Hence the number of children killed in the fighting.

But the alarming increase in the number of civilians among the Palestinian dead has jolted Israeli policymakers. They remember 1996, when an Israeli sweep against Hizbullah in southern Lebanon ended peremptorily when shells killed more than 100 civilians. Rather than withdraw from Gaza, where the fighting has so far been inconclusive, Israel is now poised to send in units of reservists (see [article](#)). This would signal a determination to destroy Hamas's strongholds completely.

The possibility of a wider ground war has spurred outside efforts to broker a ceasefire. In the vacuum of the American presidential transition, a trio of European foreign ministers (plus a brace of leading Eurocrats) have been trying to fill the diplomatic gap by shuttling around the Middle East. At the same time France's president, Nicolas Sarkozy, has been engaged in a one-man peace mission. The Europeans all carried—more or less—the same message: a call for an immediate halt to military action by Israel, matched by an unconditional ending of rocket attacks by Hamas. All that was backed by an offer of renewed European help to oversee security at Rafah, Gaza's border crossing into Egypt. This is the Gaza Strip's only opening to the outside world that does not depend solely on Israel.

Israel is holding out for ceasefire terms that would guarantee an end to arms smuggling across or under Gaza's border with Egypt. The border has never been made watertight, though the Egyptians are at present keeping it closed except for a trickle of medical aid. After meeting Mr Sarkozy on January 6th, Egypt's President Hosni Mubarak repeated the French president's calls for a ceasefire and agreed to discussions about how to police the border. The two then put their proposal to the UN. This is Mr Mubarak's first public signal that he could co-operate once again with the Americans to create a border-crossing regime that might satisfy Israel.

According to Israeli sources, this would involve American engineers and other civilians helping Egyptian forces to ensure that the ground below the border is not again honeycombed with tunnels. The Americans would use sophisticated technology to detect new digging. Above-ground fences would be strengthened and Egypt would sharpen its intelligence in the Sinai Peninsula to spot and stop arms-smugglers. The outgoing American secretary of state, Condoleezza Rice, welcomed Egypt's plan at the UN Security Council. "When this ends," she said, "there must be new arrangements in place, not a return to the status quo ante."

Mr Mubarak has publicly blamed Hamas for the violence and is keen to prevent it from boasting of a victory. And he is loth to admit that Hamas's missiles have come into Gaza via Egypt. The Egyptian government is jealous of its sovereignty in Sinai, the desert east of Gaza, but may now be ready to accept limited help from outside.

Mediators in Jerusalem and Ramallah, the headquarters of the Palestinian Authority (PA) that is still run by the Fatah group, Hamas's rival for supremacy among the Palestinians, are trying to arrange a new border regime. They envisage somehow restoring PA border guards—in fact, Fatah soldiers or police—at the Rafah crossing. They would act alongside Egyptian officers, probably reinforced by returning monitors from the European Union.

A long-established division of labour in the Middle East supposed that America would deliver Israel, in the event of a long-lasting peace deal, and the EU (the largest donor of aid to the Palestinians) would deliver the Palestinian side. But the EU does not talk directly to Hamas. It is on its list of terrorist organisations. Besides, Mahmoud Abbas, the Palestinian president, has asked Europeans not to talk to it, for fear of undermining the PA's claims to represent all Palestinians. And direct talks with Hamas might damage the EU's credibility as a peace-broker with Israel.

Some EU officials say that if a credible ceasefire deal is on offer, the EU will find ways of reaching understandings with Hamas. The EU's foreign-policy chief, Javier Solana, maintains a channel of communication through Omar Suleiman, the head of Egyptian intelligence. Dropping in on President Bashar Assad of Syria on January 6th, Mr Sarkozy asked him to use his influence to help all sides "return to reason".

If the diplomacy succeeds and the fighting stops, the Israeli government will claim that "Operation Cast Lead" has dealt a telling blow to Hamas and sent a powerful message of deterrence and determination to the wider region. The Gaza campaign has enjoyed support across the political spectrum, except among the Arab-Israeli parties. Most peace-minded Israelis see Hamas's missiles, with their increasing range, as a real threat to the state, not because of the limited damage and disruption they cause but because their incessant drizzle from across Gaza's border has begun to make the prospect of a two-state solution, with Israelis and Palestinians living side-by-side in peace, seem untenable.

As Israel's general election (due on February 10th) approaches, Ehud Barak, the defence minister who leads the Labour Party, and Tzipi Livni, the foreign minister who leads Kadima, the other main party in the ruling coalition, will both argue that the assault on Hamas in Gaza will make it easier for them—and more urgent—to forge peace with the Fatah-run PA. Mr Barak will add, of course, that it was he who planned and ran so successful a military campaign.

But will Hamas budge?

Hamas, meanwhile, has proved remarkably consistent in its aims. True to its name, derived from the Arabic acronym for Islamic Resistance Movement, its strategy has been simply to keep the flame of resistance to Israel burning, with the ultimate goal of recovering all of historic Palestine.

Until the party contested Palestinian legislative elections in 2006, and won, Hamas had conceded dominance of state institutions to its older, secular and nationalist rival, Fatah. Once it won the election and found the world, led by America, seeking to isolate it and showering aid and arms on Fatah, divisions between the parties naturally widened: to the point where the Islamists, in the summer of 2007, evicted Fatah from Gaza, leaving it in charge only of the rump Palestinian proto-state in the West Bank.

With its unilateral withdrawal from Gaza in 2005, Israel had sought to wash its hands of the crowded, increasingly radicalised territory. Yet it retained control of Gaza's borders, airspace and supplies of water and power, while continuing to hold thousands of Palestinian prisoners, and continuing to expand its settlements on the West Bank. So while Israel professed outrage at Hamas's lobbing of rockets from Gaza, which had killed precisely one Israeli between July and the start of the present Israeli onslaught, the group's supporters countered that they were simply exercising a right to "resist" this new mutation of Israeli occupation.

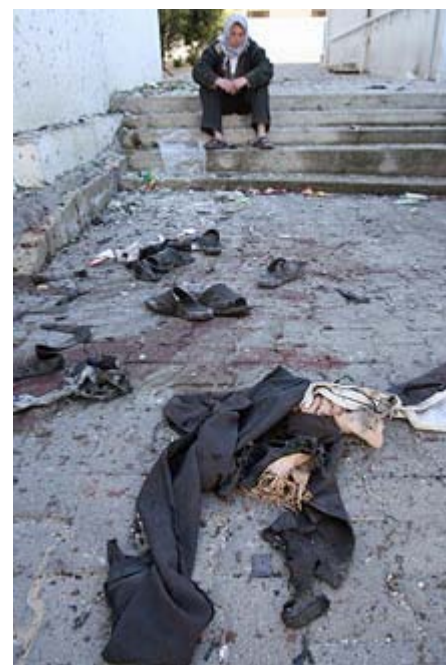
After its 2007 victory, Hamas consolidated its hold over Gaza. The mounting blockade by Israel, with American support and Egyptian acquiescence, was intended to force it to accept Israel's right to exist and to renounce violence; but Hamas refused to bend. Its leaders believed that Israel could not blockade Gaza for ever in the face of growing global concern. In particular, they reckoned that Egypt, as a Muslim and Arab neighbour, would eventually succumb to public outrage at its complicity in the siege. But Egypt's rulers proved unexpectedly stubborn; not merely because they loathe Islamists, but

AFP

because they feared, perhaps rightly, that Israel had intended all along to foist Gaza and its troubles onto them, perpetuating the truncation of the putative Palestinian state. This is why they have insisted that the border will open only in accordance with an old protocol that would let the Fatah-dominated PA, and not Hamas, control the crossing.

Hamas remains committed to the immediate aim, beyond a ceasefire, of forcing an end to the siege, preferably by obliging Egypt to open its border. Such an opening would, it hopes, not only allow for a free flow of aid, but would also amount to a tacit recognition of Hamas's legitimacy as Gaza's government. In the long run, perhaps, that may be translated into some kind of legitimacy in the West, too.

But in the meantime Hamas's fighters will continue to battle on, calculating that every day they continue to hold out, their cause gains strength. For the time being, divisions within the movement have been healed, the carnage caused by Israel is making them popular, and they are still able to strike back. On January 6th a Hamas missile hit the town of Gedera, just 20 miles from Tel Aviv, the farthest one has ever reached.



Too hard a lesson

Arab dilemmas

For Arabs, the pain of watching Gaza's agony is double. This is not just because Palestinians are their kin. It is because they have seen it all before, generation after generation, in place after place, and have been able to do very little to relieve the suffering.

Arab delays and difficulties over Gaza stem from a broader regional split that has pitted a "resistance" faction, including Iran, Syria and their militia allies, Hizbullah in Lebanon and Hamas in Palestine, against such Western-backed, pro-peace-with-Israel governments as those of Egypt, Jordan, the rump PA on the West Bank, and Saudi Arabia. These governments hope for Hamas's defeat; the resisters hope, if not for an unlikely Hamas victory, then at least for Gaza's rulers to survive, as proof that Israel cannot simply smash all its enemies into submission. On January 8th rockets were fired into Israel from Lebanon, either by Hizbullah or Palestinian fighters.

But there is hardly an Arab city of any size that has not witnessed noisy protests, directed not only against Israel or America, but also against Egypt. As demonstrators in Berlin hurled shoes at the Egyptian embassy, an online poll run by al-Jazeera, the most-watched Arab TV channel, revealed that 94% of respondents believed some Arab governments were complicit in Israel's attack.

Such feelings have now galvanised even those who had hoped to see Hamas punished. Hence the decision, by Egypt and France, jointly to float their ceasefire plan at the UN. Most governments, including the Bush administration, immediately endorsed the proposal.

Yet it remains unclear whether the actual belligerents will accept it. Israel, though responding "favourably" to the UN initiative and saying it has agreed on the "principles" of a truce, is still debating how far it is prepared to go in its efforts to crush Hamas. And Hamas leaders, though desperate for a ceasefire, will balk at any deal that reeks of capitulation.

Meanwhile Barack Obama, America's president-elect, has remained deafeningly silent, refusing to take sides, though his friends say he will leap into the diplomatic fray the moment he takes office. Israel may want to finish the military job in Gaza before he does so.

12 issues for

€26

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WORLD

MIDDLE EAST & AFRICA

Israel's military strategy**Two eyes for an eye**

Jan 8th 2009

From The Economist print edition

The role of retribution in Israel's military thinking

ISRAELI generals call it restoring "deterrence". This concept is not, as in the cold war, an arcane reckoning of missile warheads and of future nuclear annihilation. For Israel it is an immediate accounting of blood, guts and broken masonry. For a powerful but small country, in the midst of hostile peoples, deterrence means showing a readiness to fight, and to inflict enough death and destruction so that foes think twice about attacking.

In Israel's view, Hamas has been rocketing Israeli towns with impunity from the safety of Gaza's teeming masses; it had to be shown that civilians provide no shield. Israeli armed forces say they try to avoid hitting civilians, sometimes warning them before buildings are bombed. That said, civilian pain is part of the "price" Hamas must pay for its attacks. Yossi Kuperwasser, a former intelligence man, says Hamas has been thumped: "Many people have been lost and there has been heavy damage to infrastructure. Hamas's claim to be able to run the place looks baseless."

Deterrence also means restoring the standing of the Israel Defence Forces. The war in Gaza is in many ways an attempt to redress the failings of the war in Lebanon against Hizbullah, a Shia militia-cum-party, in 2006. Training and equipment have been upgraded, co-ordination between ground and air forces improved, reserves called up with enough time to prepare, and adequate supplies brought in. The operation has been planned for months. And instead of the boastful vow to destroy Hizbullah, Israel now sets a far less ambitious definition of victory: reducing rocket fire from Gaza and "changing the reality".

But Giora Eiland, Israel's national security adviser in 2006, says one big lesson has yet to be adopted: clarity about Israel's strategic goals. If the aim is to bring down Hamas, then the army will need more time, and will perhaps even reoccupy Gaza. But if the objective is simply to rebuild deterrence, then this has already been achieved and he thinks the operation should stop. The experience of Lebanon is telling. It was as brutal as the fighting in Gaza, and Hizbullah was judged the winner. Yet Israel won the diplomatic battle over the ceasefire and, this time, Hizbullah has made no serious efforts to open a "second front" to help Hamas as it did in 2006. It seems to have been deterred—for now.

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BUSINESS

Rolls-Royce

Britain's lonely high-flier

Jan 8th 2009 | DERBY

From The Economist print edition

Getty Images



A resurgent Rolls-Royce has become the most powerful symbol of British manufacturing. Its success may be hard to replicate, especially in difficult times

Editor's note

HIGH above the Pacific, passengers doze on a long flight from Asia to America. Suddenly a bolt of lightning cleaves the air. Those startled by the flash and bang soon settle back into their dreams. But on the other side of the world, in Derby, in the English Midlands, engineers at Rolls-Royce get busy.

Lightning strikes on passenger jets are common—a couple every hour—and usually harmless, but this one has caused a cough in one of the engines. The aircraft will land safely, and could do so even with the engine shut down. The question is whether it will need a full engine inspection in Los Angeles. That would be normal practice, but it would delay the return journey and keep hundreds of passengers waiting in the departure lounge.

A torrent of data is beamed from the aircraft to Derby. Numbers dance across screens, graphs are drawn and technicians scratch their heads. Before the plane lands, word comes that the engine is running smoothly. The aircraft can take off on time.

Rolls-Royce's global operations room in Derby, with 24-hour news channels, banks of computer screens and clocks showing the time around the world, looks and feels like a currency-trading floor. It seems far away from the grubby manufacturing that Derby has pioneered since the dawn of the industrial revolution. In fact, a few hundred yards down the road, furnaces roar, cutting tools whine and giant workhorses of the air take shape. The operations room is the heart of a vast industrial enterprise.

Rolls-Royce's fortunes are a matter of new urgency in a country that was once the workshop of the world yet seemed hellbent on leading the way to the post-industrial age. With light-touch regulation and tax-breaks that made it an uncommonly attractive place to hire foreign talent, Britain built gleaming monuments to finance.

From chemists and physicists to historians, many of its brightest graduates made their way to the City of London. From the towers of Canary Wharf they looked down on the remains of what was once the world's busiest port and on a past that Britain seemed to have left far behind.

Yet with the great tides of money that once washed these shores now stilled, Derby offers a different vision of Britain's future. Over the past couple of decades or so Rolls-Royce has transformed itself from a loss-making British firm into the world's second-biggest maker of large jet engines. In doing so, it has deliberately blurred the lines between making things and offering services. Its experience indicates that Britain can do both after all. To optimists it may even suggest a British manufacturing renaissance.

The country's manufacturing output has been growing over the years, but its share of GDP has been falling (as in other rich countries—see chart 1). Employment in manufacturing has been in decline. Only a handful of big manufacturing firms still exist. Some, such as BAE Systems, a defence company, rely on the government. And although industries such as carmaking survive, they do so almost entirely in foreign ownership. Britain remains the world's eighth-biggest exporter of goods, but its share of global markets has shrunk to a little more than 3%, far behind America, China and Germany (see chart 2). In services it ranks second.

Export engine

The striking thing about Rolls-Royce, however, has been its success in foreign markets. Its revenues, about 85% of which come from abroad, have almost doubled in the decade since Sir John Rose took over as chief executive. About half of the latest wide-bodied passenger jets and a quarter of single-aisle aircraft rolling off the production lines these days are powered by its engines. At the Farnborough air show in 2008, its order book was swollen by almost \$9.3 billion. This was half as much again as the \$6 billion in sales that its two main rivals, Pratt & Whitney and GE, made between them.

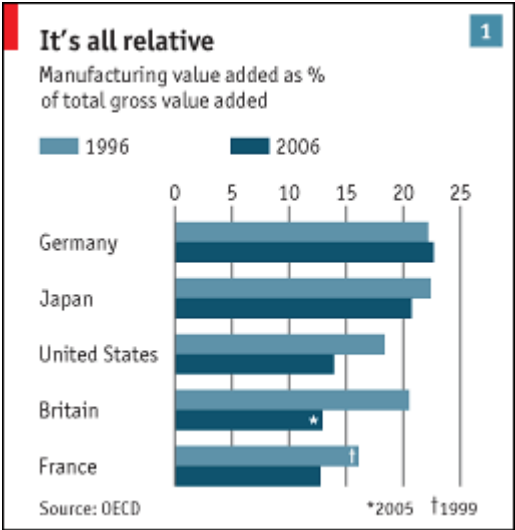
In other fields it is growing even faster. Revenues from its marine operations are running at twice the rate of 2002 and its equipment is installed on 30,000 ships. In July it set up a new civil nuclear business, hoping to ride a wave of investment in new power plants around the world that it reckons may be worth some £50 billion (\$75 billion) a year by 2023. It hopes to sell skills it developed on nuclear submarines built for the Royal Navy. Its defence business accounts for a fifth of its revenues, against three-fifths during the cold war.

Yet that business may provide a comfortingly stable source of cash as a slowing world economy prompts airlines to retire old jets and cancel orders for new ones. With the airline industry in trouble, Rolls-Royce has already had to cut some jobs. But because of the way in which it has melded technology and service, there is much to suggest that it will weather an economic downturn better than its rivals.

An understanding of the firm's success requires some understanding of the technology that goes into its civil-aircraft engines. This is not just Rolls-Royce's biggest business, it is also the one that both felled the company in 1971 and proved to be its salvation two decades later.

The best place to start is the surprisingly small, almost underwhelming, turbine blades that make up the heart of the giant engines slung beneath the wings of the world's biggest planes. These are not the huge fan blades you see when boarding, but are buried deep in the engines. Each turbine blade can fit in the hand like an oversized steak knife. At first glance it may not seem much more difficult to make. Yet they cost about \$10,000 each. Rolls-Royce's executives like to point out that their big engines, of almost six tonnes, are worth their weight in silver—and that the average car is worth its weight in hamburger.

Turbine blades are difficult to make because they have to survive high temperatures and huge stresses. The air inside big jet engines reaches about 1,600°C in places, 400 degrees hotter than the melting point of the metal



from which the turbine blades are made. (Without a proper cooling system, this would be like trying to stir a cup of hot coffee with a spoon made of ice.) Each blade is grown from a single crystal of alloy for strength and then coated with tough ceramics. A network of tiny air holes then creates a thin blanket of cool air that stops it from melting.

Making the blades is merely the entry ticket to the market. Both Rolls-Royce's main rivals have also mastered the art. In such a competitive field an incremental advance by one manufacturer is usually matched by the others within a couple of years. A study by Andrea Bonaccorsi and colleagues at the Sant'Anna School of Advanced Studies in Pisa found that over about 40 years each of the three leading engine-makers has in turn taken a technological lead, but none has held it for much more than a decade.

Rolls-Royce's triumph was not to build a slightly better engine and thus earn a temporary technological edge, but to design a completely different one. Remarkably, it did so from a position of weakness. Until the late 1960s the market for big jet engines was dominated by Pratt & Whitney, with a share of about 90%. Rolls-Royce played a bit part, making engines mainly for European aircraft manufacturers. These were losing, bit by bit, to America's biggest aircraft-makers, which had the benefit of a much larger domestic market and substantial military orders. Rolls-Royce realised that unless it could develop a large jet engine that would fit an American-made airliner, its sales of jet engines would collapse within a decade.

It bet everything on two revolutionary technologies. The first was to use carbon composites to make fan blades (the big ones you do see) far lighter than the metal ones of the time. The second was to change the basic architecture of jet engines by using three shafts instead of two. Both tasks turned out to be harder and costlier than Rolls-Royce thought. Its composite blades shattered when hit by hail or birds. Eventually it had to abandon them for the tried and tested metal ones. And by then an embarrassing series of delays and missed performance targets had caused it to run out of cash. A Conservative government nationalised the company in 1971.

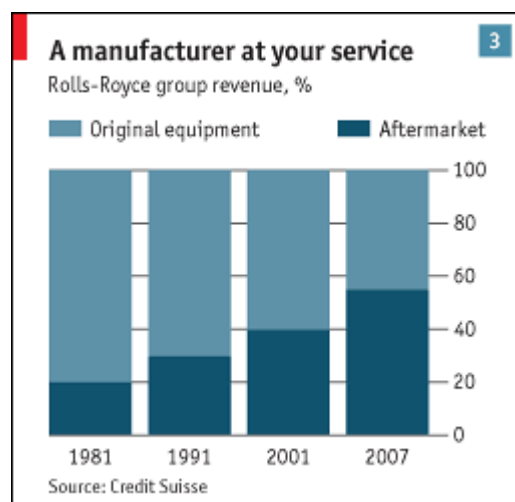
Although the new design broke Rolls-Royce, it also proved to be the base for a whole family of winning engines. These were more complex to design, build and maintain than those of rivals, but they also used fuel more efficiently and suffered less wear and tear. Much more importantly, they could be scaled up or down to fit bigger or smaller aircraft. As a result, Rolls-Royce did not have to design a new engine from scratch each time a new airliner came onto the market, allowing it to compete for sales across a far wider range of aircraft than its rivals. This was a huge advantage because the main determinant of whether a jet engine sells well is whether the aircraft it is married to sells well. Rolls-Royce can sell across the board. It is the only one of the three main engine-makers with designs to fit the three newest airliners under development, the Boeing 787 Dreamliner, the Airbus A380 and the new wide-bodied version of the Airbus A350. Of the world's 50 leading airlines, 45 use its engines.

The big pay-off from getting engines under more wings comes from selling spares and servicing them. This is because selling aircraft engines is like selling razors. The razor and engine make little if any profit; that comes later, from blades or spare parts and servicing (see chart 3). Gross margins from rebuilding engines are thought to be about 35%; analysts at Credit Suisse, an investment bank, estimate that some makers of jet engines get about seven times as much revenue from servicing and selling spare parts as they do from selling engines. Many analysts suspect that Rolls-Royce (and others) sell engines at a loss. Judging this is hard, though, because of the way Rolls-Royce accounts for long-term contracts, often by booking a profit on the sale for income that will be received only over many years. Rolls-Royce says that, on average, engines are sold at a profit.

A cut-throat business

The trouble with selling razors at a loss is that someone else may make the blades to fit them. And the juicy margins in engine maintenance have indeed attracted a swarm of independent servicing firms (and engine-makers after each other's business). Rudolph Hirdes, an aircraft-maintenance expert at Aviation Consultancy Holland, reckons certified spare parts for big jet engines can be had for one-third of the price charged by the original manufacturers.

This is where Rolls-Royce has melded its technology with service to make it more difficult for competitors to pinch its business. Rather than simply giving away razors to sell razor blades it has, if you will, offered to shave its clients every morning. Instead of selling airlines first engines and then parts and service, Rolls-Royce has



convinced its customers to pay a fee for every hour that an engine runs. Rolls-Royce in turn promises to maintain it and replace it if it breaks down. "They aren't selling engines, they are selling hot air out the back of an engine," says an investment analyst. The idea is not unique to Rolls-Royce; the other big makers of aircraft engines do much the same. But Rolls-Royce has adopted it with greater gusto. It has been offering the service for more than a decade; more than half of its engines in service are covered by such contracts, as are about 80% of those it is now selling.

Make it, sell it, service it

This may seem to support the theory that Britain would do better to concentrate on supplying services rather than on making things. Yet it shows instead that it is sometimes necessary to be good at making things to sell the services connected with them. At Rolls-Royce it is difficult to see where one begins and the other ends.

The operations room in Derby, for instance, continuously assesses the performance of 3,500 jet engines around the world, raising an almost insurmountable barrier to any rival that hopes to grab the work of servicing them. The data collected can be invaluable to airlines: it enables Rolls-Royce to predict when engines are more likely to fail, letting customers schedule engine changes efficiently. That means fewer emergency repairs and fewer unhappy passengers. The data are equally valuable to Rolls-Royce. Spotting problems early helps it to design and build more reliable engines or to modify existing ones. The resulting evolution of its engines has steadily improved fuel efficiency and over the past 30 years has extended the operating life of engines tenfold (to about ten years between major rebuilds). "You could only get closer to the customer by being on the plane," says Mike Terrett, the company's chief operating officer.

A further reason for its success is its wholehearted embrace of globalisation. Whereas British car firms once contented themselves with making shoddy cars for the domestic market, Rolls-Royce has transformed itself from a British firm into a global one. About 40% of employees work in countries other than Britain, compared with 7% two decades ago. About half its new engine projects are based abroad, along with the same proportion of its research and development. A side benefit is that it sets factories in different parts of the world in competition with one another for new projects, something carmakers have done for years to keep down labour costs.

Rolls-Royce can also draw on the strengths of local economies where it opens for business; those economies in turn adapt to the company's needs. It attracts suppliers and other related industries. In Derby, wages are above the national average. So are grades in local schools for subjects such as maths and science, prerequisites for good jobs at Rolls-Royce and the firms that surround it.

As much as Rolls-Royce's embrace of globalisation is both a cause and effect of its success, it also raises uncomfortable questions over the future of manufacturing in Britain. For there is much to suggest that, barring some fundamental changes at home, the shift abroad will continue to gather pace.

One reason for this is the lure of subsidies and other incentives from foreign governments. Britain has been no slouch at handing out taxpayers' money: in 2001 it lent £250m to Rolls-Royce to help develop bigger jet engines; in 2006 it agreed to give grants of £47m to a group led by Rolls-Royce to design an environmentally friendly engine. But others have been far more generous. When Rolls-Royce opened a facility in Germany recently it may have been influenced by a pledge from the state of Brandenburg to cover 30% of its capital costs. Similarly an estimated \$57m in assistance from state and local governments may have helped it decide to build a factory in Virginia. "We courted Rolls-Royce for five to six years," says Liz Povar of the Virginia Economic Development Partnership, which is funded by the state.

Furthermore, British executives continue to lament the country's educational standards and complain that many universities disdain collaboration with industry. Although things are improving, others often appear keener. In Virginia, part of the offer to Rolls-Royce was for state investment in education at all levels in order to help provide a skilled workforce.

And as manufacturing employment has declined in Britain, there has been less reason for the best and brightest to study the subjects that manufacturing demands. Rolls-Royce executives say that the pool of experienced engineers, process managers and skilled workers from which the company can recruit is shrinking. Many of these people used to come from carmakers or other

Rolls-Royce



industrial firms. But a once-steady flow is now a trickle.

Sir John believes that Britain needs an economic “route map” to encourage investment in manufacturing. One suggestion he makes is to ensure that local firms share in the construction of new nuclear plants—something that would, no doubt, benefit Rolls-Royce. Sir John insists that this is not special pleading for his company. He has a point: it is big enough to go where it pleases.

Such proposals would have fallen on deaf ears just a few years ago. Yet now, with the finance industry in tatters, politicians on all sides in Britain are talking enthusiastically of manufacturing strategies and the limitations of leaving industry to the whim of market forces. A government that just three years ago allowed the collapse of Rover, the last British-owned mass-market carmaker, is now seriously contemplating a bail-out of Jaguar and Land Rover, sold to Tata, an Indian conglomerate, almost a year ago.

Most believers in free markets take issue with governments which grant subsidies to attract (or keep) factories, insist that contracts be reserved for local firms or otherwise try to tilt the economy towards favoured activities. That goes for industries of all sorts, from bashing metal to banking. Light-touch financial regulation may prove to have distorted the economy. And the government has argued that the competitiveness of financial services is enhanced by tax breaks for people living in Britain but domiciled abroad (half of whom work in that industry).

There is no need to make a fetish of manufacturing, even when finance is in such bad odour. Industrial economies such as Germany are suffering too. But the success of Rolls-Royce suggests that the world will not be neatly divided into firms (or countries) that make things and those that sell services. Flying high depends on being able to do both.

Editor's note: Simon Robertson, the chairman of Rolls-Royce, is a member of The Economist Group's board. Helen Alexander, the former chief executive of the Economist Group, serves on Rolls-Royce's board. The author of this piece did not discuss Rolls-Royce with either of them.

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WORLD

UNITED STATES**The budget deficit****Waiting for God-only-knows-what**

Jan 8th 2009 | WASHINGTON, DC

From The Economist print edition

Rex Features

**America's grim fiscal outlook could either be a nightmare or an opportunity for Barack Obama**

DURING one of his debates with Barack Obama, John McCain, the Republican candidate, kept referring to the "fiscal crisis" when he meant "financial crisis". Perhaps he was on to something.

On January 7th the Congressional Budget Office (CBO), a non-partisan outfit, released projections that show the financial crash and the resulting recession are already wreaking havoc with America's finances. It reckons that the budget deficit will soar from \$455 billion in fiscal 2008 (which ended last September 30th) to an astonishing \$1.2 trillion in the current year. At 8.3% that would be the most as a share of gross domestic product since the second world war. (The CBO does, however, see it dropping to 1.1% of GDP by 2019.)

The reality is both better and worse than these numbers imply. Of this year's total, \$420 billion represents the one-off subsidy implicit in the Treasury's planned \$700 billion of injections of capital and loan guarantees into the financial system and its "effective" guarantees of the two big mortgage agencies, Fannie Mae and Freddie Mac. Neither is a cash outlay in the usual sense.

But the underlying picture is worse for several reasons. First, it does not include any estimate of the cost of Mr Obama's planned fiscal stimulus, which he will seek from Congress soon after being inaugurated. Second, the CBO assumes all of George Bush's tax cuts will expire as scheduled at the end of next year and that the Alternative Minimum Tax, a parallel levy aimed at the wealthy, is allowed to ensnare a growing share of the middle class each year. True, that is what current law, as opposed to current practice, lays down; but neither is at all likely to happen. (The AMT has repeatedly been "patched" to lessen its baleful effects, and surely will be again.)

But the real problem is that the first baby-boomers retired last year. In coming decades spending on entitlements—the three main ones being Social Security (pensions), Medicare (health care for the elderly) and Medicaid (health care for the poor)—will drive deficits and so debt up sharply. Publicly held debt will climb from 41% of GDP last year to 54% next year, the CBO predicts, then decline (on the assumption that the recession will start to come to an end). But the CBO has previously said that, as America ages and if current policies

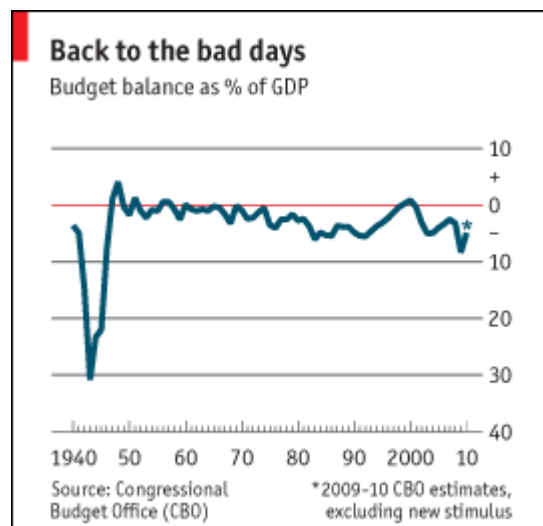
continue, it could theoretically hit an otherworldly 400% by mid-century.

The situation sounds like a nightmare for Barack Obama. The figures hang over his negotiations with Congress on a fiscal stimulus plan. As currently envisioned, it would include business and individual tax cuts and, for those who pay little or no tax, tax credits. That would include a \$500 per worker or \$1,000 per household credit that was a centrepiece of Mr Obama's campaign. It would include substantial funds for public works spending, additional Medicaid funds and other aid for cash-strapped states, and money to broaden the availability of unemployment insurance and provide health benefits to the unemployed. On January 7th Mr Obama said the package would be at the high end of estimates—which his team had previously pegged at \$675 billion to \$775 billion over two years—but not as high as some economists have urged.

Mr Obama faces three sceptical constituencies: Republicans, fiscal conservatives in his own party, and the markets. The addition of so many tax breaks to the package appears to have won over the co-operation of Republican leaders, although lengthy negotiations remain.

Fiscal conservatives are resigned to a big expansion of deficits in the short term but they want an early commitment to deal with entitlements as well. This is where the confluence of the economic and budgetary crises creates an opportunity. Since Mr Bush's tax cuts expire at the end of next year, Mr Obama could try to reform the tax and entitlement systems simultaneously, which makes economic sense since so many aspects of health care and retirement impact the tax code.

Politically, a reform that antagonises so many constituencies is hardly appetising. "When you start making choices, you start losing friends," says Kent Conrad, the Democratic Senate Budget Committee chairman and a leading fiscal hawk. He argues the job should be handed over to a bipartisan task force. But Thomas Kahn, the top staffer on the House Budget Committee, notes that some legislators worry that such mechanisms undermine the democratic process by limiting the opportunity for amendment and debate.



For his part, Mr Obama has acknowledged the urgency of addressing entitlements, but said more specifics would have to await his draft budget proposal, due for submission in mid-February. He has aimed his anti-deficit rhetoric, both before the election and since, principally at waste and earmarks, the pet projects legislators insert into spending bills. But as Maya MacGuineas of the Committee for a Responsible Federal Budget, a watchdog group, notes, such spending is at most \$30 billion a year, or 1% of total expenditures. By contrast, entitlements amount to \$1.2 trillion, or 41% of the whole; and, left unreformed, will grow to 60% by 2030.

Still, Ms MacGuineas thinks Mr Obama has to start with waste and earmarks to build the necessary credibility for bigger steps. "Before you say, 'Ladies and gentlemen, your Social Security and Medicare benefits are going down and your taxes are going up,' they want to know there are no more bridges to nowhere."

Will the markets co-operate? Since November stock and credit markets have rallied partly as previous initiatives gain traction and partly in anticipation of more aggressive actions by the incoming administration. Record deficit projections have not spooked investors: the dollar has strengthened as the overseas outlook turns grimmer, and deflation worries have driven Treasury yields to their lowest in over half a century. But as financial panic subsides, the prospect of huge current deficits combined with the coming entitlements crunch could cause investors to worry America will one day inflate its way out of the debt or even, in the extreme, default. The resulting higher interest rates would elevate the cost of servicing the federal debt, further aggravating the deficit. The threat of such dangerous debt dynamics is ample incentive for Mr Obama to hurry up and explain how he will tame the deficit once the recession is over.

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WORLD

UNITED STATES

The new surgeon-general

Health screen

Jan 8th 2009

From The Economist print edition

Barack Obama's choice is smarter than some critics think

SHOULD the post of America's top doctor be filled by a smooth-talking television star? It might soon be. Rumours are swirling that Barack Obama wants Sanjay Gupta, CNN's chief medical correspondent, to serve as America's next surgeon-general.

At first sight, the idea seems barmy. On grounds of substance, it seems odd to put a talking head in such a job, given that health reform will be a priority for the new administration. And on style, Mr Obama is already criticised by some as being too Clintonesque in his eagerness to curry favour with the media. Some critics denounced the presumed choice this week; Paul Krugman of the *New York Times* even claimed that Dr Gupta did not deserve the job because he unfairly attacked Michael Moore's movie "Sicko" (which in turn made the ridiculous claim that Cuba's health system is better than America's).

But Dr Gupta may yet prove a clever choice, for three reasons. First of all, he is not merely a pretty face. He is a qualified neurosurgeon who practises his craft and holds a post at Atlanta's Emory University. Second, doctors with roots in the subcontinent are greatly over-represented among the country's medical establishment but have long felt neglected. Elevating a prominent Indian-American may help Mr Obama court America's medical lobby, which has traditionally been hostile to reform.

But the biggest reason to think Dr Gupta may succeed is the fact that the only real power the surgeon-general has is the use of his bully pulpit to promote public health goals, such as healthy eating and stopping smoking. Some previous holders of the post were vocally so clumsy that they lost their effectiveness or their jobs: Joycelyn Elders was sacked by Bill Clinton for encouraging the teaching of masturbation. Others have been grey men who failed to get media attention. That, at least, is a problem Dr Gupta is unlikely to have.

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WORLD

UNITED STATES

Transitional woes

Reality check

Jan 8th 2009 | WASHINGTON, DC
From The Economist print edition

The Democrats are hitting a few speed bumps

ON JANUARY 6th Fred Thompson, a former senator and actor, glad-handed his way across the Senate floor. Edward Kennedy, who suffers from a brain tumour, strode up and down its aisles. And the 91-year-old Robert Byrd had an aide wheel him about. But on the 111th Congress's first day, everyone's mind was on who was barred from making small talk atop the chamber's blue carpeting. In a heavily trailed showdown, the Senate's secretary refused to let Roland Burris, the man appointed to fill Barack Obama's seat, onto the floor.

As they gear up to run Washington, DC the Democrats' problems are growing, and Mr Burris is the most distracting—for the moment. Few worry openly about his qualifications. Though he is hardly a figure of great renown, except for his ego (he has pre-built himself an elaborate mausoleum, listing his achievements), he did serve as Illinois's attorney-general. Rather, senators object to the man who appointed him: Rod Blagojevich, Illinois's governor, who is facing indictment on corruption charges.

Harry Reid, the Senate's majority leader, warned Mr Blagojevich not to appoint anyone to Mr Obama's open seat, and vowed not to seat him if he did. In a flagrant act of political nose-thumbing, Mr Blagojevich defiantly tapped Mr Burris anyway, daring the Senate to reject his choice, who would be the only black member of the chamber. The might-be senator then travelled to Washington to knock on the Senate's doors, insisting he had the law on his side. (Which he probably did, except that his paperwork was incomplete.)

Damaging rows over scandal and arcane procedure are hardly new on Capitol Hill. But the once deft Obama presidential transition is producing political drama now, too. On January 4th Bill Richardson, New Mexico's governor and Mr Obama's choice for commerce secretary, announced he would not take the post after all; an FBI investigation into state contracts awarded to some of Mr Richardson's contributors is intensifying. A fight has broken out between Mr Richardson's people and Mr Obama's as to whether the governor had offered full disclosure.

Then, on January 5th, leaks claimed that Mr Obama had named Leon Panetta, Bill Clinton's chief of staff, as CIA director, even though Mr Panetta has no direct experience of the intelligence world. The American left has hated the intelligence community ever since George Bush used it to make a case to invade Iraq. That might explain why Mr Obama chose an experienced outsider. But Dianne Feinstein, the incoming chairman of the Senate intelligence committee, is nonetheless infuriated that Mr Obama didn't consult her before the startling announcement.

Not all of Mr Obama's recent appointments have encountered brickbats. He chose Tim Kaine, Virginia's moderate governor, to head the Democratic National Committee. He also asked Elena Kagan, the well-regarded dean of Harvard Law School, to be solicitor-general, which increased speculation about her possible appointment to the Supreme Court, should one of the justices leave Mr Obama with a vacancy to fill. But on January 6th Mr Obama was back in the firing-line, accused of making another dubiously qualified appointment in the shape of Sanjay Gupta, a TV presenter and doctor, to be surgeon-general. The critics are probably wrong on that one (see [article](#)).

Mr Obama and the Democrats have already lost some of the sheen they got from their electoral victory last year. Mr Obama's campaign theme of change began with the restoration of competence, not to mention cleanliness, to the halls of government. Now the Democrats seem to have taken the mantle of scandal from the Republicans. With a big stimulus plan and plenty of social programmes on the agenda, the last thing they need is to have their post-election honeymoon cut short by the perception that they can't even keep their own house

—or, more accurately, their own Senate—in order. Perhaps that is why, as *The Economist* went to press, the Senate Democrats looked poised to relent over Mr Burris. So much for principle.

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WORLD

UNITED STATES

Barack Obama's BlackBerry

Subject: Russia and China

Jan 8th 2009

From The Economist print edition

Another look at the president-elect's inbox



"IT MAY seem an odd time to be thinking about anything foreign bar Gaza, but you really need to consider how you are going to treat two guys you won't have much in common with but will be seeing a lot of—Vladimir Putin and Hu Jintao. Without the co-operation of Russia and China, the United Nations is of little use to us. But if you are seen to be letting them push you around, our right-wingers will tear you apart.

It's important that you meet both of them as soon as reasonably possible—though not before you've seen Britain, Germany, France and Japan. You ought to work your charm on the Chinese first. They've been co-operative of late, on North Korea most obviously, but also to some extent on Iran. Above all, they keep on buying our Treasuries. Plus they haven't rocked the boat on Taiwan. In fact, things are going pretty swimmingly across the strait, which is one big thing we don't have to worry about. Also, our trade deficit with China is starting to look a bit better. True, that's only because of the recession-driven collapse in our demand for their imports, but it might help keep Congress quiet.

Then there's Mr Putin. Don't make George Bush's initial mistake of trusting him; but don't start out too combative either. We all know that neither Georgia nor Ukraine are going to be let into NATO any time soon, so what's the point of needlessly annoying Moscow by banging on about it? You might think it wise to find ways to

soft-pedal that one.

With the oil price leaving his economy in the tank, Putin may be less prickly in 2009 than he was in 2008 (though his gas-games don't bode well), so we need to capitalise on that. This would be a good time to get him to help us turn the screw a bit tighter on Iran, for instance.

Probably the toughest call you will have to make regarding Russia is whether or not you want to push ahead with deploying interceptors for the missile shield (which, let's face it, may not work) into Poland and the Czech Republic.

The truth is that the missile interceptors are not there to protect us or them from Moscow, but to protect us from a possible strike from Iran. Is a deal available that would allow you to delay the interceptors in return for Russia doing a lot more to help us stop the Iranians getting their hands on nukes? Or will that look like giving in to Russian blackmail? This is one call that only you can make.

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WORLD
UNITED STATES

California's budget

Crimson tide

Jan 8th 2009 | LOS ANGELES

From The Economist print edition

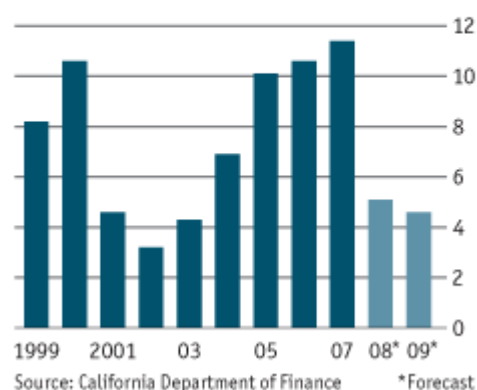
The world's eighth-biggest economy shuffles towards fiscal oblivion

ARNOLD SCHWARZENEGGER was skiing in Idaho when his office released a detailed outline of California's 2009-10 budget. It would be unfair to suggest that the governor is unconcerned about the state's dire fiscal situation. On the contrary, he has tried to focus minds on it for months. But the episode does, perhaps, hint at how seriously he expects his proposed solution to be taken.

California, first in many things, is facing America's worst budget crisis. The gap between projected revenues and spending during this fiscal year and next amounts to \$41.6 billion, which is almost half the total sum that the state expects to raise next year. Unlike the federal government, California is not allowed to get out of the jam by running a deficit. It is finding it hard to borrow to meet even short-term needs. Infrastructure work has virtually stopped. If nothing is done to close the gap soon—and perhaps even if it is—the state will begin issuing IOUs as early as next month.

State without much gold

California's capital-gains tax receipts, \$bn



Recession triggered the crisis but did not cause it. California relies heavily on income taxes, especially those paid by the top 1% of earners. These veer up and down with the markets. But instead of saving money in boom years, the state locks in higher spending on public services and embarks on projects that need long-term investment. Dave Cogdill, head of the Republicans in the state Senate, likens it to a family that adopts children in good times, only to find that it cannot afford to feed them when the economy sours.

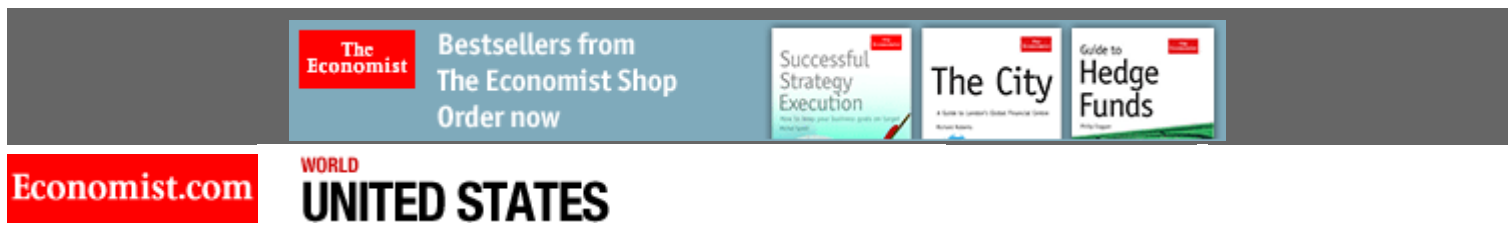
Mr Schwarzenegger's solution, which he will describe in detail later this week, combines swingeing spending cuts (even to normally inviolable schools) and equally swingeing tax increases. He wants to lift the sales tax by 1.5% until 2012. This would take it to between 8.75% and 10.25%, depending on where one is in the state. Although painful, the governor's proposed budget is still rather optimistic. It assumes, for example, that federal spending on infrastructure will jump, that the cost of fighting fires will be less than half of what it was this year, and that the state will be able to sell \$5 billion in bonds by July.

The plan anyway faces crippling opposition in the state Capitol. The Democrats who dominate both houses of the legislature find deep cuts to education and health care unpalatable. The Republicans, who can muster enough votes to block the governor's budget, refuse to consider tax increases unless they are accompanied by a root-and-branch overhaul of state finances and a mass sell-off of state assets. The divide between the two camps is as wide as Yosemite Valley.

The Democrats have devised a plan to get around this problem, albeit a desperate and legally questionable one. They want to relabel many taxes as "fees" and increase them. Although it takes two-thirds of legislators to pass a tax increase, fees could be increased by a simple majority vote. Republicans, who have more than a third but less than half of the seats in both chambers of the legislature, would be overridden. Mr Schwarzenegger vetoed the Democrats' proposed budget this week, although he did not reject their ruse in principle.

As the politicians squabble, the budget hole deepens. The governor has put a deficit counter on his [website](#), like the national debt clock in New York. It does not appear to be concentrating minds. Noreen Evans, a Democratic member of the state Assembly, cannot see how the deadlock can be broken: "I'm known in the Capitol as a Pollyanna, and I'm losing hope."

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Student loans

College on credit

Jan 8th 2009 | AUSTIN
From The Economist print edition

Student advocates say that this bail-out will not work

WITH unemployment rising, house sales falling and retirement accounts shrivelling, college students are not at the top of most people's worry lists. But they face a miserable set of financial circumstances. Tuition costs and other fees are soaring: up 439% since the early 1980s, says a recent report from the National Centre for Public Policy and Higher Education. Family incomes have not begun to keep pace. This year's average bill from a private college is about \$25,000, according to the College Board, a body that, as well as managing standardised tests such as the SAT, also studies financial aid for students. Public universities are far more affordable, with an average price tag of \$6,500 for in-state tuition. But that is still a big chunk of the budget for a poor or middle-class family. And living expenses quickly run up the tab, even if a student makes do with a grotty apartment and lives on noodles.

The unsurprising result is that more students are borrowing to finance their education. According to the College Board, student debt has ballooned from \$41 billion ten years ago (in 2007 dollars) to \$87 billion today. Nearly two-thirds of those who graduate from a four-year programme, public or private, are in debt. Last year a borrower's average burden, according to the Project on Student Debt, was slightly more than \$20,000.

And there is no relief on the horizon. A handful of private universities, mostly those with large endowments, promise students grants rather than loans. But most places, facing budget troubles of their own, cannot afford to be generous. Cash-strapped governors from the state of Washington to Indiana have proposed deep budget cuts for public universities. Florida's governor wants to let such universities raise tuition fees by 15% a year. The state's colleges are much cheaper than the national average, but they are creakier and struggle to compete for the best teachers and students.

So the borrowing will continue. And that poses another problem. Most student loans come from the government. But as the number of students wanting to borrow has increased, more of them have turned to private sources. Government funds are limited and come with complicated eligibility requirements and a lot of confusing paperwork. Federal loan limits have increased in response to rising tuition costs, but they are still capped and often do not cover the full cost.

During the past academic year, again according to the College Board, students borrowed \$17.5 billion from the private sector. Ten years earlier it was only \$2.5 billion. But in the past year several dozen private student lenders have shut up shop. If the private lending business loses steam, students could be marooned.

Last November Hank Paulson's beleaguered Treasury Department announced that it would buy up \$200 billion of asset-backed securities based on car loans and credit-card debt and student loans. This, he says, is vital to get the economy chugging along again. It sounds like an innocuous idea. But there is a problem with it. If a student is going to borrow, it is generally better to go through the government.

Federal loans are subsidised, and they offer better forgiveness and repayment provisions. Private loans carry high interest rates—up to 19% these days. And they are very hard to wriggle out of, even if the borrower goes bankrupt. "They really are not a form of student aid," says Lauren Asher of TICAS, a group that studies college affordability. "They're an expensive form of credit." But to an unsuspecting student or parent, reading the cheerful college literature about financial aid, it can be hard to tell the difference. By bailing out some of the private lenders, Mr Paulson risks giving the seal of government approval to a sometimes dodgy business.

Consumer finance

The layaway way

Jan 8th 2009 | ST LOUIS

From The Economist print edition

A new lease of life for an old scheme

THE worst economic crisis since the Depression of the 1930s has brought back one of that era's innovations—with a modern twist. American consumers, caught in the credit squeeze or unwilling to pay extortionate interest rates on their credit cards, are rediscovering the delights of the layaway plan.

For those readers who are rather too young to be familiar with the idea, a layaway plan allows a buyer to pick a particular piece of merchandise which the shop puts in storage. Over a set period of time, typically one to three months, the buyer makes small payments towards the total cost. On full payment he or she receives the goods. If he cannot complete the agreement the payments are refunded, minus a service charge.

Before credit-card companies began handing out cards to anyone and everyone, and before retailers issued their own store cards almost blindly, layaway was the only way most people could finance big purchases. This "poor man's credit" fell out of favour in the 1980s, when it was unfairly stereotyped as "ghetto financing", and few noticed when America's biggest retailer Wal-Mart, discontinued it in 2006.

But K-Mart, another huge chain, which never dropped the service, recently made layaway the centrepiece of its festive-season advertising. For a \$5 service fee and a refundable \$10 cancellation fee, customers were able to layaway presents without going deeper in debt. Burlington Coat Factory and Marshalls, two clothing stores, also offer layaway, as do smaller regional chains, and the number looks likely to increase. Sears has just started its own layaway programme, though Wal-Mart (the world's largest company in terms of revenue) has said it has no plans to resume it.

A new firm, [eLayaway](#), has now brought the 1930s concept into the 21st century cyberworld. For a 1.9% service charge customers can choose from about 1,000 local retailers online and arrange for monthly deductions from their bank accounts. The firm's customer base has expanded more than tenfold in a year. And eLayaway is now taking online orders for Valentine's Day jewellery, just as many neighbourhood jewellery stores once did.

Not everything from the Depression can make a comeback: sealed windows in modern bank buildings make it hard for people to jump out of them. But if layaway is back, can Christmas clubs and green stamps be far behind?

AP



Something to look forward to



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WORLD
UNITED STATES

Texas politics

Happy together

Jan 8th 2009 | AUSTIN

From The Economist print edition

A bipartisan spirit has suddenly taken hold

WHEN this newspaper last checked in with the Texas legislature, which meets only every other year, a bipartisan coalition was trying, and failing, to stage a coup in the House of Representatives. The veteran speaker, Tom Craddick, was running the show with an iron gavel. As the minority party, Democrats were obviously frustrated. But even some Republicans were tired of Mr Craddick's heavy hand with committee assignments and campaign funds. As the legislative session drew to a close in May 2007, resentment swelled into mutiny. Rumours flew around: did Mr Craddick's opponents have the votes to throw him out? The state would never know. When meddlesome legislators approached the podium, Mr Craddick simply refused to recognise them. No one could say a word against him. When the session ended, Mr Craddick was still the speaker.

Mr Craddick's clock has finally run out. When the House reconvenes on January 13th, it will elect a new speaker. Barring some last-minute misfortune that will be Joe Straus, a San Antonio Republican with a moderate tone and good timing. One week ago few had heard of him. Then he emerged from a private meeting of anti-Craddick Republicans as their choice for speaker. The Democrats who had pledged to vote against Mr Craddick were amenable. Mr Straus let it slip that he had pledges from 76 people. The House has 150 members. As everyone did the maths the list of Straus supporters grew. A dozen other candidates withdrew their bids.

Mr Straus is in an unusual position. He was picked by Republicans, but owes his win to Democratic support. For some in his party this is a mark against him. Social conservatives think he is a closet liberal: he supports the existing laws on abortion and voted against banning gay foster parents. But moderate Republicans like Mr Straus's political pedigree—he worked for the Reagan and Bush senior administrations—and fiscal conservatism. And their House majority is down to a mere two seats. A strict partisan would have little room for error.

The Democrats, for their part, are overflowing with bipartisanship. They struggled with Mr Craddick. A 2003 redistricting effort, in the most notorious example, was so cantankerous that at one point 53 Democrats fled to Oklahoma so as to deprive the House of a quorum. Mr Straus promises to work across the aisle. Some Democrats compared him to Barack Obama, and one pronounced him "cute". A happier legislature will be bad news for political rubbernecks. But no one else is complaining.

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Lexington

Leading the lawmakers

Jan 8th 2009

From The Economist print edition

Until he becomes unpopular, Barack Obama will get most of what he wants from Congress

Illustration by KAL



"CHANGE begins at home," say the billboards in Washington, DC. They are adverts for IKEA, a discount furniture store, urging people to spruce up their apartments with new sofas. But they also describe Barack Obama's agenda. The president-elect was chosen to stop wasting blood and treasure on foreign wars and start fixing what's broken at home. As the flames in Gaza attest, the rest of the world is hard to ignore. Nonetheless, Mr Obama started work in the capital this week with a hugely ambitious domestic programme. He wants to rescue the economy from free fall, extend health care to nearly everyone and re-engineer the way Americans produce and consume energy. This package will be somewhat costlier and harder to assemble than an IKEA bookshelf, and he cannot hope to accomplish it alone.

As Obamamania grips the planet, it is easy to forget that power in America is divided. The president cannot do much, especially at home, without a willing legislature. Before he can sign a bill, Congress must pass it. Before he can spend money, Congress must appropriate it. Before his nominees for high office can start work, the Senate must approve them. The executive and the legislature are supposed to be coequal branches of government, so the first meeting of the 111th Congress on January 6th was, in theory, just as important as Mr Obama's impending inauguration. Few saw it that way. No cheering crowds filled the Mall, nor were lavish parties thrown to celebrate. But the success of the new presidency depends as much on the 535 unpredictable denizens of Capitol Hill as it does on Mr Obama himself.

For all their power, America's lawmakers are surprisingly little-known. Harry Reid, the Senate majority leader, is a fascinating man. He was born in a shack in Searchlight, Nevada, where his mother took in laundry from the local brothels. He ran the Nevada gaming commission and was nearly murdered by gangsters. As the Senate's top Democrat, he has mercilessly hounded George Bush, whom he considers possibly the worst president ever. Yet he could walk down any street in America without being recognised. Nancy Pelosi, the speaker of the House of Representatives, is somewhat better-known, partly because she is the first woman to fill that post. But many

Americans who know her name are hard-pressed to say what exactly she does. Indeed, during last year's election campaign, only about half of Americans knew which party controlled the House. (It was the Democrats.)

How will Congress work with Mr Obama? Some say he will charm it like a snake. His party has the same hefty majority in both chambers, with 59% of seats to the Republicans' 41%. He has no formal power to boss Democratic lawmakers around, but he can set the agenda and promote it with his huge and expertly wielded megaphone. If his presidency is deemed a success, his party will reap the electoral benefits. Just as Mr Bush has recently dragged congressional Republicans down, a popular President Obama would help Democrats maintain their majorities in 2010. So Mr Reid and Ms Pelosi will be eager to speed his proposals—with which they mostly agree, anyway—into law.

Speed will be of the essence. The economy is in dreadful shape. Wise folk concur that a swift and powerful stimulus is required. The public are receptive: nearly two-thirds say the government should spend more to revive the economy. Democrats are anxious not to let the crisis go to waste. Some see a once-in-a-lifetime opportunity to reshape America. They liken the current times to the Depression of the 1930s, in part because they want to enact a new New Deal. And they figure that a big chunk of their wish-list can be whizzed through as part of a stimulus package. More money for health care means more jobs for nurses. More money for green technology means more jobs fixing solar panels on roofs. "The house is burning down, and the president of the United States says this is the way to put out the fire," said Bertrand Snell, a Republican congressman, urging his colleagues to support Franklin Roosevelt. Seventy-five years later, plenty of Democrats hope that Mr Obama will follow FDR in uniting the country, taming capitalism and bringing back happy days.

Not to be taken for granted

But will Congress really be so pliant? In the Senate, Republicans have just enough votes to mount a filibuster and block bills. They are in a foul mood, not least because of a disputed vote recount in Minnesota, where Democrats claimed victory this week. And they have ideological objections to the Obama agenda. Mitch McConnell, the Republican leader in the Senate, frets that he will hire 600,000 new civil servants while congressional Democrats waste a fortune on "things like Mob museums and waterslides". Fiscally conservative "Blue Dog" Democrats may rebel if the stimulus grows too big. And public support may prove fragile. Though voters broadly support action to curb greenhouse gases, provide universal health care and kick-start the economy, they may change their minds if that leads to higher fuel bills or taxes.

Despite all this, the chances are that Mr Obama will enjoy a lengthy honeymoon. For one thing, he shows every sign of handling Congress deftly. Both he and his vice-president are former senators, as are his proposed secretaries of health (Tom Daschle) and state (Hillary Clinton). His team is packed with people who know how Capitol Hill works. Rahm Emanuel, his chief of staff, was the fourth-ranking Democrat in the House. Philip Schiliro, his liaison to Congress, used to work for Henry Waxman, who now heads the House committee that will draft energy bills. Mr Obama is also shrewdly reaching out to Republicans, proposing that a large part of the stimulus should take the form of tax cuts. As long as he is popular, he will get most of what he wants. And he could remain popular for a while. Since the economic crisis conspicuously began under Mr Bush, Mr Obama can plausibly blame him for everything that goes wrong and then take the credit for the recovery, when it comes.

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WORLD
THE AMERICAS

Politics in Brazil

Lula's last lap

Jan 8th 2009 | RIO DE JANEIRO
From The Economist print edition

A freakishly popular president has only a year left before electioneering curtails his mandate. He will spend it reacting rather than reforming

EPA



REPEATS are often disappointing. It is rare indeed to find a president in his second term with an approval rating of 80%, as Brazil's Luiz Inácio Lula da Silva now enjoys. No American president since the second world war has managed it. In Latin America, only Colombia's Álvaro Uribe at the height of his success last year against the FARC guerrillas has touched a similar level of adoration. So Lula, a pragmatic former trade-union leader, is entering his penultimate year in office in a position in which he ought to be able to do almost anything.

Yet this apparent omnipotence is illusory, not least because it will be brief: by early 2010 the president will start to be overshadowed by the campaign to elect his successor. He is also constrained by his own left-wing Workers' Party (PT); by his political allies; by the economic troubles that only recently reached Brazil's shores and have yet to be felt to their full extent; and by his temperamental compulsion to preserve his popularity. "I would not like to be called a populist," he sometimes says, "but I do like to be popular."

Lula still talks about reforming Brazil's labyrinthine tax system and improving the way its political parties and elections work. These were supposed to have been the priorities of his second term. Both are properly matters for Congress, though if he wished the president could use his vast political capital to try to force them through.

Yet they are forever being postponed, sometimes on flimsy excuses. Tax reform was put off at the end of last year because of the gloomy economic outlook. In fact, that makes simplifying the tax code (which according to the World Bank takes a typical Brazilian company 2,600 hours a year to comply with) more important than ever. It will not be considered again until the end of February. As for political reform, this is more likely to be decided in the courts: Brazil's elected officials are still waiting to see how much bite there is in a ruling by the Supreme Court that prohibits the common practice of switching parties straight after an election.

"People have been talking about these reforms since 1988 [when Brazil's constitution was approved]," says João Augusto de Castro Neves, a political consultant in Brasília. "It is like a badge of political seriousness to do so." Instead of pursuing them, he reckons, Lula will be fully occupied just keeping his coalition government together. The Party of the Brazilian Democratic Movement, a ramshackle concoction of regional political barons that is the coalition's biggest force, is trying to secure the presidencies of both houses of Congress, which are being contested at the moment. If it succeeds the party will apply its customary leg-irons to any attempts at reform. If not, its leaders will need placating, which will amount to the same thing.

Unlike Mr Uribe in Colombia (see [article](#)), Lula has made it clear that he will not seek to cling to office by changing the constitution to allow him to run for a third consecutive term. The idea was floated by leaders of the Workers' Party, which worries about its fortunes once its talisman has gone. Commendably, Lula scotched it, leaving the PT searching for a viable successor. He has pushed the candidacy of Dilma Rousseff, his chief of staff. She is a competent political insider, but lacks mass appeal. But even if the centre-right opposition wins power, Lula knows that his social policies, centred on *Bolsa Familia*, a cash-transfer scheme benefiting 11m poor families, are unlikely to be overturned.

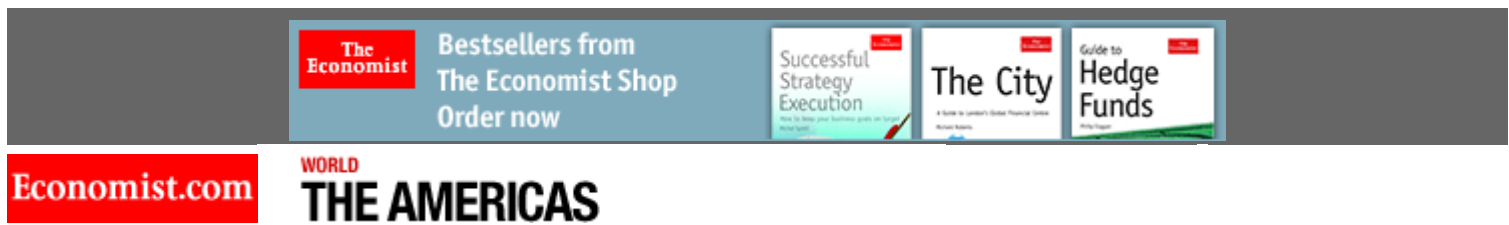
Until the election most of Lula's energies are likely to be taken up with crisis-management. According to IBOPE, a pollster, 74% of Brazilians expect this year to be better than last. They are likely to be disappointed: the economic data will get worse as the year progresses because the economy has only recently started to splutter after growing rapidly for the first nine months of 2008.

"Any preconceived political plans will have to be torn up to deal with this crisis," says Raul Velloso, a consultant in Brasília who follows public finances. Mr Velloso is worried about possible further weakness in the exchange rate (the real depreciated by 17% against the dollar in the last three months of 2008), and also by the ability of Brazilian companies to roll over their debt.

Brazil's scope for fiscal stimulus is limited. Chile's government this week announced a \$4 billion bundle of measures aimed at creating 100,000 jobs and helping poorer families. It can easily finance the resulting fiscal deficit forecast at 3% of GDP this year because it built up a war chest of public savings when prices for copper, its main export, were high.

But Brazil's government, with a much bigger public debt, needs to preserve its primary fiscal surplus (ie, before interest payments) to retain the confidence of bondholders. Tax revenues will slow along with the economy. The government's priority is to implement its expansionary "growth acceleration" programme of public investment (better known as PAC from its initials in Portuguese) rather than adopt new measures, says Nelson Barbosa, a deputy minister of finance. Everything the government does this year will be presented as part of the PAC, says a civil servant in Lula's office.

If inflation remains stubborn, preventing the Central Bank from cutting interest rates, the government will come under pressure, especially from the PT, to find other ways to boost growth. These could include guaranteeing credit to farmers and construction firms. In recent years, whenever the economy has started to wobble Brazil's politicians have calmed markets by demonstrating their commitment to economic orthodoxy. Some commentators worry that this commitment may be flagging. But this year, with governments around the world intervening in markets, investors may even be reassured if Brazil does the same—up to a point.



Politics in Colombia

Third term temptation

Jan 8th 2009 | BOGOTÁ
From The Economist print edition

Álvaro Uribe pushes his luck

THOSE among Álvaro Uribe's closest collaborators who harbour presidential ambitions waited patiently throughout 2008 for their boss to decide whether or not he will try to seek a third term himself in a presidential election due in 2010. He coyly refused to commit himself. But soon enough he will have to. In March Colombia's Senate is due to debate a bill to hold a referendum on changing the constitution to allow Mr Uribe to run again. And ministers and legislators must resign their jobs by May if they want to be eligible to stand themselves.

Since he became president in 2002 Mr Uribe has overseen a big security build-up and a steady fall in violence, especially in the populated central part of the country. Partly because of the resulting boost to confidence, the economy has grown strongly. His popularity allowed Mr Uribe to persuade Congress and the courts to approve a constitutional change allowing him to run for (and duly win) a second term in 2006. There followed a series of debilitating scandals over links to right-wing paramilitaries which shook the government—and then a string of successes last year against the FARC guerrillas which have invigorated it.

While his supporters last year gathered 4m signatures calling for a referendum, Mr Uribe neither backed nor shunned their efforts. But last month he gave the clearest sign yet that he wants the referendum bill to be approved. During a 17-hour debate in the lower house on the last day of the parliamentary year, he first sent ministers to press waverers and then issued a decree allowing the session to continue past midnight. That was enough to ensure the bill's passage to the Senate.

A third term for Mr Uribe still faces big obstacles. As approved the bill would allow him to run again only in 2014, not 2010. Officials say that they will try to change the wording in the Senate, where the measure commands greater support. But the legality of such a change will eventually be decided by the Constitutional Court. And the electoral authority is still investigating who financed the petition campaign, how the funds were used and whether it breached spending limits.

The earliest a referendum could be held is December. And by then the political weather may have changed. Colombia has traditionally been wary of strong presidents. In allowing Mr Uribe to run in 2006 the Constitutional Court appeared to have been swayed by the president's overwhelming public support.

According to Invamer-Gallup, a pollster, Mr Uribe's popularity rating remains above 70%. But only 54% of those asked supported his re-election, down by 20 points since July. At the end of last year the government was shaken by the anger of thousands of savers bilked when several pyramid schemes collapsed. Last year inflation nipped at living standards. Now the economy is starting to slow, hit by the woes of the United States and Venezuela, Colombia's main export markets.

Even if Colombians do decide they want their president to carry on, the outside world might be alarmed at the prospect. On January 13th George Bush is to bestow the Presidential Medal of Freedom on Mr Uribe in honour of their close alliance. But Barack Obama may be less supportive, especially since Hugo Chávez, Venezuela's leftist president with whom the United States has testy relations, is also seeking to lift a bar on a third consecutive presidential term. Mr Uribe risks looking as autocratic as his neighbour.

Several of the president's closest allies may be hoping even more fervently that he desists. Juan Manuel Santos, the defence minister, would be a strong contender in 2010, but has said he will not run against his boss. So has Fernando Araújo, a former guerrilla hostage and later foreign minister. But Germán Vargas Lleras, a hitherto loyal senator, says that he will stand for president whatever Mr Uribe decides. By prolonging the suspense about his intentions, Mr Uribe has managed to avoid becoming a prematurely lame duck. But he might be well advised to conclude that waiting until 2014 would be both statesmanlike and expedient.

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WORLD
THE AMERICAS

Quebec's demography

The cradle's costly revenge

Jan 8th 2009 | MONTREAL

From The Economist print edition

A baby bump courtesy of the taxpayer

AS A French-speaking outpost in a predominantly English-speaking continent, Quebec has always been sensitive about its demographic prospects. For a long time these were encouraging. The province was legendary for its families of 15 or more children. Its population more than tripled between 1900 and 1960; its relative weight within North America also increased. The *revanche du berceau* ("revenge of the cradle") dreamed of by some romantic nationalists as retaliation for the British conquest of 1759 didn't seem so far-fetched.

Then came a sudden rebellion by Quebecers against their Catholic heritage and church-dominated institutions. The birth rate plunged from the highest in Canada to the lowest. By the mid-1980s the fertility rate—the average number of children born to a woman—dropped to 1.36. Since a rate of 2.1 is needed to maintain a stable population, nationalists, and others too, began worrying about extinction.

This stung the provincial government into action. After much fine-tuning under several different administrations, signs have at last emerged that its efforts are bearing fruit. The first effort was a "bucks for babies" scheme. Parents were paid C\$500 (\$425 at today's exchange rate) and C\$1,000 for their first and second offspring respectively; subsequent children earned as much as C\$8,000. But Quebecers seemed to be unbribable.

So the government stepped in to support child care. While this can cost C\$50 or more a day per child elsewhere in Canada, Quebec offers big subsidies to day nurseries and childminders provided they charge parents just C\$5 a day (increased to C\$7 in 2004). Despite long waiting lists for places, the province has developed a reputation as parent-friendly. Parts of Quebec bordering Ontario saw an influx of young families, even though the move involves paying much higher income tax.

Even so, the birth rate edged up only modestly. But in 2006 the Liberal provincial government of Jean Charest introduced a provision for parental leave that is more generous than anywhere else in North America. And at last the children came. The number of births in the province jumped almost 8% that year (with a particular bump in January as parents delayed conception to qualify for leave), and then a further 2.6% in 2007. Early figures for last year show the trend continuing. The fertility rate has risen to 1.66, still below the replacement level but higher than the national average.

"Baby boom is a big word. It's more of a little bump," cautions Céline Le Bourdais, a demographer at Montreal's McGill University. "It will have to be seen over the long term." From that perspective it may prove unsustainable. Both subsidised day care and the parental-leave programme, which allows parents to take almost a year off at up to three-quarters of their salary, have been popular beyond the government's wildest projections. Their cost is way over budget. There are now 200,000 subsidised day-care places across the province, each costing about C\$13,000 to the government, and with plans for 20,000 more within two years. The parental-leave programme, which was forecast to require C\$1 billion annually, already costs 50% more.


At a provincial election last month Mr Charest managed to win a third term with a narrow majority (having governed with a legislative minority in his second term). With Canada's economy sliding towards recession, the fiscal calculus is more complicated. So he may be tempted to cut spending on day care and parental leave. Both

Illustration by Claudio Munoz







programmes help to make Quebec the most taxed and indebted place in North America. But they are popular, and many Quebecers see them as a price worth paying to prevent a demographic death sentence for their culture.

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WORLD
THE AMERICAS

Housing in Argentina

Misery in their midst

Jan 8th 2009 | BUENOS AIRES
From The Economist print edition

A fight over an iconic shantytown

NOT far from the Sheraton Hotel in the Retiro district of Buenos Aires there is another building jocularly known to locals by the same name, where beds are available for a more modest fee. This precarious rooming house marks the entrance to Villa 31, the Argentine capital's oldest *villa miseria* (shantytown). Now the settlement has become the focus of hostilities between Mauricio Macri, the conservative city mayor, and the left-leaning national government of President Cristina Fernández de Kirchner.

Villa 31 nestles between the city's bus terminal, its largest railway station and its port. But on its western edge it abuts skyscraper offices and plutocratic apartment buildings on Avenida del Libertador, whose balconies facing the River Plate look out over its maze of makeshift dwellings. Office workers and apartment owners complain that Villa 31 is home to thieves who prey on commuters at night and a source of protesters who periodically block the highway that bisects it. But Villa 31's impoverished inhabitants prize its proximity to downtown schools, hospitals, entertainment and jobs.

Villa 31 sprang up during the Depression, when immigrants from Italy and Poland who had lost their jobs settled by the port hoping to secure day labour. Many of Buenos Aires's posher areas used to include similar enclaves of poverty. But a military dictatorship in the 1970s destroyed most of them, expelling their residents to distant suburbs. Villa 31 survived only because 46 plucky families refused to leave and secured a court order preventing their removal.

Subsequent elected mayors have repeatedly promised either to clear the slum or urbanise it. But a plan to give residents property titles was never implemented, and an attempt to bulldoze homes was halted by protests. The *villa* has just carried on growing: its 15 hectares (37 acres) now house 40,000 people.

Mr Macri was elected in 2007 on a platform which included a promise to clear the shantytown. He argues that it is unsafe, with many of its multi-storey buildings in danger of collapsing. But Villa 31 mostly stands on land belonging to the national government. City officials accuse ministers of hindering their plans and aiding the growth of the *villa* by providing building materials to its residents. Ms Fernández's supporters counter that Mr Macri is backing property developers set on gentrifying the area, whatever the human cost.

Some of the residents of the *villa* say they would welcome being rehoused elsewhere. Amanda Jiménez, a Bolivian immigrant, complains of robberies and that her house floods with sewage when it rains. Others say they hope that the *villa* becomes a normal city neighbourhood. "We want to pay our electricity bills, and be Argentines like everyone else," says Maria Martínez, another resident. At the moment it looks like neither will get their way.

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WORLD
ASIA

Sri Lanka

The Tigers' last stand

Jan 8th 2009

From The Economist print edition

A long-awaited military breakthrough comes at a high cost

AFP



FOR the third time in as many months, Sri Lanka's prime minister, Ratnasiri Wickremanayake, this week avoided revealing to parliament the number of casualties in the bloodiest military operation ever staged against the rebel Liberation Tigers of Tamil Eelam (LTTE). Opening the monthly debate on extending the state of emergency, imposed most recently in 2005, he said the government had entered the "final phase of eradicating terrorism". Since November, however, he has dropped any reference to deaths and injuries.

No wonder, say defence analysts. Thousands of soldiers have been killed or wounded or are missing in the campaign President Mahinda Rajapaksa launched against the Tigers in August 2006. The capture on January 2nd of Kilinochchi, the rebels' administrative capital, came at a particularly heavy cost. For months some ministers had been saying the breakthrough was imminent. But it was stymied by monsoonal rains and fierce resistance. In the end, the conquest came as a surprise.

Mangala Samaraweera, an opposition MP, says casualty figures have been spiralling since September, forcing the government to suppress "the stark reality of war". Hospitals are brimming over with injured soldiers. White flyers with black lettering and grainy photos of uniformed men, now dead, are appearing ever more frequently on village walls. But buoyed by a string of victories and a lavish recruitment drive, young men—almost all from the Sinhala Buddhist majority—still line up to enlist.

The army's next objective is Mullaitivu, the Tigers' most fortified base, from where their chief, Velupillai Prabhakaran, is directing the defence of what he calls "Eelam"—the traditional homeland of Sri Lanka's Tamil minority. Not much homeland is left. President Rajapaksa has poured more money into the war than ever before

in the 25-year conflict, strengthening the army, navy and air force to unprecedented levels. The Tigers have lost vast swathes of terrain and large numbers of fighters.

Citing intercepted communications, General Sarath Fonseka, the army chief, claimed this week that some 8,000 rebels were killed in fighting last year alone. Fewer than 2,000 Tiger cadres survived, he said, and finishing off the rest "will not take one year". Mr Prabhakaran and his fighters are now trapped inside 40 square km (15 square miles) in Mullaitivu. This week troops captured a line of defence at Muhamalai in the Jaffna Peninsula and regained control of Oddusuddan. They are now approaching Elephant Pass, which connects Jaffna to the rest of the country.

Tiger positions in Mullaitivu are being pounded every day with artillery, mortar and multi-barrelled rocket fire. The air force is bombing areas believed to be frequented by Mr Prabhakaran. He is thought to be moving within a sophisticated system of underground bunkers, and remains elusive. Nevertheless, there is so much confidence about the possibility of his arrest that India's ruling Congress party has already demanded his extradition over the assassination in 1991 of Rajiv Gandhi, a former Congress leader and prime minister.



More firecrackers were lit around the country after Kilinochchi was captured than to greet the new year. President Rajapaksa reaffirmed that the war will continue until the rebels are defeated. He also called on the Tigers, in "a final message", to lay down their arms and surrender. This week a ban on the LTTE, lifted in 2002 to enable peace talks, was renewed.

Advances on the battlefield are propping up the government, under fire for alleged corruption and economic mismanagement that has brought double-digit inflation. The ruling coalition is now certain to sweep local elections in two important provinces scheduled for February 14th. If the military gains are sustained, it is also likely to win by a landslide in the parliamentary elections that Mr Rajapaksa has indicated he will call after April.

The Tigers, for their part, fight on. In a muted interview granted to the pro-rebel website, TamilNet, this week, their political head, B. Nadesan, dismissed the capture of Kilinochchi as an insignificant setback. Still, displaced civilians from Tiger-controlled areas have slowly started filtering out. A massive outflow, which the government expects soon, will open the Tigers to a full-scale military onslaught. Their response is familiar. This week saw three bombings, including a suicide-attack, in Colombo. As the army closes in on their last northern bastion, the Tigers are expected to resort to more terrorist raids.

Few now dispute Mr Rajapaksa's claim that the Tigers will be defeated this year. Ahilan Kadirgamar, an activist with a network of moderate overseas Tamils, feels the rebel movement is on its last legs but presses for a political solution to Tamil grievances in the post-Tiger era. Like many Tamils, he fears that wiping out the Tigers will create a political vacuum, leaving them with neither leadership nor clout.



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WORLD
ASIA

South Korea

Barrack-room brawls

Jan 8th 2009

From The Economist print edition

A low moment in the country's path towards a mature democracy

Reuters



Taking steps against the opposition

FOR many proud South Koreans, it was a cringe-inducing sight, all the worse for being beamed around the world: as a rapidly weakening global economy sucked South Korea down with it, the country's politicians brawled and scuffled. From December 26th, the National Assembly was transformed into a battleground, when politicians from the opposition Democratic Party (DP) began a sit-in, barricading themselves inside to deny the ruling party access to the main chamber and Speaker's office. The sit-in was called off on January 6th, with all sides saying the assembly will return to normal. Restoring pride in South Korean democracy will take a lot longer.

The opposition's objections covered a sizeable proportion of the 95 bills that the Grand National Party (GNP) of President Lee Myung-bak said it urgently wanted to pass in order to help the economy and improve competitiveness. The GNP has a solid majority in the assembly, hence the DP's physical tactics—democratic process go hang. Among the bills the opposition objected to was a law that would allow industrial companies to own banks, and another opening up mass media to new investment. Both, the DP claimed, would concentrate unaccountable power in the *chaebol*, the country's industrial conglomerates. Above all, the DP objected to the ratification of a free-trade agreement (FTA) with the United States.

This is hypocritical, since, when the DP (under a different name) was itself the majority party, it had backed its leader, the former president, Roh Moo-hyun, in pushing for the FTA, negotiated and signed on his watch. Now, DP assemblymen prefer to identify with the pact's presumed losers, such as rice-farmers, who will remain shut out of American markets. During his campaign, President-elect Barack Obama also expressed opposition to the deal, describing it as "badly flawed" for not doing enough for America's carmakers. Sensing its chance, the DP said it would keep up the sit-in unless the ruling party agreed to put off a vote on ratification until Mr Obama took up office. This week, the GNP blinked first, agreeing also to opposition demands that other offending bills be passed only after a "consensus" had been reached.

The odds remain in favour of the FTA's eventually being passed. But the farce has cost a lot, argues a senior official in the presidential palace, the Blue House. The future of other necessary reforms—notably, revamping and eventually privatising huge public-sector land and housing corporations—is now up in the air.

On the other hand, though heads are likely to roll within the GNP's parliamentary leadership, Mr Lee's own

battered image might benefit by comparison with the rumpus in the National Assembly. As it is, his poll ratings have been on the rise as his office attempts to inject a sense of purpose into confronting an economic crisis that has seen currency and exports collapse, and joblessness rise. On January 8th a “war room” opened in the Blue House. Mr Lee will chair regular meetings of his most senior policymakers to make sure that the administration’s proposals—a \$39 billion, four-year package of job-creation measures was announced just this week—are actually implemented. Mr Lee, a former businessman, would have you believe that when he rolls up his sleeves, it is not to play at fisticuffs, but to get things done.

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WORLD
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Indonesia's economy and the election

So far so good

Jan 8th 2009 | JAKARTA

From The Economist print edition

The president has quite a good crisis

WITH only three months until parliamentary elections, Indonesia's six-month-old campaign has moved up a gear. For once, thanks to the global economic slump, it is as much about substance as about style and personalities. And, unlikely as it seemed six months ago, President Susilo Bambang Yudhoyono's government can hold its head pretty high.

The data suggest the fourth-quarter slowdown in Indonesia was much less pronounced than elsewhere in South-East Asia. Economic growth for 2008 as a whole is likely to exceed 6%. Many other indicators are also robust. The 2008 budget deficit was 0.1% of GDP and the government has earmarked \$3.5 billion to spend on tax breaks and infrastructure projects.

In late 2008 the currency, the rupiah, lost a fifth of its value against the dollar, but the slide has halted. The cost of insuring Indonesian government bonds against default has come down sharply. Inflation, still running at an annual rate of 11%, is falling, enabling the central bank this week to cut its benchmark interest rate by one-half of a percentage point, to 8.75%.

Most banks are healthy, thanks to radical reform after the Asian crisis of a decade ago. And in 2008 the country achieved rice self-sufficiency for the first time in 24 years. Manufacturing is starting to feel the heat but only 25,000 workers have been laid off since November. And, according to research by the Asia Foundation, an American NGO, the huge informal sector has yet to feel much of an impact of the crisis.

President Yudhoyono can certainly take some credit for all this. He courted unpopularity by raising the prices of government-subsidised fuel when oil was soaring last year, and has now been able to cut them twice. Measures have been taken to support the financial sector and the poorest in society, and his stimulus package will both offer tax incentives and finance additional infrastructure projects. Moody's, a credit-rating agency, gave Indonesia a "stable" outlook in its annual report this week, expecting the authorities to manage the impact of the crisis competently.

Factors that have nothing to do with the president's policies are also helping. Domestic demand accounts for two-thirds of GDP, so though Indonesia remains vulnerable to sharp falls in the prices of commodities such as coal and palm oil, collapsing exports will not hit it as hard as its neighbours. The lack of infrastructure development in recent years means a few billion dollars will have a much greater impact than it might otherwise have done.

The government, however, needs to get the funds flowing fast and it is bad at disbursing money quickly. It also needs consumers to keep spending. Here the signs are ambiguous. Many Indonesians are not savers by nature. Yet carmakers, for example, are predicting a 25% contraction in sales. Food producers are less gloomy.

However, Indonesia, which suffered worse than any of its neighbours in the crisis of the late 1990s, has not yet weathered this one. It is handicapped by the weakness of the rule of law, the poor investment climate (see [article](#)), labour militancy and creeping protectionism.



The elections pose another hazard: the extent to which government ministers are ready to put the country's interests ahead of their parties' electoral prospects is in doubt. And then there are the global unknowns that could wreak havoc. But Mr Yudhoyono is probably sleeping better these days than most of his regional counterparts; and better than he himself could have hoped just a few months back.

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Jan 8th 2009 | TAWA VILLAGE

From The Economist print edition

Less a path-breaking land reform than a public-relations stunt

ROUGHLY 30 years ago (the exact date is disputed), a group of farmers in the eastern province of Anhui secretly decided to parcel out their village land to individual households. The event became celebrated as the beginning of the end of the rural “people’s communes” disastrously promoted by Mao Zedong. Now a group of villagers in Beijing’s outskirts is hoping to gain similar fame.

In late October they erected a billboard in Tawa village, 90km (56 miles) north-east of the city centre, overlooking a parking lot in front of a cluster of single-storey buildings. Here they had been trying to create a weekend idyll for the urban middle classes. In vain: their efforts to make it look a bit like a commune, with Maoist slogans and open-air dining hall, may have overestimated nostalgia for the bad old days.

The new billboard proclaimed that China’s first auction of rural land was going to take place in Tawa. Not just the buildings were on offer, but also a vast expanse of land behind them stretching up to the picturesque peaks of a mountain range—in all some 670 hectares (1,650 acres). The billboard showed Communist Party leaders raising their hands at a plenary meeting of the Central Committee that month. “Peasants thank the party centre,” said the accompanying slogan. The thanks were for a vague resolution that optimists believed signalled a softening of the party’s stance on trading rural land and housing, which are subject to far stricter controls than those that cover urban property.

Unlike the furtive break-up of the communes 30 years ago, Tawa’s land-auction plans were splashed over newspapers in Beijing. The auction house posted large advertisements on a couple of Beijing buses, showing the thumbprints of the 18 village representatives who had approved the sale, recalling the celebrated thumbprints of the commune-dismantling Anhui villagers. They advertised an auction due to take place on December 28th.

In fact, it was delayed. Local officials pointed out a couple of problems. For one thing, there was far less land available for auction than advertised—some of it is forestry which cannot be transferred. For another, as in cities, ownership cannot be traded, only “land-use” rights, and the present users do not have all the papers they need to prove their rights. The necessary documents could take more than a month to process. Officials ordered the billboard to be taken down, citing opposition to the use of leaders’ faces in advertising.

James Astill

**It takes a village**

No specific objections have been raised to the idea of an auction. But contrary to the villagers’ advertising, it is hardly path-breaking. Peasants have been legally trading land-use rights for years. Moreover, for “wasteland”, like swathes of Tawa’s mountain slopes, auctions are common. So peasants have been grumbling less about

restrictions on how they sell their rights, than about the shortness of leases and the “collective” ownership principle covering rural land. Local officials often claim to represent the collective and take big cuts from any deals, leaving little to the land users. Mortgaging rural land or even selling one’s own house to non-villagers is banned.

Even if Tawa does hold its auction, it will do little to change perceptions about how problematic rural land reform is proving, and how little the party is really doing to tackle it, for all the Central Committee’s encouraging words. The prime mover behind Tawa’s auction is a village party secretary, Zhang Yuwang, who happens to own, he claims, the usage rights to most of the land in question. Mr Zhang lives in another village a long distance away. Several years ago, in return for taking in some of Tawa’s peasants relocated as part of a poverty-alleviation scheme, it was given rights to the mountainous estate.

So Tawa’s revolutionary reform turns out to be little more than a typical story of a rural official trying to make money from land. Mr Zhang refused to talk to your correspondent and yelled at him for trying to interview a villager on the street. Mr Zhang’s skill has been to persuade some of Beijing’s newspapers (though scepticism has since crept in) that he is a reformist pioneer. Zhao Xiaokai, an adviser to the auction house, still insists that China is embarking on a “land revolution that will help the global economy” by unlocking peasant spending power. He also points out, more prosaically, that all the media attention can only help his business.



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WORLD
ASIA

India and Pakistan

Dodging the dossier

Jan 8th 2009

From The Economist print edition

Exasperated with Pakistan, India tries international diplomacy—for now

EVER since the attack on Mumbai in November that left over 170 people dead, India has thundered against Pakistan's complicity in the atrocity. But this has produced neither a full Pakistani admission of responsibility nor the requested surrender of terrorist suspects to India. This week India stepped up its efforts. It released a dossier of evidence to Pakistan and other governments. And it sharpened its accusation against Pakistan's government. More than simply ignoring or conniving at preparations for the attack, argued India's prime minister, Manmohan Singh, some of its agencies must have been actively involved in an operation of such sophistication.

The dossier includes the interrogation of the one surviving attacker, intercepted communications, and the evidence of their weaponry. Pakistan had insisted it had seen no evidence linking the government—or indeed, until this week, any Pakistani citizens—to an attack it blamed on “stateless actors”. And it suggests that India might be planning military reprisals. India has denied this, but Pakistan has moved troops from the Afghan border in readiness. Indian diplomats say the talk of a threat from India is a smokescreen to divert attention from Pakistan's failure to tackle the real issue: its nurturing of terrorists.

They do not spell out the implication of their analysis (though many private Indian commentators do): that if elements of the Pakistani army and government were involved in the attack, their intention was precisely to create friction with India. This would enable them to move troops from an unpopular war on the Afghan border. And it would reassert the dominant role of the army and its intelligence service over a notionally civilian government.

This puts India in a bind. If it responds belligerently, it plays into Pakistan's hands. But if it rules out military action its threats are toothless. Hence it has mounted a concerted diplomatic drive to persuade Pakistan's allies—notably America and Britain—to put pressure on its government and army to roll up the terrorist networks.

Pakistan will respond by emphasising the fragility of civilian rule; the army's self-proclaimed role as a bulwark against Islamic fundamentalism; and its vital contribution to the West's war in Afghanistan. In the past, these arguments have enabled Pakistan to withstand efforts to confront the terrorists. Now, however, public anger in India is such that if the government has nothing to show for its diplomatic blitzkrieg—or worse still, if there is another attack linked to Pakistan—it may be forced to bare its teeth after all.

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WORLD
ASIA**India's traditional crafts****Looming extinction**

Jan 8th 2009 | VARANASI

From The Economist print edition

Skilled silk-weavers are feeling the squeeze of competition

IN EUROPE, Asma could expect a fat grant for the yarn she is twisting from milky filaments of silk. In Varanasi, the centre of a centuries-old weaving industry, Asma and her mentally disabled son labour together on the earthen floor of a squalid hut, watched by her dying mother, in a state of wretchedness that is shocking even in India.

The shimmering thread that Asma and her 18-year-old son are twisting, on a rickety frame of sticks and string, will take four days to complete; and will bring them 100 rupees (\$2.30). A local trader, who supplied the filaments and commissioned the work, will dye the thread, and supply it to another family of weavers. They will transform it into a bright sari.

Varanasi's estimated 300,000 weavers, of whom 90% are Muslim and the rest Hindu *dalits* (formerly "untouchables"), have always been poor. But recent years have brought new hardships as demand for their wares has shrivelled. Around half the city's weavers are now employed in other work, or jobless, according to Bunkar Dastkar Adhikar Manch, an outfit that lobbies for them.

Globalisation and westernisation help explain this. Many city-dwelling Indian women have adopted Western-style dress, reserving the sari for weddings and other traditional events. And young women, in particular, often tend to prefer cheaper, plainer saris—made by machines and decorated with garish glitter and beadwork.

The silk used in these garments is mostly produced in the industrialised cities of southern and western India, or imported from China. Some of Varanasi's weavers are reported to have migrated to Gujarat in western India to operate power-looms. And those who remain are failing dismally to adapt to the changing times. Too poor to invest in power-looms, they are too divided, and perhaps naive, to wrest greater control of their market from exploitative middlemen.

It would help if a few more were educated. In school-time, the streets and murky houses are filled with children—including many skilled weavers. In one hovel, seven-year-old Ashraf is working a ten-hour day alongside his gaunt and bearded grandfather. The rainbow-coloured sari growing under their fingers will take ten days to make, and earn them 600 rupees. After they have finished it, they have no more work lined up.

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WORLD

MIDDLE EAST & AFRICA

Ghana's election

A damned close-run thing—and a fine example to the rest of Africa

Jan 8th 2009

From The Economist print edition

Reuters



The opposition wins. So do Africa and democracy

IN THE end, the presidential run-off proved to be every bit as tight as the first round of voting on December 7th. On that occasion, the candidate of the ruling New Patriotic Party (NPP), Nana Akufo-Addo, triumphed by a very small margin over his main rival, John Atta Mills of the National Democratic Congress (NDC)—but not by enough votes to avoid a run-off. At the second time of asking, however, on December 28th, the result was reversed—by such a tiny number of votes that the electoral commission had to rerun the vote in one district just to make sure. Only on January 2nd was Mr Mills officially declared the winner; he was sworn in as president five days later. He got nearly 50.2% of the vote, compared with 49.8% for Mr Akufo-Addo. It was the smallest margin of victory in Africa's electoral history.

Just as important as the result was the conduct of the poll—and the readiness of the loser to accept defeat with grace. After fiascos in Kenya, Nigeria and Zimbabwe in the past couple of years, everyone in Africa (and abroad) was hoping that Ghana would start to redeem the continent's tarnished democratic credentials with a fair poll. The power-sharing agreement that was meant to resolve last year's electoral stand-off in Kenya seems increasingly shaky; the one in Zimbabwe was never implemented. Africa needed a decent election in one of its leading countries—and a loser who would concede defeat.

There were a few wobbles on the way, but in the end Ghana did not disappoint. The campaign was hard-fought and often bitter in tone. There were several reports of intimidation and attacks at polling stations during the run-off on December 28th, more so than in the first round of voting. With the result so close, it was inevitable that tempers should flare a bit; police had to control a raucous crowd outside the electoral commission on December 30th with water canon. But in the end both parties' appeals for calm were respected and, crucially, Mr Akufo-Addo quickly conceded defeat after the final result was declared. The much-respected outgoing president, John Kufuor, who belongs to Mr Akufo-Addo's party, accepted the defeat too.

There may yet be some legal wrangling from glum NPP people, but all foreign and domestic observers seemed

happy with the election, so the result should stand. Furthermore, after all the harsh rhetoric, Mr Mills managed to sound as conciliatory as possible in his acceptance speech. Indeed, he had little choice. Such a narrow victory hardly gives him a ringing mandate to govern, let alone force through radical changes. And though his party increased its number of seats in Parliament in the election on December 7th to become the single biggest party, the NDC still lacks an overall majority. That will make it easy for opposition parties, led by the NPP, to frustrate the government's legislative ambitions if they unite on specific issues.

Ghana has been one of Africa's successes in recent years. Since the return to democratic government in 1992 after decades of military rule, human rights and individual freedoms have been strengthened and the economy has been growing at a perky average of 6% a year. But some parts of the country remain wretchedly poor, particularly in the north. That is partly why the centre-left NDC won its victory.

Mr Mills, a former academic who was vice-president in the late 1990s, is a moderate with little apparent inclination to change the broadly free-market policies of Mr Kufuor's governments over the past eight years. But he will hear calls from the left wing of his own party to do so. They will be amplified by the populist and charismatic former president, Jerry Rawlings. He did much in the campaign to rally the party's rank and file, so he and his supporters will expect the government to spend more on their people through social projects as a reward. Yet opening the spending taps would widen the current-account deficit and increase inflation, which is already rising. A contest between Messrs Mills and Rawlings over the new government's direction may be as intense as the battle Mr Mills has just won for the presidency.

Oil, however, may help the new man. Its discovery offshore two years ago could provide the new government with revenues of as much as \$3 billion a year as early as 2010, half as much again as it gets at the moment. But oil has corrupted and polluted Nigeria, just down the coast. Having avoided Kenya's and Zimbabwe's electoral failures, everybody will now be watching to see whether Ghana can avoid Nigeria's hydrocarbon mistakes.

Ethiopia and Somalia

Back into the abyss?

Jan 8th 2009 | NAIROBI

From The Economist print edition

Scary possibilities for the future of Africa's most utterly failed state



EXACTLY two years after it invaded Somalia with American encouragement, Ethiopia has begun to withdraw its remaining 3,000 troops. It will keep its spy network in place and will patrol its borders aggressively against incursions by jihadists. But it will no longer take responsibility for keeping order in what is probably the most violent, hungry and smashed-up country in the world.

Ethiopia is trying to portray its withdrawal as a success. Maybe so, if judged by the narrow criteria of securing Ethiopia from a full-scale attack by Somali Islamists and irredentists determined to "recover" the eastern bits of Ethiopia inhabited by ethnic Somalis and then to draw them into a Greater Somalia caliphate. But the biggest question about the withdrawal concerns Somalia's own future.

Optimists say the resignation on December 29th of Somalia's president, Abdullahi Yusuf, is a hopeful sign that a UN-brokered peace deal between the feeble transitional government and moderate Islamists may be taking hold. Mr Yusuf favoured warlordism over reconciliation, goes this argument, so the chances of peace should improve markedly with his departure. There is talk of electing a new president within weeks.

But the pessimists have the stronger case. A mission of 1,600 Ugandan and 1,300 Burundian peacekeepers still in Mogadishu under an African Union (AU) mandate will also pull out within weeks unless they get extra support. That seems unlikely. Nigeria, Malawi and Ghana have shown no sign of honouring their pledges to send troops, nor is it clear that any other AU country has the logistical back-up the Ugandans and Burundians are asking for. American and European governments, whose navies are patrolling Somalia's waters against pirates, together with Chinese, Indian and other ships, have ruled out military intervention inside Somalia itself. So Ethiopia's withdrawal may simply leave a power vacuum, to be filled in short order by Islamist militias that are now even more dangerous than those crushed by the original invasion at the end of 2006.

Mr Yusuf's gunmen may return north to their more or less autonomous homeland in Puntland, perhaps to profit from piracy. Various armed groups would then fight for control of Mogadishu, Somalia's capital, and of central

Somalia. These include a patchwork of militias loyal to rival clan elders and warlords, along with moderate Islamists, radical Islamists and private security groups hired by businessmen.

The radical Islamists known as the Shabab (Youth) are the best-organised and most ruthless. If the moderate Islamists find more in common with the Shabab than with the warlords and what is left of the transitional government, the fighting could be as bad as at any time since Somalia imploded in 1992. The outcome will depend partly on who has most cash to keep paying the gunmen. That is why all sides will battle for ports, markets, slaughterhouses, banana plantations—and anything else that earns a bit of money.



Iraq

Sovereign, sort of

Jan 8th 2009 | BAGHDAD
From The Economist print edition

Iraq regains more of its sovereignty, but it is unclear what that will entail

TWO new flags flying over the Green Zone, the fortified swathe of central Baghdad on the west bank of the Tigris river, symbolise a power shift—on paper, a fundamental one—from the United States to Iraq that took place on New Year's Day. The Iraqi colours once again flutter outside Saddam Hussein's old presidential palace, for nearly six years the American-led coalition's seat of power. Down the road, still in the zone, the Stars and Stripes now flies over the world's largest American embassy, which opened officially on January 5th.

At the start of the year, with the expiry of their UN Security Council mandate, the 146,000-odd American troops across the country also came under the Iraqi government's authority for the first time since the invasion of 2003. As part of a security agreement between Iraq and America, the American troops should withdraw from Iraq's cities by the middle of this year and leave the country altogether by the end of 2011. Relishing the moment, Nuri al-Maliki, Iraq's prime minister, proposed that January 1st be declared a national holiday to celebrate Iraq's regained sovereignty.

But many Iraqis say that too few real changes have yet occurred on the ground to make them feel that their country is truly sovereign again. That, they say, will happen only when the last American soldier has gone. American soldiers still help man the main checkpoints between the rest of Baghdad and the Green Zone, though Iraqi soldiers are increasingly prominent there too.

Now the road outside the presidential palace, hitherto controlled by the Americans, is closed; part of a car park opposite has been cleared of vehicles. The Iraqi government insisted that all officials from the coalition countries, starting with America's proconsul, Ryan Crocker, should vacate the palace completely by December 31st, prompting a hectic dash to remove files and equipment in time.

But in a sign of friction among Iraqis, no one has yet moved in, since Mr Maliki and Jalal Talabani, Iraq's president, who heads one of the two main Kurdish parties, both claim a right to the massive marble-floored building. Barham Salih, one of two deputy prime ministers, dismissed the stand-off with a smile. "This is politics," he said. "This is what Iraq is all about."

In military terms, a shift in the nominal authority over counter-insurgency operations from American to Iraqi hands, which has been happening province by province over the past two years, has yet to make much difference on the ground: American forces still provide the critical air power, logistics and communications that underpin the war effort in areas where fighting is still going on, particularly Nineveh province in the north. But there has been a steady improvement in the quality of Iraqi troops, who now number more than 267,000, alongside 262,000 local police and 37,000 border guards. There are also more than 100,000 "Sons of Iraq", many of them former insurgents, in militias formed by the mainly Sunni tribal councils; some are being folded into the army and police.

Another tricky issue is the fate of some 18,000 detainees still in American hands. Under the Iraqi-American security accord, they should now come under Iraqi jurisdiction. A new committee is assessing them case by case. In theory, they should either be freed or, if there is enough evidence, prosecuted. Several hundred are foreigners suspected of being jihadists; it is most unlikely that either the Americans or the Iraqis will let them loose, whether or not there is enough evidence for prosecution. And even the local ones cannot count on a mass early release, which Iraq's Sunni politicians are calling for. Most of them are Sunnis and Iraq's new Shia establishment is wary of what they might do, even in a more sovereign country.

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WORLD
MIDDLE EAST & AFRICA**Morocco****The sacred and the profane**

Jan 8th 2009 | RABAT

From The Economist print edition

It remains a crime to criticise the king, who still has the final say

DRIVE into Morocco's countryside and you are likely to come across neat piles of white stones stacked on hillsides, forming giant Arabic letters that spell out the country's motto, "Allah, al-Watan, al-Malik" (God, the Nation, the King). These words are officially sacred: any challenge to what they represent is punishable by law. King Muhammad VI's Morocco has made much progress towards freedom of speech, but his regime still enforces the three-word motto with alacrity.

McDonald's, America's fast-food giant, recently discovered the limits of that tolerance when it was forced to apologise after distributing a map of its restaurants in Morocco without including the disputed Western Sahara as part of the kingdom. Despite calls for a boycott in the nationalist press, the chain's swift self-abasement sufficed to quell the row, perhaps because it had already proved its commitment to national integrity by marketing a "McSahara" hamburger.

But other offenders have got off less lightly. In recent years, as the result of a spate of libel suits, journalists have had to pay ever-bigger fines which, press watchdogs say, are aimed at muzzling the independent press. Rachid Niny, editor of the bestselling populist daily *al-Massae*, was fined 600,000 dirhams (about \$70,000), only a month after a court had told him to pay a record fine of 6m dirhams in another case. Mr Niny says that the growing size of the fines is meant to shut down his newspaper.

Two of Morocco's most outspoken journalists have had to go into exile. Ali Lamrabet was banned from practising his profession, and Aboubakr Jamai fled to escape a massive fine. Other cases against leading journalists are pending; one has been charged with "prejudice to the person of the monarch". The regime's political opponents face similar sanctions. Nadia Yassine, daughter of the leader of Morocco's largest Islamist group, al-Adl wa al-Ihsan (Justice and Benevolence), has had a trial for *lèse-majesté* pending for three years, since she claimed in a casual remark to a journalist that she was not averse to having a republic.

Justice and Benevolence is an unusual Islamist movement. It combines Sufi mysticism, modern political language and the personality cult of its leader, Sheikh Abdesalem Yassine. It is also the country's sole remaining serious political force that has not been brought into the official fold. Most other dissidents, on left and right, made their peace with the regime more than a decade ago, when King Hassan II, who died in 1999, was paving the way for his son. But followers of Justice and Benevolence refuse to take part until two of the constitution's articles are revised: the 19th, which gives a lot of power to the king, recognising him as Commander of the Faithful, thus heir to the Prophet Muhammad and rightful leader of Morocco's Muslims; and the 23rd, which states that "the person of the king is sacred and inviolate". As a result, Justice and Benevolence faces steady repression. It is not certain that it will still refuse to compromise once Sheikh Yassine, now a fragile 80-year-old, has gone. But the rewards for joining mainstream politics look less tempting than before.

Abdelilah Benkirane, leader of Morocco's other big Islamist group, the Justice and Development Party, the largest opposition force in parliament, accepts that his movement's transition from secrecy to full integration has come at a price; it is kept in check by electoral shenanigans and other means. "The public is deeply dissatisfied with political parties, which operate under severe restrictions," he says, pointing to a record low turnout in a general election in 2007, when his party came second rather than winning handsomely, as expected.

Mr Benkirane is no revolutionary. "I am deeply committed to this state, to the role of the king as holder of the balance between different parts of our national identity," he says. "But there are only two ways to get out of this impasse. Either, against all odds, we remove the administration's tight control of politics or we show we can make an impact by taking part in government." But so far the regime seems bent on continuing to exclude

Justice and Development from a governing coalition, which coalesced on an anti-Islamist platform.

Many secular-minded politicians agree that the regime controls politics too tightly. The biggest parties are hamstrung by their deference to the old establishment and by a phenomenon that some Moroccans call “transhumance”: the way politicians connected to the palace change their affiliation according to the calculations of the day. “We were right to integrate our parties into the system after wasting too many years fighting or boycotting it,” says a former minister from a left-wing party. “But we must keep up the pressure.”

Yet whereas Morocco’s monarchy has nimbly managed the transition from Hassan II to Muhammad VI and has steadied politics by opening it up to former dissidents, most political parties have not quite adapted to the new system, nor have they shown much sign of democracy within themselves. So people see little point in politics, reckoning that “all real decisions”, as they tend to put it, are still made in the palace or the interior ministry.

Nice enough when he’s home

As a result, the king has come under greater scrutiny by his people. He is said to be both reclusive and thin-skinned, occasionally losing his temper with his advisers. He spends a lot of time outside the country; at one point last year, the cabinet found itself constitutionally unable to enact new laws because he had been away for several months. When he comes home, he catches up on lost time by criss-crossing his country, opening new public facilities and dispensing largesse as ministers and governors trot along behind.

In September a court in the southern town of Agadir sentenced a blogger, Muhammad Erraji, to two years in prison plus a fine. Mr Erraji had criticised the king’s habit of doling out gifts on his trips, arguing that it encouraged a “culture of dependency”. Though the verdict was overturned, it showed that the taboo against directly criticising the king is still fiercely upheld. Later that month another young man, Yassine Bellasal, was sentenced to a year in prison (suspended) and a fine for offending the king. Mr Bellasal’s crime was to spray a spoof graffito of the national moto—“God, the Nation, the Barça”—replacing the monarch with his favourite football club, FC Barcelona. An appeals court recently upheld the verdict, suggesting that, even in football-mad Morocco, some things are still considered more sacred than the beautiful game.

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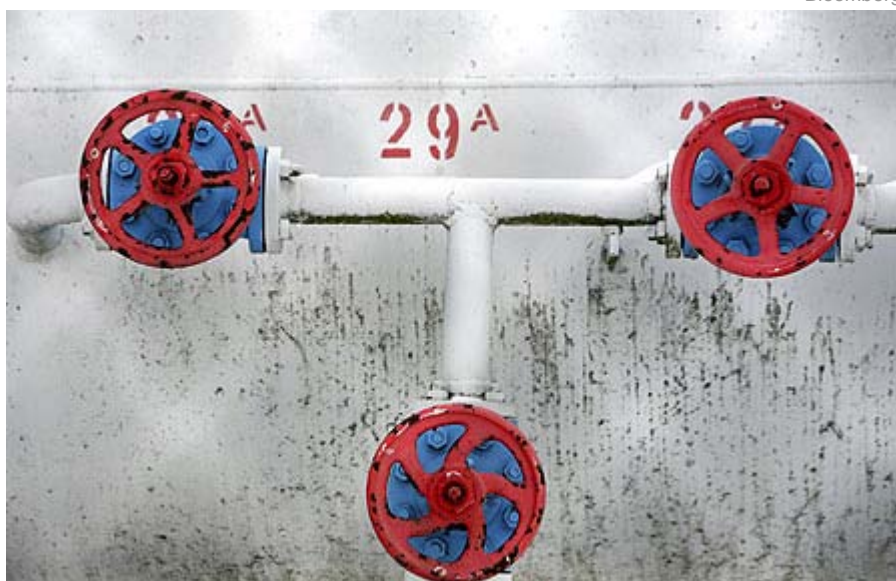
WORLD
EUROPE

Russia, Ukraine and gas

Pipe down

Jan 8th 2009 | MOSCOW

From The Economist print edition



The annual gas squabble between Russia and Ukraine turns nastier—to the alarm of much of Europe

IT STARTED as an ordinary gas dispute between Russia and Ukraine, of the sort that has occurred every winter since January 2006, when Russia first cut off gas supplies to its neighbour. But it has since grown into the biggest energy emergency the European Union has seen in years.

Just before the new year, European consumers received a letter from Alexei Miller, head of Gazprom, Russia's gas giant. "Gazprom is doing everything possible to avoid any disruption of gas deliveries to Europe," it said. "However, if events develop along an unfavourable scenario, the problem of Ukrainian transit will be a common problem for Russia and Europe."

The EU, which gets a quarter of its gas from Russia, mostly through Ukraine, watched the two sides exchange accusations, but stayed out of the row. It went out of its way not to lay blame and to treat it as a technical dispute. "The EU trusts that we can count upon assurances given that gas supplies to the EU will be unaffected," said Andris Piebalgs, the energy commissioner.

Despite a worsening economy, Ukraine felt confident: it had enough gas stocks to last until the spring, and it could confiscate Russian gas. Russia cited a transit agreement it signed three years ago to separate EU contracts from those with Ukraine. But on January 5th both sides pushed the conflict over a new red line. A dubious court ruling in Kiev annulled the transit agreement. Hours later, Vladimir Putin, Russia's prime minister, abruptly ordered Gazprom to reduce gas supplies to Europe through Ukraine by the amount Ukraine was said to be stealing from Russia (a charge Ukraine denies).

"Ukraine had neither the need nor the intention to steal Russian gas," insists Hryhory Nemyria, Ukraine's deputy prime minister. Gazprom's erratic behaviour, he adds, was threatening to undermine a complex transit system. All Ukraine had been doing was taking enough "technical" gas to ensure that the system continued to function.

The Russian demand that Ukraine should compensate EU customers for the loss of gas out of its own reserves was simply unreasonable, said Mr Nemyria.

It is still fuzzy who was ultimately responsible for deciding to cut the gas to central and western Europe. But some countries felt the effects immediately, in bitterly cold weather. Hungary, Slovakia, Bulgaria and Romania were hit hard, but the gas freeze also affected Germany, France and Italy. As attitudes hardened, Mr Putin insisted that no gas at all should cross the border. His direct personal involvement has now made the dispute more political.

Throughout, Russia has portrayed Ukraine as a flaky transit country that is jeopardising European energy security and is thus unfit for any form of integration with the EU. Alexander Medvedev, deputy chief executive of Gazprom, declared that Ukraine had blocked the transit pipeline and "is responsible for everything that has happened." The Ukrainians insist the conflict has exposed Russia (yet again) as a bully that uses gas as a political weapon.

Ukraine has no contractual agreement with EU customers, though it has ratified the EU's energy charter, whereas Russia has not. Gazprom still has an obligation to deliver gas. Russia's gas reservoirs are full; unless it resumes pumping soon, it may have to start burning gas. The two sides have now restarted talks and agreed to let international observers monitor the pipeline, which could be a signal of renewed gas flow. Yet both countries' reputations have suffered.

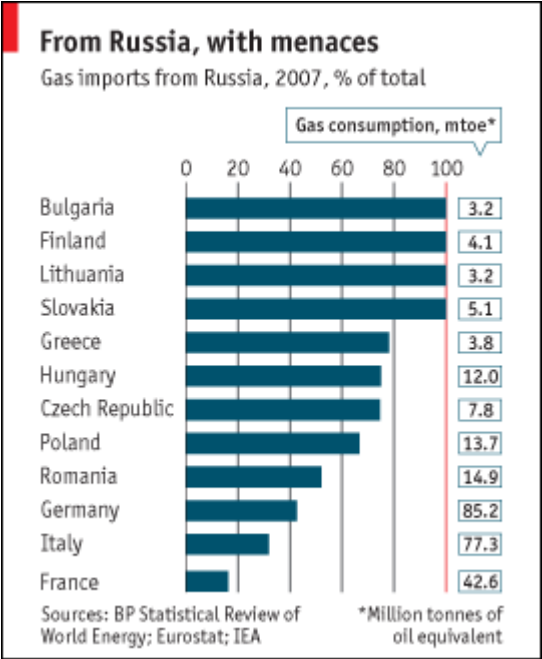
The dispute has several layers. The first is about money. For years Ukraine has been paying below market prices for gas. Gazprom's (reasonable) argument has been that Ukraine, which last year paid \$179.50 for 1,000 cubic metres, should pay market prices that are more than twice as high. Last October Russia and Ukraine agreed to make a gradual transition to market prices and long-term direct contracts.

The question is what market prices mean. Although it has been underpaying for its gas, Ukraine says it was also undercharging Gazprom for gas transit to Europe. Its transit fee of \$1.60 for 1,000 cubic metres per 100km is half what is charged for transit by some other countries. Gazprom has offered to sell gas to Ukraine at \$250 for 1,000 cubic metres while leaving the transit fee unchanged. Ukraine's counterbid was to pay \$201 only if the transit fee was raised to at least \$2.

Had this been a purely commercial dispute, a compromise would surely have been struck. But as ever with Russia and its neighbours, there are second-layer political undercurrents. Little love has been lost between Ukraine and Russia ever since the "orange revolution" brought anti-Russians to power in Kiev four years ago. Recently, Russia has accused the Ukrainians of supplying arms to Georgia during the war in August and said it would take this into account when forming its policy. "A more serious crime than arms deliveries in a conflict zone cannot be imagined," Mr Putin told Yulia Tymoshenko, his Ukrainian counterpart, when the two discussed gas prices in October.

The third layer is the political rivalry within Ukraine between Ms Tymoshenko and the president, Viktor Yushchenko. What complicates matters is a controversial intermediary, RosUkrEnergo, which is part-owned by some Ukrainian businessmen and Gazprom. It was set up on Mr Yushchenko's watch and Ms Tymoshenko wants to scrap it. This may explain why, when Ms Tymoshenko was ready to fly to Moscow to conclude negotiations on December 31st, Mr Yushchenko stepped in to undermine her (in a different version, her trip was called off by Moscow).

Europe has long stood aside from Russia's fraught gas relationship with Ukraine. It now has no choice but to jump in. The main lesson from this crisis, says Gazprom, is that alternative pipelines bypassing Ukraine are needed. Ukraine retorts that further integration with the EU is the answer. But until Europe diversifies its sources of energy, it will remain hostage to Russia's rows with its neighbours.



France's minority politicians

Ethnic troubles

Jan 8th 2009 | PARIS

From The Economist print edition

In different ways, Nicolas Sarkozy's racial-minority ministers are causing him grief

WHEN France's Nicolas Sarkozy picked three women from racial-minority groups to join his government in 2007, the appointments seemed as daring as the casting looked perfect. In a country with few minority stars outside sport and entertainment, and only a single black parliamentarian from the mainland, the president's new faces brought freshness and modernity. He also upstaged the Socialist Party, which preaches anti-racism but never appointed any minority ministers when in power. And his selection deftly acknowledged France's diversity: the Maghreb, black Africa and the heavily Muslim French *banlieues*.

AFP



Dati before delivery

Two ministers—Rachida Dati, the glamorous justice minister, and Fadela Amara, the cities minister—are of North African origin, born to working-class immigrant parents and raised on grim French housing estates. The third—Rama Yade, the young human-rights minister—is the Senegalese-born daughter of a diplomat, whose family emigrated to France and who made it to an elite French university, Sciences-Po. All three come from a Muslim background.

Eighteen months on, however, and Mr Sarkozy is finding that his feisty minority ministers are giving him more than a spot of trouble. The biggest headache has been Ms Dati—and not because, at the age of 43, she has just given birth to a baby girl whose mystery father she declines to identify. (The French, to their credit, consider such affairs to be a private matter, and the media have devoted little space to the birth.) Rather, it is the high-handed way in which Ms Dati has carried out her job, combined with her taste for the high life.

Much of the substance of Ms Dati's reforms of the judicial system makes sense. This week plans were unveiled to abolish France's controversial investigating magistrates, who have huge powers both to investigate suspects and to send them for trial, and whose solitary role has been blamed for some recent miscarriages of justice. Other reforms include the geographical reorganisation of the courts, whose distribution has not changed in nearly 50 years despite big population shifts, and the introduction of minimum sentences for repeat offenders.

Yet Ms Dati's clumsy dealings early in her tenure with protesting magistrates and judges have succeeded only in rallying them against her, making her later efforts at reform a lot harder. An exasperated Mr Sarkozy has had to take matters into his own hands, at one point holding talks with a magistrates' union without her. Even though she rushed back to work this week after a mere five days' maternity leave, it was he who announced the scrapping of investigating magistrates. Ms Dati's designer tastes—she once posed for the cover of *Paris-Match* in a pink leopard-print Dior evening dress—and imperious manner have not won her friends. In her short time in office, two directors of her cabinet have resigned, and several other staff.

Ms Dati is the most senior minority minister, but Mr Sarkozy has also had a stormy time with Ms Yade, who handles human rights at the foreign ministry. When the president invited Libya's Muammar Qaddafi to Paris, she insisted to a newspaper that France was "not a doormat on which a leader, terrorist or not, can come to wipe the blood of his crimes from his feet". Mr Sarkozy was not amused. More recently, the 32-year-old refused his request that she should stand for election to the European Parliament in June. She would prefer, she said sniffily, to win a "national electoral mandate".

The least controversial of the three is Ms Amara—although even she once breached political etiquette by calling the government's plans for DNA tests for immigrants "disgusting". Ms Amara's problem has been neither poor judgment nor mismanagement but rather a lack of money to put much flesh on her *plan banlieue*, an attempt to revive prospects in the French suburbs. Her down-to-earth approach—she still lives in her two-room flat in eastern Paris, refusing grand official lodgings—and her plain-talking style go down well with voters. In a recent popularity poll, despite her relative invisibility, she ranked four places ahead of Ms Dati.

The difficulty for Mr Sarkozy is that he cannot afford to let any of his minority ministers fail. Long before his election as president he argued the case for a Condoleezza Rice *à la française*. Barack Obama's election has added urgency to the efforts to find one. Even if Mr Sarkozy were to move Ms Dati, say, he would probably have to offer her another job. Any hint at incompetence would be seized on, however absurdly, as racism. In the short run, the answer, as with most such puzzles, will probably be for the Elysée quietly to take charge of troublesome dossiers—if, that is, it has not done so already.

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Montenegro's economy

Not quite a crash

Jan 8th 2009 | PODGORICA

From The Economist print edition

But the fallout from the world's economic slowdown may be large

Correction to this article

A RECENT Montenegrin [video](#), released on the internet, shows two shrieking teenagers filming the speedometer of their car as they roar through a tunnel at 260kph (160mph). Although the appearance of the film earned the boys criminal charges, at least they did not crash. In a curious manner, the video mirrors Montenegro's present fate. After three years of breakneck growth, the economy is rapidly slowing down. It has not quite crashed—but the aftershocks could still be nasty.

Tim Judah



A toxic red aluminium lake

The capital, Podgorica, has been expanding fast in recent years. Flats and offices have sprouted all round the city's edge as developers flush with cash from sales of villas and apartments on the coast to Russian, British and other investors have poured the proceeds into new property. But in the past few months, as the number of foreigners investing in coastal property has dried up, so has the cash. Workers at many building sites across the city have lost their jobs. Property prices have fallen by 50% or more.

Down by the coast things are as bad or worse. Planned developments, many aimed at rich Russians, have been scaled back, though the government hopes to lure Gulf Arab investors to take their place. Growth figures say it all. In 2006, the year it declared independence, Montenegro's economy grew by 8.6%. In 2007 it accelerated to 10.7%. Last year the government forecast 8%, but the correct figure will be lower. And in 2009 the government is planning for growth of only 5%—and the IMF is talking of a mere 2%.

That will be disappointing to the Montenegrins, even if in these hard times some growth is better than none. But the government is also grimly aware that, besides coping with the general fallout from the global financial crisis, it faces two home-grown problems. The biggest is a huge aluminium factory on the edge of Podgorica. Its fumes are toxic, it makes a loss and it consumes gargantuan quantities of subsidised electricity. It is controlled by Oleg Deripaska, a Russian tycoon well known in Britain and elsewhere, who is now locked in disputes with the Montenegrins. Aluminium prices have crashed; unless he keeps getting subsidised electricity from the government, he will, he says, have to shut the whole place down.

In any other country this might not be front-page news. The problem for tiny Montenegro, with a population of only 650,000, says Sasa Popovic, an economist, is that the factory and its related industries account for a vast 40% of GDP. So its closure would be a huge political blow to the government of Milo Djukanovic, the prime minister.

He has already been embarrassed by a second matter. In December the government had to bail out a troubled bank owned, in large part, by his brother and, to a lesser extent, by his sister and himself. That Prva Banka was considered the family bank lured large numbers of people, companies and even government departments to transfer their accounts to it. But the end of the boom means that many of the bank's borrowers cannot pay back their debts. "We are very nicely packaged from the outside," says Daliborka Uljarevic, an analyst, "but when you open the box it does not look so nice inside."

Gordana Djurovic, Montenegro's Europe minister, admits that the bank affair seems "unusual" but insists that no laws were breached and that the cost of doing nothing was higher than the cost of doing something. Understandably she is keener to talk about good news. Just before Christmas Montenegro lodged a formal application for the status of candidate to join the European Union. Formal candidacy is "realistic" by December, claims Ms Djurovic.

Montenegro may by then have a new government. An election may even be called for March 29th. Mr Djukanovic is currently riding high in the polls, but much of that reflects the disarray of the opposition rather than his own personal popularity. Mr Popovic reckons that Montenegro's economy may not crash but go into a kind of hibernation. That might give the opposition a chance to reorganise and make up lost ground—which explains why the prime minister may choose to go to the country sooner rather than later.

Correction: the original version of this article referred to Daliborka Uljarevic as a financial analyst. She is in fact Executive Director of the Centre for Civic Education. This was corrected on January 9th 2009.



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WORLD
EUROPE

The left in Italy

Scuola di scandalo

Jan 8th 2009 | ROME

From The Economist print edition

A sad lesson that scandal is not the preserve of the right

WALTER VELTRONI, leader of Italy's main opposition Democratic Party (PD), asserted recently that his was a "party of good people". Mesmerised by the spectacle of a prime minister, Silvio Berlusconi, whose political career has been lived one step ahead of the courtroom, most non-Italians have been prepared to take such remarks at face value. Italy's centre-left may be a bit dull and worthy, and somewhat tarnished by the communist past of many of its leaders (including Mr Veltroni). But, give or take a rotten apple, it has always seemed fundamentally honest.

Yet in little more than a month, that benign view has been swept away in a slew of prosecutors' warrants and summonses. On January 5th the centre-left mayor of Naples, Rosa Russo Iervolino, unveiled a new and reshuffled city administration. There were six new faces in her 16-strong team. Four of their predecessors had been arrested on suspicion of taking part in what prosecutors claim was a plan for the "systematic looting" of public funds. A fifth had committed suicide after he too came under investigation for corruption and other alleged offences.

The scandal in Naples, which revolves around a €400m (\$545m) public-services contract, is the most substantial but by no means the only one to have assailed the opposition. Since the end of November, centre-left politicians have been put under suspicion, or even arrest, in seven other cities and regions.

The PD was created by a merger between a party composed of former communists who had disowned Marxism and another that provided a home for the more progressively inclined Christian Democrats, whose movement collapsed in a welter of graft allegations in the early 1990s. The Christian Democrats were known for their cronyistic, patronage-based style of politics. Now it seems that old practices die hard, and that they have infected parts of the PD like a cancer.

The devastating impact of corruption allegations on the opposition was highlighted in mid-December, when Mr Berlusconi's party swept to victory in an election in Abruzzo. The vote had been forced by the resignation in July of the PD's regional governor after he was arrested and jailed, accused of taking a €6m bribe. The PD's share of the vote plunged from 35% three years ago to less than 20%. A rival opposition party, the Italy of Principles party, increased its share of the vote fivefold to 15%.

Italy of Principles is led by Antonio Di Pietro, a former prosecutor who leapt to national prominence when he tried to nail Mr Berlusconi in court in the so-called "clean hands" anti-corruption drive of 1992-94. Since his old adversary was returned to power last April, he has been more vigorous in opposition than Mr Veltroni, and was gaining on the PD leader even before the Abruzzo poll. But Mr Di Pietro too has now had his wings clipped. His son, Cristiano, a provincial lawmaker, quit the party after he was caught up in the Naples sleaze inquiry. Transcripts were leaked of telephone conversations in which he seemed to be asking for jobs and advancement for his friends.

The sole beneficiary of the scandals is Mr Berlusconi, who has found himself in the novel position of being able to talk reproachfully and credibly of a "moral issue" facing his rivals. Their embarrassment offers him more than a short-term advantage. He has signalled that his main initiative in 2009 will be a reform of the judiciary that critics fear will hobble the magistrates who have pursued him for more than 15 years. To push through such controversial changes, Mr Berlusconi needs to stake out the moral high ground. Thanks to the left, for perhaps the first time in his long and tempestuous political career he may now be able to do so.

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Poland's public television

Tragedy or farce?

Jan 8th 2009 | WARSAW

From The Economist print edition

A putsch at Poland's public-television enterprise reflects murky politics

Illustration by Peter Schrank



PUBLIC broadcasting in Poland is a fractious business. Ruling parties habitually try to unseat their predecessors' placemen amid howls of protest from opposition parties who did much the same when they were in power. Now the main ruling party, Civic Platform, is enjoying the sight of television bosses installed by the former Law and Justice government being fired. What is odd is that the new boss, Piotr Farfal, comes from the League of Polish Families (LPR), a radical right-wing outfit, normally seen as an arch-enemy by Warsaw's liberals. Yet in this case, the usual criticism is missing.

The story starts with the general election in 2005, after which the LPR, along with another small party, Self-Defence, went into coalition with Law and Justice and won places on the bodies governing public radio and television. The coalition lost the 2007 election and the two smaller parties retreated to the fringes of political life. But now their representatives in public broadcasting have mounted a coup at Polish state television (TVP), suspending the incumbent chairman and two colleagues.

TVP's new boss is Mr Farfal, once active in the LPR's youth wing. As a teenager, he was associated with a skinhead magazine that printed stridently anti-Semitic articles. Now aged 30, Mr Farfal strongly denies that he has extremist views. He says he just wants to make TVP run better.

Leaving aside the inevitable allegations of politicisation, there is plenty of scope for improvement at TVP. Andrzej Wajda, Poland's most eminent film director, has attacked the state broadcaster in an unusually sharp tone for bungling the international distribution of his Oscar-nominated film, "Katyn".

Some wonder if the putsch is the result of a deal between the former LPR leader, Roman Giertych, and the

Civic Platform prime minister, Donald Tusk. The government may secure friendlier coverage in the run-up to the European elections this summer. Mr Farfal has already reinstated a newsreader seen as sympathetic to the government.

This all comes at a time when Poland may have more chance to influence European Union affairs, as its neighbour, the Czech Republic, has taken over the EU's rotating presidency. The need for a better-informed public, given the fragile economies of eastern Europe, has never been greater. The Polish media used to be the best in the region. Squeezed by falling revenues, they have recently become noticeably more sensational. A recent poll has shown young people in Poland disinclined to become involved in political affairs. These latest events are hardly likely to rekindle their enthusiasm.

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WORLD
EUROPE

Charlemagne

Of antibiotics and globalisation

Jan 8th 2009

From The Economist print edition

The surprising link between protectionism and pill-popping

Illustration by Peter Schrank



EUROPE'S leaders began 2009 in a spooked frame of mind, and not just because of wars over Gaza and gas. The street riots in Greece before Christmas left several fretting that conditions may be ripe for wider unrest, even a "European May 1968". The French president, Nicolas Sarkozy, was so alarmed by his chats with fellow European Union summitters in December that he went home and postponed a school reform that was sparking protests.

As unemployment rises, governments are sure to face calls to shield their voters with protectionist barriers to trade. Most EU leaders are sensible folk who know that such policies may look attractive to individuals but would harm the wider public. Whether they are brave enough to explain this to their voters is another matter. Even if they are, voters in some countries may refuse to believe them, taking the view that their rulers are liars, interested only in looking after themselves.

Without a crystal ball, it is impossible to predict where political trouble might strike. So Charlemagne has a suggestion. There has been much recent research into a public-health problem that shares some surprisingly similar features: the overuse of antibiotics. Consumption of these drugs varies strikingly across Europe, with Greeks, the heaviest users, taking three times as many as the Dutch, who use the fewest. Rather like trade protection, the popping of an antibiotic offers false comfort to individuals. In an anonymous 2008 survey, Greek paediatricians said that 85% of parents demanded antibiotics for children with the common cold virus. As with political debates over free trade, some people appear to suffer from a corrosive lack of trust when the authorities tell them that they are demanding the wrong thing. Even when told that antibiotics cannot fight viruses, 65% of Greek parents in the survey insisted they did until their doctors gave in.

Scientists talk of a broad north-south divide in Europe, with the Dutch, Germans, Scandinavians and Baltics consuming few antibiotics, but lots being guzzled in the Mediterranean. The main users are Greece, Cyprus, France and Italy, with Spain almost as high once illicit sales without a prescription are counted. Just as with trade barriers, pill-popping has bad side-effects. For example, in most north European countries, penicillin can deal with a common nasty, streptococcus pneumonia in all but 5% of cases. But in high antibiotic consumers like Cyprus, France and Spain, more than a quarter of cases do not respond to penicillin.

The antibiotic divide has been leapt on by some north Europeans as a stick for bashing feckless Latins. Flemish nationalists from the Dutch-speaking north of Belgium note that Europe's antibiotic frontier runs right through their country, with French-speakers in the south consuming far more than Flemings. Belgians as a whole consume twice as many as their Dutch neighbours. Questions have even been asked in the Belgian parliament about how the kingdom ended up on the wrong side of a "Latin v Calvinist" divide.

Herman Goossens, a Flemish doctor who has also worked in the Netherlands, sees a cultural element to antibiotic use, but is wary of politically charged talk about pill-munching Francophones. He notes that southern Belgium is also home to lots of former coalminers with chronic ailments. He prefers to talk of different attitudes to risk. In the Netherlands, if somebody has a nasty cold and their doctor gives them antibiotics, they will say "my doctor is a coward, he goes straight for the strong drugs," says Mr Goossens. "That is very different in Flanders."

Dominique Monnet, at the European Centre for Disease Prevention and Control, an EU agency, sees a link between drug use and a population's tolerance of uncertainty. But he adds caveats. Germany's low use of antibiotics, for example, must take into account the popularity of alternative medicine, he says. One study found that 40% of Germans disliked antibiotics, fearing they weaken the body's natural immunities.

And economic and structural factors cannot be ignored. Some countries require a doctor's certificate for people off work with flu—and, while at the doctor, why not ask for a prescription? Some impose drug budgets on family doctors, which they may not exceed. Expensive modern antibiotics are less often prescribed in ex-communist countries. Places like Belgium and France allow patients to shop around among doctors, so that those who refuse to prescribe may lose income. In Greece, Italy and Spain, it is shockingly easy to buy antibiotics without a prescription, and self-medication is popular. An undercover survey in Athens in 2008 secured antibiotics without a prescription in almost all the pharmacies visited.

The protectionist drug

But above all, many experts come back to levels of anxiety, and intolerance for uncertainty, as a key driver of antibiotic demand. And this may explain one final correlation. A Eurobarometer poll last year asked Europeans whether globalisation offered an opportunity for economic growth. The map of the results is remarkably similar to the map of antibiotic consumption. Compare countries that use the most antibiotics with those most sceptical of the benefits of globalisation. Four of the top five match; and, at the other end of the scale, six of the bottom ten match. (America, a place addicted to interventionist medicine, would be near the top of an EU chart for antibiotic use: it is also a country currently wrestling with strong protectionist instincts.)

Yet this correlation also gives grounds for hope. Education and transparency work wonders in reducing antibiotic use: public information campaigns in France and Belgium have been notably successful. Cultural differences cannot be erased altogether: some societies will always be more trusting or anxious than others. But trust can be built. Many forms of protection are illusory, and may harm your family and neighbours. Those in authority should explain this, whether it is a popular message or not.

Interest rates

Combating the recession

Jan 8th 2009

From The Economist print edition

The base rate falls to an all-time low in the battle against the downturn

Eyevine

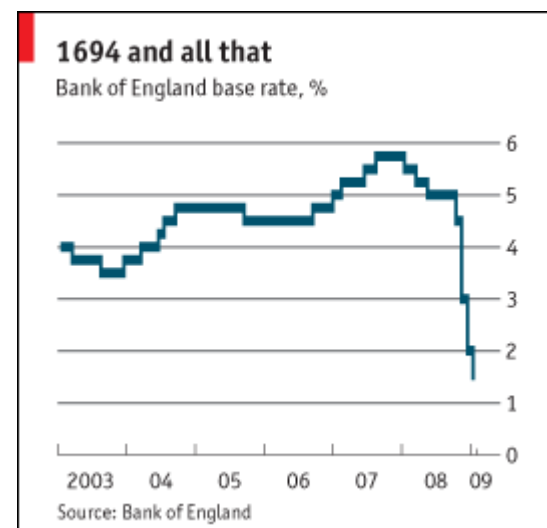


THE decision made history. On January 8th the Bank of England cut the base rate from 2% to 1.5%, the lowest since the central bank was founded in 1694. The Bank of England's mission then was to provide war finance. Its task now is to fight a recession that looks increasingly likely to be the worst since the second world war.

The bank's latest move means that the base rate has now fallen by an extraordinary 3.5 percentage points since the start of October (see chart). It followed a clutch of closely watched business surveys of purchasing managers that painted a dismal picture of the economy in December. Manufacturing was mired in the deepest downturn since the survey started in 1992. Construction activity plumbed new depths. And activity in private services stayed close to its record low in November.

The findings, together with earlier surveys, confirm that the recession intensified towards the end of last year. Official figures published in late December showed that GDP fell in the third quarter by 0.6%—rather than the original estimate of 0.5%—from its level in the spring. It now looks as if GDP declined by a further 1% or so in the last three months of 2008, according to Capital Economics, a consultancy.

The outlook for 2009 is dispiriting. Despite the fillip from the temporary reduction in value-added tax, consumer spending will fall sharply. Households will retrench as unemployment rises and those with jobs fear they may lose them. Spending will be hit, too, by weak stockmarkets and shrinking housing wealth. House prices fell by 15.9%



in the year to December, according to Nationwide Building Society.

The economy will also be clobbered by cuts in capital spending. Since the prices of homes still have a long way to fall, housing investment will remain depressed. Businesses are already cutting their capital programmes, with more to come in the year ahead. Capital Economics is predicting that GDP will fall by 2.5% in 2009, the biggest annual decline in the past 60 years.

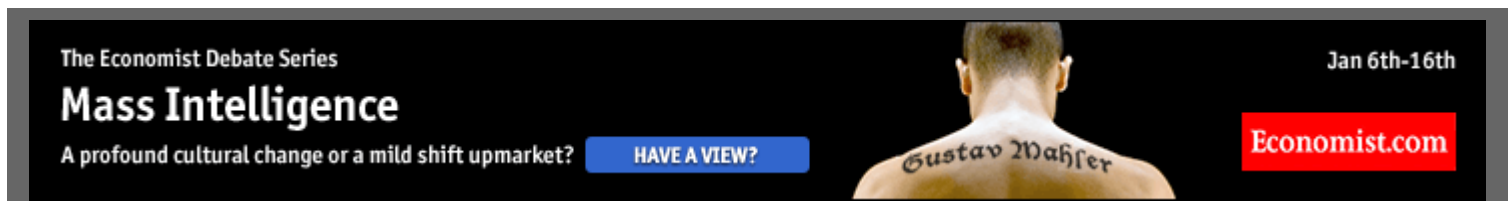
A common cause of these downward pressures on the economy is the banking malaise, which has undermined equity and property markets and curtailed the routine provision of finance to business. That makes it all the more ominous that banks are expecting to restrict credit still further. A survey by the Bank of England published on January 2nd found that lenders had reduced the availability of credit to both households and companies in the three months to mid-December and expected to curb it still further in the first quarter of 2009.

Banks' reluctance to lend as they strive to repair their overstretched balance-sheets is impairing the effectiveness of monetary policy. But the sheer scale of rate cuts over the past three months is helping many indebted households. About half of mortgage borrowers have variable-rate loans and are therefore generally benefiting from the reduced cost of servicing their debt. Savers are grumbling about the sharp fall in interest rates on their deposits and the Conservative opposition has pledged tax concessions to help them. Yet, however unfair it may seem to the thrifty, rate cuts are needed to boost the overall economy.

Another way in which monetary policy retains some of its clout is through the exchange rate. Ahead of the Bank of England's decision, the pound clambered back from near parity against the euro at the end of last year to €1.11 on January 7th as gathering gloom about the euro area's prospects led foreign-exchange dealers to factor in an early cut in European interest rates. But the hefty depreciation of around a quarter in sterling's trade-weighted value since mid-2007 will still bolster the economy by making British producers of tradable goods and services more competitive both in foreign markets and at home.

The fall in sterling will also blunt deflationary pressures that might otherwise exacerbate the credit crisis, since when prices start falling the burden of debt rises in real terms. As consumer-price inflation was still 4.1% in the year to November, deflation might seem a remote prospect. But inflation will tumble in the coming months because of lower oil prices and the recession.

Despite this help for the economy from looser monetary policy, the worry is that the Bank of England is running out of ammunition as the base rate heads towards zero. And in any case the conventional strategy of lower rates may not be strong enough as long as banks continue to restrict credit. One solution would be to force-feed them with even more capital, but Gordon Brown said on January 4th that this was not a front-runner among possible new measures. Nor is "quantitative easing"—printing money to buy assets. However, the government is planning a package of further help to support bank lending in the battle against recession.



Saving jobs

Holding back the tide

Jan 8th 2009

From The Economist print edition

The prime minister's "jobs summit" is unlikely to achieve much

TWO months ago trade unionists rejoiced that 332 jobs had been saved at JCB, a maker of construction equipment, because 2,500 workers agreed to work fewer hours for less pay, although 178 had to go. That was before orders at JCB "fell off a cliff", in the words of Keith Hodgkinson, a union representative. Now another 398 workers are likely to have gone by February. This week there was no production at all at JCB's Staffordshire works. Instead, 2,000 staff were undergoing training.

The reality of the recession is that jobs will be lost, despite some companies' best intentions. JCB's overriding problem, explains Mr Hodgkinson, is that neither buyers nor dealers can get credit. Getting the money flowing, says the Confederation of British Industry, is the best way to save jobs. That is why it is sceptical that a "jobs summit" between government and business leaders, due on January 12th, will produce better answers.

Gordon Brown has said he wants to create 100,000 jobs by investment in health, education and infrastructure, and to mitigate unemployment by encouraging more apprenticeships, "green" industries and possibly direct loans to needy companies. Among the proposals likely to be kicked around are subsidising wages, introducing training days and giving workers sabbaticals. Britain's foreign-owned motor manufacturers, Honda, Nissan, Vauxhall and Jaguar Land Rover, are already applying some of these measures.

But, as JCB's experience suggests, these are unlikely to stem the rising tide of unemployment. General predictions are that the jobless total will reach 3m before things begin to get better. And some industries will shrink, especially financial services, "whose excesses need to be wrung out", admits Stuart Fraser, head of policy and resources for the City of London. The City lives on being a competitive market, he says; yet if jobs have been subsidised anywhere it is in banking, with billions of pounds poured into recapitalisation.

The government is coy about subsidising jobs elsewhere, though there is a growing lobby for the support of Jaguar Land Rover in the interests of manufacturing in general. In this sector skills are particularly hard to replace once redundancies are made. Not only are the car manufacturer's 15,000 British jobs at stake, so are 60,000 ancillary jobs in the West Midlands.

An unappetising prospect is one of creeping nationalisation, in which only the public sector creates employment. With spending on health and education high on the prime minister's agenda, a big chunk of any new jobs will be public. "I don't want to see a new army of civil servants," says David Kern, economic adviser to the British Chambers of Commerce.

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WORLD
BRITAIN

The death of Sir Alan Walters

Mrs Thatcher's monetarist guru

Jan 8th 2009

From The Economist print edition

His economic advice proved politically costly

ON USHERING visitors into his home Sir Keith Joseph, a punctilious host, would proffer a handshake by way of welcome. On this occasion, however, the senior Tory politician was shocked when his younger guest pointedly refused to take his hand. Instead, he got a volley of abuse about his role in “debauching the currency”. Such was the pedagogic style of Sir Alan Walters, who died on January 3rd, aged 82.

At the time of their meeting, in 1974, Joseph was beginning a total re-evaluation of economic policy provoked by Edward Heath’s disastrous government, in which he had served. That had ended with a Keynesian public-spending binge, the orthodoxy of the day, to stimulate the economy. But instead of helping, it had caused runaway inflation and a rash of strikes. Surely there was another way?

Joseph had sought out Sir Alan as the leading British exponent of the counter-revolution in economics, led by Milton Friedman at the University of Chicago. Monetarists argued that only by tackling the amount of money circulating in the economy could governments tame inflation, then the scourge of Western economies. This would force them to cut public spending—and in Britain to demolish overmighty trade unions, which extorted wage rises without any increase in productivity.

This, in short, became the essence of Thatcherism. Sir Alan and others hammered this message home to Joseph and his closest political ally, Margaret Thatcher. The politicians were converted, and Sir Alan became Mrs Thatcher’s guru on the new policies after she took over as leader of the Conservatives in 1975.

Like his political leader, Sir Alan was from a relatively poor background in the unfashionable east Midlands. And like her, he nurtured a lifelong disdain for middle-class intellectual socialists.

As her special adviser in Downing Street, he played a vital role in two of the most important episodes of her premiership. In 1981 he was brought back from academia to stiffen her resolve in pushing through a budget that cut public spending during a recession, the decisive break with the Keynesian past.

And in 1989, even more controversially, he returned to help her in a dispute with her chancellor, Nigel Lawson, who wanted sterling to join the European Exchange Rate Mechanism, a prelude to the euro. Sir Alan, like the prime minister, shared an instinctive distrust of such currency systems; he famously called this a “half-baked” idea. Mr Lawson resigned over what he saw as interference in economic policymaking, and Sir Alan had to go too. But in the long run Sir Alan’s view prevailed; the British still seem to prefer their pound, even in its present debauched state, to the euro.

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WORLD
BRITAIN

School-leaving age

Delaying the final bell

Jan 8th 2009

From The Economist print edition

Extending compulsory education is no panacea for idle youth

WORKLESS children were “idling in the streets” and “tumbling about in the gutters”, wrote one observer in 1861 of the supposedly baleful effects of a reduction in the use of child labour. Such concerns eventually led to schooling being made mandatory for under-tens in 1880. The minimum school-leaving age has been raised five times since then and now stands at 16; but panic about feral youths menacing upright citizens and misspending the best years of their lives has not gone away.

Today’s equivalent of the Victorian street urchin is the “NEET”—a youth “not in education, employment or training”. And the same remedy is being prescribed: by 2013 all teenagers will have to continue in education or training until age 17, and by 2015 until 18. Now there are political rumours that the education-leaving age could be raised sooner, perhaps as early as this autumn. Bringing the measure forward is said to be among the proposals being prepared for the “jobs summit” Gordon Brown has grandly announced.

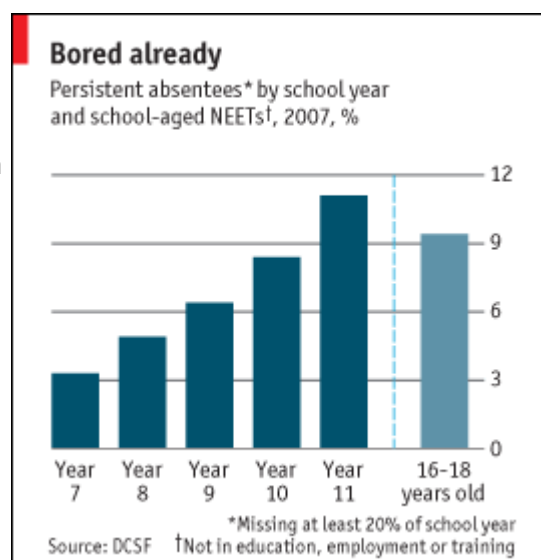
During downturns young people tend to have more difficulty finding, and staying in, work than older ones. So a policy that would keep them off the jobless register has obvious appeal for the government. Youngsters who have studied for longer may, moreover, be better placed for an eventual upturn, whenever that might be. And, unlike other measures on Mr Brown’s wish-list, this one is achievable by ministerial edict.

Such political pluses may be great enough to outweigh the practical negatives. The Department for Children, Schools and Families, which would have to implement the changes, says there are no plans to speed them up, and schools and further education colleges would struggle to find room for extra students at such short notice. The Association of Colleges says its members will manage if they have to, but it fears that money to pay for the extra places will not be forthcoming.

But whether the measure happens sooner or later, the hoped-for transformation of young people’s skills may not materialise. The behaviour of 16-18-year-olds forced to study for qualifications they do not want is foretold in that of under-16s now. The share of pupils who are frequently absent rises from 3% at the start of secondary school (year 7) to 11% in the final year of compulsory education (year 11)—a pretty close match for the share of 16-18-year-olds who are NEET (see chart). That suggests many newly conscripted learners, rather than knuckling down, will simply move from NEETdom to truancy.

Alison Wolf, an educationalist at King’s College London, has analysed the financial returns to education and concluded that many 16-year-olds who now leave education are making a rational choice. Most who have done reasonably well at school go on to take A-levels or one of a few other well-respected qualifications—and boost their lifetime earnings by doing so. But 16-year-olds with poor qualifications are usually eligible only for courses that increase future earnings just a little, or not at all, presumably because they impart few skills that are valued by employers.

The government hopes its new “diploma”, which lies somewhere between traditional academic courses and vocational ones, will provide the long-sought path to employability for youngsters not on course for A-levels.



But the omens are not good: a mere 3,300 16-year-olds started diplomas last autumn, and just 1,400 at a level deemed equivalent to A-level, far fewer than had initially been expected. The main effect of raising the education-leaving age, predicts Ms Wolf, will be to put businesses off hiring under-18s, because of the requirement that they receive at least a day's training a week. NEETs, meanwhile, will continue to vote with their feet.




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WORLD
BRITAIN

Commercial property

Hard times

Jan 8th 2009

From The Economist print edition

Tenants are gaining the upper hand in the market

THE shutters have come down. The lights are out and the signs are being removed. On high streets and in shopping centres across the country once proud stores are being hollowed out, casualties of Britain's retail slump. Experian, a credit-scoring firm, reckons that by the end of 2009 almost one in six shops will be standing empty as yet more stores close.

If retail property is in a bad way, office developments are even more shaky. In London's financial district, cranes stand silent behind the hoardings of half-finished buildings. Preliminary figures suggest that demand for office space in the City during the fourth quarter of 2008 was at or close to a record low, says Neil Prime of Jones Lang LaSalle, a property consultancy.

That is contributing to sharp drops in the prices of commercial properties (see chart). IPD, a data provider, says they slumped some 6% in November, the most recent month for which it has statistics. That takes the total drop in property values to about 32% since the market peaked some 18 months ago, easily surpassing the 27% peak-to-trough crash that took place between November 1989 and May 1992.

Dramatic as these numbers are, they may underestimate the full extent of the decline, because so few transactions are taking place. And few believe prices have reached their bottom. "There is very broad consensus that we are looking at a fall of about 50% (from peak to trough) but the risks are to the downside," says Sabina Kalyan, a strategist at CBRE Investors, a real-estate fund manager.

Rents are falling, too, as the mass of empty space coming on to the market in areas such as London strengthens tenants' bargaining-power. In the West End, the capital's swankiest neighbourhood and home to a previously blossoming but now withering crop of hedge funds, rents declined by 8% from their peak in the spring of 2008 to November, according to Capital Economics, a consultancy. In the City they are likely to fall by some 15% this year, reckons Mr Prime.

Moreover, falling rents are not the only way in which tenants are getting the upper hand at the expense of landlords. New tenants are being offered much longer rent-free periods as an inducement to sign 15-year leases: 36 months typically, up from 18 months just a year ago. In the 1980s most new leases in Britain committed tenants for 25 years and allowed landlords to raise rents at regular intervals. Now the average length of lease is about ten years and many can be abandoned after five years.

"The 25-year lease is dead," says John Fraser-Andrews of HSBC, a bank. That is of little comfort to property investors, who for many years were attracted to London's market precisely because it promised such stable returns. But for the economy as a whole, the shift may be for the better. In the recession of the early 1990s, many firms failed because they were unable to cut the costs of renting as their businesses slowed. Amid the gloom of the current downturn, their ability to do so now may be one of the few sources of comfort to struggling retailers and financial firms.



Third-party politics

Preparing for government?

Jan 8th 2009

From The Economist print edition

The tantalising prospect of a hung parliament adds allure to the Lib Dems

GORDON BROWN refuses to rule out a general election this summer, though the prime minister used an interview on January 4th to claim the idea was the furthest thing from his recession-filled mind. The outcome of the poll is no less in the balance than its timing, which gives Britain's third party an historic opportunity.

Surveys of voting intention suggest the election may be the first since 1974 that fails to produce a parliamentary majority for any party. Politicians and civil servants are preparing for a hung parliament too. On January 1st the Liberal Democrats said they would be discussing their manifesto with Whitehall's finest before the vote, a step usually taken only by the main opposition party. Whispers abound that they and the Labour Party are exploring a coalition in secret talks. Meanwhile the "golden triangle" of mandarins—the cabinet secretary, permanent secretary of 10 Downing Street and the queen's private secretary—are studying precedent to ready themselves for the aftermath of an inconclusive poll.

Paradoxically, the Lib Dems' chance to play kingmakers could come after a poor election showing. Their share of the vote in general elections rose from 17% to 22% between 1997 and 2005 as the electorate, relaxed about the economy, heeded their pitch on issues such as the environment and the Iraq war. But with recession likely to trouble voters until at least June 2010, the last possible election date, the Lib Dems may struggle. Polls put them at around 15% and several of their 63 constituencies, especially in England's south, are vulnerable. Despite the lustre of Vince Cable, their treasury spokesman, their ratings for economic competence are as low as 4%.

Yet, barring catastrophe, the Lib Dems will remain the only realistic coalition partner for Labour or the Conservatives. Which of the two they favour has long been a subject of conjecture, but clues lie in Nick Clegg's first year as their leader. Although doubters regard him as gaffe-prone, even for someone lacking the costly spin-doctors protecting the other main party leaders, he has won praise for giving the party's confusing mix of social democrats (who dominate the base) and old-fashioned liberals (prevalent among MPs) a clearer sense of what they stand for. He has embraced tax cuts and market-based reforms in public services, and defied the mood in favour of state intervention by marking his first anniversary as leader with a speech extolling liberalism.

Many worry that all this leaves the Lib Dems sounding like the Tories. But "it is better to be right than distinctive," says Julian Astle, a former Lib Dem adviser and now co-director of Centre Forum, a think-tank influential with the party. He wants Mr Clegg to go further by reversing his party's opposition to student fees, the final shibboleth remaining from Charles Kennedy, his more left-wing predecessor-but-one. Besides, the Lib Dems are defending most of their seats against the Tories. And there is enough of the old religion in Mr Clegg to keep activists on side—his tax cuts are aimed at low earners and on January 7th he became the first senior British politician to call for Mr Brown to condemn Israel's military operation in the Gaza Strip.

Mr Clegg avoids saying what he would do in a parliamentary stalemate, and not only because it would seem presumptuous. A deal with either big party would anger some in his divided tribe (it is ironic that a more proportional voting system, a demand the Lib Dems are likely to make in return for their support, could eventually see the party break up). He must hope for a hung parliament in which one party is much the biggest, in effect taking the choice out of his hands. However burdensome, the chance to shape the next government even after a disappointing election for his own party is one Mr Clegg's predecessors would envy.

Bagehot

Year of judgment

Jan 8th 2009

From The Economist print edition

The recession is increasingly likely to help the Tories

Illustration by Steve O'Brien



THE sausages do not look especially appetising. But combined with a tin of tomatoes, some scrapings of courgette and a sprinkling of thyme, advises an advertisement for Sainsbury's, they make a nice pasta sauce. "Love your leftovers", the advert enjoins. There are no celebrity chefs.

It is real, and it is here. For a time, last autumn, the downturn seemed to preoccupy Westminster more than it did the rest of Britain. Not any more. Austerity has ousted luxury and quality in marketing campaigns. Jobs are evaporating: inside the shells of Woolworths stores, all now closed, CCTV screens suspended from the ceilings flicker eerily, like macabre art installations. The pain is plain, and so, increasingly, are the main parties' strategies for dealing with it—and the likely political outcome.

The government's approach has two basic elements. First, eschew all blame: American financiers and impersonal global forces are now responsible, in ministerial rhetoric, for the limited effect of measures designed to ameliorate the recession, as well as for causing it in the first place. Second—and after the political success of the bank bail-out last October—do something! Thus the perpetual economic "summits" in Downing Street, and Gordon Brown's progress through the regions this week, with his cabinet in tow like the retinue of a Tudor monarch.

The theme of the next Number 10 summit, scheduled for January 12th, is jobs. Mr Brown has been talking about generating up to 100,000 of them through accelerated infrastructure spending, a stimulus adumbrated in November's pre-budget report, along with the cut in value-added tax (VAT). He has announced (again) a wish to create more apprenticeships. But, in private, some of his associates argue that redundancies may prove less politically toxic for the government than was the case in past recessions—because they will not be concentrated, as they previously were, among low-skilled industrial workers ill-equipped to find alternative employment. These

days, the argument runs, few workers expect to spend their careers in a single job, and the labour market is flexible enough for most to find new ones.

The equally pressing imperative for government, therefore, is to address the über-worry beneath the fear of redundancy: voters' terror, especially acute in Britain, of losing their homes. The government wants to prevent almost all involuntary repossessions, through, for example, a mortgage-interest deferral scheme. Safeguarding homes is relatively cheap (much cheaper than rehousing people who get evicted), and politically rewarding: a rescued homeowner is likely to be more grateful to Mr Brown than the beneficiary of more general remedies.

And beneath the crisis-management, Labour is nurturing a quiet political hope. It is that the time of maximum anxiety about the economy may be now. The hope is based on the fact that recessions, like other calamities, only ever affect a minority: that disaster, as Auden put it, always happens "while someone else is eating or opening a window or just walking dully along". Most of those voters now fretting about their prospects, and doubting Mr Brown, will ultimately keep their jobs and their homes, and perhaps even gain from falling prices and interest rates.

The perils of power

Self-exculpation, hyperactivity (contrasted with alleged Tory inertia), homes and hope: that is Labour's political strategy. It is likely to be undone by the sort of wishful thinking that prevented the government from acknowledging the trouble sooner.

The problem for oppositions in crises, as the Conservatives have discovered, is that they can talk but not act. But the flip-side of the government's prerogative on action is that it is judged on it—and the time of judgment is nigh. The banking rescue, and Mr Brown's strutting promises of state activism, impressed enough voters for his poll numbers to rally last year. But it is now grimly apparent that the initial bail-out, while it may have prevented an outright collapse of the banking system, failed to galvanise lending. Even implementing the interest-deferral scheme for homeowners has proved inconveniently tricky.

Meanwhile, the psychology of anxiety is unlikely to be as forgiving to the government as it would like. Most people, it is true, will keep their jobs. But most will soon have a friend or relative among the hundreds of thousands who will lose theirs, or will be obliged glumly to accept posts with lower pay. Discontent is likely to ripple outwards from the immediate victims and across the country. Ministerial protests that a bad situation might have been even worse, were it not for the government's fixes, are unlikely to wash. Anger is much likelier to mount than diminish.

As it does so, the Conservatives' uncontaminated impotence may become more an asset than a liability. The trick for David Cameron, the Tory leader, has been to find a path between incredible grandstanding and the seeming irrelevance that has been the result of occasionally agreeing with Mr Brown. Mr Cameron has yet to hit on a rhetorical register between bitter and bumptious. But he has started to hone a recession strategy of his own. On January 5th he announced plans to offer tax-relief to some savers and pensioners—politically savvy and sensibly discrete—while sketching a vision of a thrifty post-recession economy. He still has no macro-policy to rival Mr Brown's stimulus. But if that flops, he may not need one—until he gets into office.

There are few fixed rules for the political consequences of recessions. Whether they boost or damage incumbents or oppositions depends on where the blame falls and who seems to offer a better prospectus for recovery. And the politics of downturns are dynamic: they have already swung and oscillated in this one, as the mood has shifted from anger to partial reassurance. But it seems unlikely that the atmosphere will be as propitious for Mr Brown in 2009 as it became at the end of 2008. His moment of recessionary uplift may be about to pass.

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WORLD
INTERNATIONAL**Libel tourism****Writ large**

Jan 8th 2009

From The Economist print edition

Are English courts stifling free speech around the world?

Illustration by David Simonds



SEEN one way, it is nothing short of a scandal. Small non-British news outlets and humble non-British authors (in many cases catering almost wholly to a non-British public) are being sued in English courts by rich, mighty foes. The cost of litigation is so high (\$200,000 for starters, and \$1m-plus once you get going) that they cannot afford to defend themselves. The plaintiffs often win by default, leaving their victims humiliated and massively in debt.

There is another side to the story, of course. Attempts to collect damages for libel and costs from people outside Britain are rare and often fruitless. Just because someone is rich, or holds a foreign passport, or lives abroad, that does not mean that they should not seek justice in an English court. Sometimes the defendants are global news organisations with a substantial presence in Britain. Sometimes the plaintiffs are dissidents, complaining about libellous attacks on them by state-friendly foreign media; a lawsuit in London may be their only chance of redress.

Yet some cases are still startling. Two Ukrainian-based news organisations, for example, have been sued in London by Rinat Akhmetov, one of that country's richest men. One, the *Kyiv Post*, had barely 100 subscribers in Britain. It hurriedly apologised as part of an undisclosed settlement. Mr Akhmetov then won another judgment, undefended, against *Obozrevatel* (Observer), a Ukraine-based internet news site that publishes only in Ukrainian, with a negligible number of readers in England. Judgment was given in default and Mr Akhmetov was awarded £50,000 (now \$75,000) in damages in June last year. The best-known case is that of Rachel Ehrenfeld, a New York-based author. She lost by default in a libel action brought by a litigious Saudi national, Khalid bin Mahfouz, over allegations made in her book "Funding Evil". It was published in America and available in Britain only via internet booksellers. Since then she has been campaigning hard for a change in the law.

Yet no attempt has been made to collect the £50,000 in costs and damages awarded against Ms Ehrenfeld, says Mr Mahfouz's lawyer, Laurence Harris. He adds: "It doesn't appear that we've had any chilling effect at all on

her free speech.” (Even now, British booksellers are offering second-hand copies of Ms Ehrenfeld’s book over the internet.) Although Ms Ehrenfeld is sometimes portrayed as being unable to come to Britain because of the lawsuit, he says there is no reason why she can’t visit England “unless she is bringing a lot of money with her”. He notes: “We abolished debtors’ prisons some time ago.”

Nonetheless, cases such as these have outraged campaigners for press freedom in both Britain and America, who are trying to change the law in both countries. The states of New York and Illinois have passed laws giving residents the right to go to local courts to have foreign libel judgments declared unenforceable if issued by courts where free-speech standards are lower than in America. Ms Ehrenfeld sought such a ruling in late 2007 in New York state courts but failed; with the new law in place she may try again.

Now the campaign has moved to the American Congress. A bill introduced into the House of Representatives last year by Steve Cohen, a Democrat, sailed through an early vote but stood no chance of becoming law. A much tougher version submitted to the Senate, the Free Speech Protection Act, also gives American-based litigants an additional right to countersue for harassment. The bills have been strongly supported by lobby groups such as the American Civil Liberties Union, which fear that the protections offered by the First Amendment are being infringed by the unfettered use of libel law in non-American jurisdictions.

Similar concerns are being expressed in Britain. In a debate in the House of Commons last month Denis MacShane, a senior Labour MP, said that “libel tourism” was “an international scandal” and “a major assault on freedom of information”. Lawyers and courts, he said, were “conspiring to shut down the cold light of independent thinking and writing about what some of the richest and most powerful people in the world are up to.” He cited, among others, cases heard in London where a Tunisian had sued a Dubai-based television channel and an Icelandic bank had sued a Danish newspaper.

Mr MacShane also said the Law Society should investigate the actions of two leading British firms that act for foreign litigants, Schillings and Carter-Ruck, implying that they were “actively touting for business”. Neither wished to comment on the record, though both, like other big law firms, have websites promoting their services and highlighting their successes.

British members of a parliamentary committee dealing with the media are now broadening a planned inquiry into privacy law and press regulation. The chairman, John Whittingdale, says the committee has received a large number of submissions from people worried about libel tourism.

These go well beyond the usual media-freedom campaigners. Groups that investigate government misbehaviour say their efforts are now being hampered by English libel law. “London has become a magnet for spurious cases. This is a terrifying prospect to most NGOs because of legal costs alone,” says Dinah PoKemper, general counsel at the New York-based Human Rights Watch. It recently received a complaint from lawyers acting for a foreign national named in a report on an incident of mass murder. “We were required to spend thousands of pounds in defending ourselves against the prospect of a libel suit, when we had full confidence in the accuracy of our report,” she says.

The problem is not just money. Under English libel law, a plaintiff must prove only that material is defamatory; the defendant then has to justify it, usually on grounds of truth or fairness. That places a big burden on human-rights groups that compile reports from confidential informants—usually a necessity when dealing with violent and repressive regimes. People involved in this kind of litigation in Britain say that they have evidence of instances where witnesses have been intimidated by sleuthing and snooping on behalf of the plaintiffs, who may have powerful state backers keen to uncover their opponents’ sources and methods.

Private matters

A further concern is what Mark Stephens, a London libel lawyer, calls “privacy tourism”, arising out of recent court judgments that have increased protection for celebrities wanting to keep out of the public eye. In December alone he has seen seven threatening letters sent by London law firms to American media and internet sites about photos taken of American citizens in America. “Law firms are trawling their celebrity client base,” he says.

The more controversial and complicated international defamation law becomes, the better for lawyers. The main outcome of the proposed new American law would be still more court cases, with lucratively knotty points of international jurisdiction involved. Prominent Americans with good lawyers may gain some relief, but for news outlets in poor countries it is likely to make little difference. And as Floyd Abrams, an American lawyer and free-speech defender, notes, a book publisher, for example, will still be nervous about an author who has written a “libellous book”.

Mr Stephens, the London lawyer, is taking a case to the European Court of Human Rights, where he hopes to persuade judges that the size of English libel damages is disproportionate. If you get only around £42,000 for losing an eye, why should you get that much or more from someone writing something nasty about you, he asks. But even limiting damages is not enough. For reform to have any effect, it will have to deal with the prohibitive cost of any litigation in London.

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WORLD

INTERNATIONAL**Nuclear safeguards****Every little helps**

Jan 8th 2009

From The Economist print edition

But will still counts for more than legal powers or cash

EKING out the pennies, working at times with begged-and-borrowed tools, but expected to pit their wits against hard nuclear cases like Iran and North Korea, inspectors at the International Atomic Energy Agency (IAEA) now have two reasons to smile. The United States has become the 89th country to bring into force a toughened nuclear-safeguards agreement. (By accepting stricter scrutiny of their own civilian nuclear activities, the Americans have boosted the IAEA's hand as it chivvies laggards to co-operate.) Also, America's president-elect, Barack Obama, supports a doubling of the IAEA budget by 2020, partly to help the inspectors' work.

The IAEA's job is to ensure that countries abide by the Nuclear Non-Proliferation Treaty (NPT). With all five official nuclear-weapons states now signed up to an Additional Protocol (Britain, China, France and Russia adopted the new safeguards earlier; India, unrecognised as a nuclear power and outside the NPT, will soon follow), the agency's moral power will grow.

A list of tougher safeguards was agreed in 1997, after it was realised how easily Saddam Hussein had cheated inspectors, to pursue secret bomb projects, before the 1991 war. Instead of just mandating checks on declared material, the new rules let inspectors go in at shorter notice; give them more information; and let them snoop more widely, with better techniques.

The trouble is, signing up is voluntary. More than a decade on, fewer than half the world's governments have an Additional Protocol in force; of the more than 100 that don't, some have potentially misusable nuclear materials or technology. That includes Iran, which signed but refuses to implement the protocol unless the UN Security Council abandons efforts to halt its suspect nuclear programme, North Korea and Syria (where an alleged secret reactor still being built was bombed by Israel in 2007). It also includes Algeria, Argentina, Brazil and others. Meanwhile 30 countries (including Myanmar, Saudi Arabia and the United Arab Emirates, all with nuclear interest) still do not have even the weaker safeguards system required by the NPT.

Making the tougher safeguards universal would help inspectors. But even these can do only so much. The Additional Protocol is an excellent way for those who don't cheat to show their virtue. Those who have built or hankered after a bomb and thought better of it—South Africa before it joined the NPT, or Libya when it was caught out and confessed—do better to offer even fuller co-operation still.

Where inspectors are stymied, the UN Security Council is supposed to back them up. But Russia hesitates to sanction Iran, and China long shielded North Korea. Better, says Pierre Goldschmidt, an ex-head of safeguards at the IAEA, to end all favouritism. The council should agree on a binding process for any country found in non-compliance. First, inspectors would get temporary powers to demand all access they needed. If doubts persist, all sensitive nuclear work should stop; if that is refused, all military co-operation with the state would end forthwith. No skin off Iran's nose today, perhaps. But had all this been in place when it was first caught out in 2003, its uranium and plutonium work might have been stopped before it really got going.

Illustration by Claudio Munoz



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BUSINESS

Second-act chief executives

Comeback kings?

Jan 8th 2009 | NEW YORK
From The Economist print edition

Steve Jobs triumphed, but most returning bosses do not do so well

Landov



DOES Michael Dell, founder of the world's second-biggest computer-maker, regret going back to run the firm that bears his name? He says not. But nearly two years after returning as chief executive to the troubled firm he had left on a high two years before, he shows no sign of repeating his earlier success. On December 31st Dell announced another restructuring and the departure of some senior executives Mr Dell had recruited to lead his turnaround. The firm's share price has fallen by more than half since Mr Dell's return.

Meanwhile, at Starbucks, a year after Howard Schultz (pictured) returned as chief executive, the coffee chain's share-price has fallen by half and it is unclear whether his new strategy is working—especially as the recession makes sales data hard to analyse. So far, neither chief executive seems likely to repeat the spectacular second act of Steve Jobs at Apple. Its shareholders rejoiced this week when, responding to rumours that he was on his deathbed, Mr Jobs said his health is improving and he intends to carry on as chief executive (see [article](#)). Since Mr Jobs returned to Apple following its acquisition of another of his start-ups, NeXT, in 1996, its share price has grown roughly 20-fold.

Messrs Dell and Schultz and their shareholders can take some comfort from the fact that even Mr Jobs got off to a shaky start the second time around. But there is an ominously long list of disastrous second-act chief executives. Kenneth Lay's second act ended with the bankruptcy of Enron, his trial for fraud and early death. Ted Waitt was unable to revive Gateway, the computer-maker he founded, when he returned for a second stint as boss in 2001. Paul Allaire, who successfully ran Xerox during the 1990s, lasted only 15 months the second time around. And so on.

That there are so many disappointing second acts is perhaps not surprising, given the difficult circumstances in which they tend to begin. According to Rudi Fahlenbach of Ohio State University, former chief executives typically “come back when the firm is doing awfully”. In a recent study of 60 returning chief executives, he and two other economists found that they typically replaced bosses under whom the firm’s share price had dramatically underperformed its industry benchmark—by 20% a year on average.

The returning chief executives in the study had been particularly strong first time around, and most had not been retired for long, so they could plausibly claim to have remained familiar with the inner workings of the firm, making them better placed to revive it than any outside candidate. Indeed, most of them (including all but two of those studied by Mr Fahlenbach et al) were members of the board that reappointed them, and in many cases the chairman. Strikingly, Apple’s Mr Jobs was an exception, having distanced himself from Apple after being ousted in a boardroom battle in 1985—a separation that may have contributed to his second-act success.

This raises a troubling question: did most of these returning executives ever really leave? And did they contribute to the poor performance of their successors? Their presence on the board may have hindered initiatives that they regarded as threatening their legacy.

Elvis has not left the building

“There was no alternative,” said Charles Schwab after returning as chief executive of the financial-services firm of the same name in 2004. “There was really only one person in the world who could do the things required for the company.” Well, maybe: the firm’s share price has doubled since he returned, despite the financial crisis. But having a successful predecessor sitting on the board (and, as is often the case with second-act chief executives, a big shareholder to boot) cannot have made life easy for David Pottruck, who had taken over from Mr Schwab in 2003.

Intriguingly, many chief executives whose poor performance prompts their predecessors to return—75% in the Fahlenbach study—were internal appointments, often hand-picked by the returning boss. Their failure typically became clear very quickly: on average, they were gone within two years. This suggests that many second-act chief executives deserve some of the blame for the problems they have to fix, if only because of inept succession planning.

In some cases returning chief executives remain so close to the helm of the firm that dismissing their successors and making a comeback is largely scapegoating. At Starbucks Mr Schultz replaced Jim Donald, and promptly changed the firm’s strategy—but the rapid expansion that got Starbucks into trouble was Mr Schultz’s strategy as much as Mr Donald’s, says Jeff Sonnenfeld of the Yale School of Management. Indeed, it is said that Mr Donald was in Mr Schultz’s office twice a day to check he was doing the right thing.

Two crucial questions must be asked before a chief executive is allowed a second act, says Mr Sonnenfeld. First, does he or she have a strategy that is more than a “quest to recapture heroic stature”? Too often bosses, like generals, dislike being away from the heat of battle, and use their past heroic status to undermine their successors and lobby for their own return.

Second, is the returning manager able to avoid being blinded by past triumphs? Mr Jobs is famously unsentimental, and took being forced out of Apple as an opportunity to think afresh. This may be the crucial test for Mr Dell who, after all, gave his name not just to the firm but to a whole business model (just-in-time, made-to-order manufacturing using an outsourced supply chain), key elements of which have since been adopted by his competitors.

To his credit, Mr Dell has consistently said that a new model is needed to revive his firm; his difficulty has been finding one. Cost-cutting, selling in shops as well as online, a push into developing markets and hiring some prominent outside executives have not worked. Perhaps promoting some Dell insiders will.

By contrast, Mr Sonnenfeld fears, Mr Schultz may be too nostalgic, trying to revive the old Starbucks strategy of creating a “third space in life for lingering coffee drinkers”. Maybe. Yet a strategy of closing outlets opened during a period of overexpansion, introducing healthier options and improving customer service got McDonald’s out of a very similar crisis a few years back. Messrs Dell and Schultz both risk tarnishing their strong reputations with unimpressive second acts. History may be kindest to bosses who quit while they are ahead—and do not come back.

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Jan 8th 2009 | SAN FRANCISCO

From The Economist print edition

Health problems complicate one of the greatest-ever corporate comebacks

IN THE annals of history, Steve Jobs appears to have one-upped Napoleon. The emperor made an impressive comeback from his exile on Elba, but it lasted only a momentous “hundred days” (111, to be precise). By contrast, Mr Jobs escaped from his 12-year exile in 1996 to return to the company that he had co-founded, Apple, and leads it still.

After being ousted in 1985 in a boardroom coup, he struggled for several years, buying or founding companies and pursuing old interests. Over time, these succeeded in their own right—Pixar, now owned by Walt Disney, became the most successful animated-film company—or as part of something else. NeXT failed commercially but succeeded technically: its software powers Apple’s products today.

Napoleon’s comeback ended at Waterloo. But since his own return Mr Jobs has led Apple to its greatest successes yet. The iPod and the iTunes online music store have transformed the music industry. (This week Apple announced that it would soon drop the anti-copying software that has long been a nuisance for music lovers.) The iPhone has vaulted the mobile-phone industry forward, just as the original Macintosh changed the computer industry in 1984. Apple’s computers and laptops are resurgent.



Reuters

Surprisingly thin

If there are concerns, these too would have sounded familiar to Napoleon, who probably died of stomach cancer. Mr Jobs had cancer of the pancreas, and had part of it removed in 2004. Characteristically, he had not disclosed this for some time. And although he appears to have beaten the cancer, he shocked investors last year by mounting a stage looking sickly and gaunt. A “common bug”, he said at the time. But he is gaunt still.

Fears grew last month, when Apple abruptly announced that Mr Jobs would not, for the first time since his return to the company, give the keynote speech at Macworld, an annual trade show in San Francisco. This week Philip Schiller, Apple’s marketing boss, gamely took Mr Jobs’s place. On January 5th Mr Jobs also disclosed, for the first time, some of the details of what ails him. It is, he said, “a hormone imbalance” that has been “robbing” him of proteins, and that has a “simple and straightforward” remedy. This is plausible, since losing part of the pancreas often impairs the production of certain digestive enzymes.

Mr Jobs, a Napoleonic type in many ways, including his management style, has one more advantage. The emperor had turncoats such as Talleyrand around him. Mr Jobs has a strong executive team and a board which this week promised its “complete and unwavering support”.

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BUSINESS

Corporate governance

India's Enron

Jan 8th 2009 | DELHI
From The Economist print edition

Scandal hits India's flagship industry

SATYAM means "truth" in Sanskrit, an ancient Indian language. On January 7th Satyam Computer Services, one of the country's biggest software and services companies, revealed some alarming truths about Indian capitalism, even in its spiffiest industry. The company's founder and chairman, B. Ramalinga Raju, confessed to a \$1.47 billion fraud on its balance sheet, which he and his brother, Satyam's managing director, had disguised from the company's board, senior managers and auditors for several years. "It was like riding a tiger, not knowing how to get off without being eaten," Mr Raju wrote.

The tiger carried Mr Raju deep into the woods. Quarter after quarter, he inflated Satyam's profits, even as operations expanded and costs grew. The company, which is listed on both the New York Stock Exchange (NYSE) and the Bombay Stock Exchange, now claims to have 53,000 employees, and customers in 66 countries, including 185 companies in the *Fortune* 500. In its books for the third quarter it reported 50.4 billion rupees (\$1.03 billion) of cash and 3.76 billion of earned interest that do not in fact exist. It also understated its liabilities by 12.3 billion rupees and overstated the money it is owed by 4.9 billion.

The ride took a final turn on December 16th, when Mr Raju tried to buy two firms owned by his family, Maytas Properties and Maytas Infra, for \$1.6 billion. Satyam's supine board approved the proposal but shareholders revolted. They thought it was a brazen attempt to siphon cash out of Satyam, in which the Raju family held a small stake, into firms the family held more tightly. In fact, it turns out, it was Mr Raju's last desperate attempt to plug the hole in Satyam's balance sheet with Maytas's assets.

The deal was swiftly aborted. In the aftermath, four non-executive directors quit, hoping to salvage their own credibility, and Mr Raju's creditors came knocking. They dumped most of the Satyam shares he had pledged as collateral for the 12.3 billion rupees in loans. The ride was over. The daunting task of rescuing Satyam falls to Ram Mynampati, its chief operating officer, who is now interim chief executive.

The task of rehabilitating corporate India is equally daunting. It has long basked in the reflected glory of its information-technology firms. Run by cerebral, clean-living professionals, they employ India's brightest youngsters and serve the bluest of blue-chip companies. These digital ambassadors have lent corporate India a certain "mystique", says Sharmila Gopinath of the Asian Corporate Governance Association (ACGA), based in Hong Kong. But that reputation rests largely on the efforts of one or two companies, such as Infosys, which are impeccably run. Investors delude themselves if they think standards in most Indian technology firms, let alone the rest of its 9,000 listed companies, are close to those set by Infosys.

The illusion persists because it is not easy to gauge corporate governance objectively. ACGA's own 2007 ranking of corporate governance placed India third out of 11 Asian countries, behind Hong Kong and Singapore, but far ahead of China, in ninth place. India's financial-reporting standards are high, its principal regulator, the Securities and Exchange Board of India, is independent of the government, and its business press is enthusiastic. But enforcement is weak, loopholes large, and shareholder activism is lacklustre. "There is virtually no voting by poll at AGMs", ACGA notes, "and meetings are often held in remote locations."

The government has introduced a new companies bill, which would allow shareholders to pursue class-action lawsuits, but it will probably lapse when elections are called some time before May. Even if a new government passes the legislation, India's cumbersome courts tend to delay justice to the point of denying it.

New laws may matter less than the spirit that animates them. Satyam's independent directors, for example, met the standards set by the NYSE. But they did not ask hard questions. Directors in India may sit on as many as 15 boards, which leaves them little time to do their job properly.

But even an assertive board and reputed auditors will struggle to stop managers who are determined to hide their dirty laundry from view. About half of the 30 companies in the Sensex, India's benchmark stockmarket index, are run by business families, most of who trace their roots back to the closed economy of India's past. "They don't always understand the new rules," says Ms Gopinath. "Until investors stand up and say these practices are unacceptable, what reason do companies have to change?"

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BUSINESS

Business in Indonesia

Bakrie's bounceback

Jan 8th 2009 | JAKARTA

From The Economist print edition

A well-connected conglomerate avoids collapse—but exactly how is unclear

GIVEN its size and political connections, the recent turmoil surrounding Indonesia's Bakrie group has provided a test case for whether the country can escape its crony-capitalist past and become a safer place to do business. Three months ago a debt crisis at the sprawling conglomerate, owned by the family of Aburizal Bakrie (pictured), a senior government minister, triggered a meltdown on the Jakarta stockmarket, forcing its closure for three days. There was talk of a government bail-out, fiercely opposed by Sri Mulyani Indrawati, the finance minister and a leading cabinet reformist. In the end private investors came to the rescue and the taxpayer was spared. But lingering doubts over the somewhat mysterious deals behind Bakrie's salvation mean the episode cannot yet be declared a clear sign of progress.

In mid-2008, with commodities riding high, the group's holding company, Bakrie & Brothers (B&B), took out \$1.4 billion in loans, using as collateral most of its 35% stake in Bumi Resources, one of the world's biggest coal-mining firms. Then came the credit crunch, the collapse in commodities and the flight of Western capital from emerging markets. By November the Bakrie empire was valued at one-tenth of the \$8.2 billion it had been worth in June and could not guarantee the loans, even with cash and share top-ups. The end seemed nigh as defaults began.

Two months later, however, the group looks in pretty good shape. B&B says it has cleared more than \$1.1 billion of debt from its books while retaining ownership of 15% of Bumi, indirect control of another 6.4% and voting rights over a further 4.2%. Much of the rest of the Bakrie empire, which includes mobile telecoms, plantations, energy and property, remains intact.

So how did the Bakries pull it off? Nobody outside the family's inner circle knows for sure. The negotiations have been characterised by a lack of openness—the business equivalent of Javanese shadow puppetry. What is known is that Bumi controls two world-class mines that have caught the attention of suitors, especially Indians and Chinese looking to feed coal-fired power stations. (Tata Power of India paid \$1.1 billion in 2007 for 30% of the two mines.) This may explain why Northstar Pacific, a local private-equity fund, endured months of talks with B&B. Northstar first tried to build a consortium to buy the debt in exchange for the pledged shares. When this failed it formed a joint venture with B&B that will own 21.4% of Bumi. Northstar is taking on \$575m of Bakrie debt in return for 30% of the joint venture but neither party has explained the details of the deal, unveiled on December 25th.

Other deals forming part of the rescue are equally opaque. In early December B&B said it had paid off \$200m, thanks to gains from hedging some of its dollar loans. No details were given. Then it said it had surrendered a 6.7% stake in Bumi to Brentwood Ventures, an Australian hedge fund that took over \$150m of Bumi's debt—ostensibly a far better deal than Northstar got. Again, no details were given. Nor was there an adequate explanation for why trading in Bumi and B&B shares remained suspended for almost a month after the stockmarket reopened.

A further worry is the overlap between the senior management of Bumi and B&B. Bumi's announcements since October, including plans for a rights issue and the acquisition of three coal-miners for \$570m, have further

AFP



Bakrie pulls it off

perplexed analysts. It also borrowed hundreds of millions of dollars in the third quarter. Some \$230m has been invested with Recapital Securities, a Bakrie-linked firm, with little explanation.

The Bakries made their fortune under the authoritarian Suharto regime, lost it in the 1997-98 Asian financial crisis that toppled the regime, then restored their riches under the wobbly democratic governments that followed. They seem to have sorted things out without taxpayers' help, which is more than can be said of some big Western firms. But they remain a powerful family in a country with weak capital-market regulation. Given the lack of disclosure about the deals, minority shareholders in both B&B and Bumi do not yet know if they should be cursing the Bakries—or cheering their brilliant deal-making.

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Adolf Merckle

Empire lost

Jan 8th 2009

From The Economist print edition

What the life and death of a reclusive billionaire says about German business

THE very wealthy are usually celebrated during their lifetimes and then quickly forgotten in death. In this, as in many other respects, Adolf Merckle was an exception. Although he was ranked by *Forbes* magazine last year as the world's 94th-richest person, with an empire worth some \$9.2 billion, he was barely known outside Germany—and almost as little-known within it. Yet the secretive billionaire achieved a notoriety in death that he had avoided in life. On January 5th he killed himself by lying down on a railway track in front of a train as bankers were beginning to circle his family firm. They were threatening to dismember an empire that he had painstakingly built up over five decades.

Many in Germany saw the modest 74-year-old as a hapless victim of the credit crunch. His family described him as "broken" and "helpless" in the face of the financial crisis. Günther Oettinger, the premier of Mr Merckle's home state of Baden-Württemberg, said he was "deeply shaken" by his death. In a report on the [website](#) of *Spiegel*, a respected news magazine, Mr Merckle was referred to as an "entrepreneur of the old school".

Mr Merckle, however, also represented a buccaneering style of capitalism and appetite for risk that are at odds with what many see as the defining values of German business. Mr Merckle's financial woes seem to have arisen from bets he placed late last year that the share price of Volkswagen (VW), a carmaker, would fall, by selling shares that he did not own. In "short-selling" VW he was siding with mostly foreign hedge funds and engaging in a form of trading that is grudgingly accepted in America and Britain, but is still frowned upon in Germany.

When Porsche, a German carmaker with aspirations to take control of VW (and which this week passed a 50% shareholding threshold), revealed that it had cornered the market in VW's shares, short-sellers were thrashed. Mr Merckle is thought to have lost some €400m (\$550m), an amount he had been trying to raise in recent weeks from a consortium of banks.

His empire was not felled by that loss alone. The deeper cause was that it was built almost entirely on debt. Some bankers reportedly think that VEM, the holding company for his family firm, owed as much as €5 billion. Much of this debt was incurred buying companies. Debt-fuelled buy-outs, too, would not have seemed out of place in Britain or America. But in Germany they are deeply distrusted. In one of his last interviews Mr Merckle bristled at comparison between his firm and hedge funds, telling the *Frankfurter Allgemeine Zeitung*, a German newspaper, that he was trying to fund sound companies, but had been "lumped together with hedge funds."

Yet despite Mr Merckle's coyness and the still insalubrious reputation in Germany of private equity and hedge funds, these business models are in fact steadily gaining ground. So Mr Merckle was not quite as much of an exception as he might have seemed, says Wolfgang Gerke, a finance professor at the Bavarian Finance Centre in Munich. The big difference between him and Germany's new managerial class, says Mr Gerke, was not that he took risks and they did not, but that when he got it wrong, "he paid with his life."




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BUSINESS

Corporate jets

Deeply uncool

Jan 8th 2009

From The Economist print edition

Companies are rushing to get rid of their private jets—or are they?

WHEN the bosses of General Motors, Ford and Chrysler flew in their corporate jets to Washington, DC, to beg for financial aid in November, they encountered some stormy weather. Outraged politicians lambasted them for their extravagance, and commentators noted the incongruity of travelling by luxury jet to ask for money. On their next visit to Washington the chastened executives travelled by car.

This time it was those in the business-jet industry who cringed. The car bosses could have stood up for their corporate jets, defending them as time-saving tools. But because they “didn’t have the guts to defend their actions”, says Michael Boyd of the Boyd Group, a consultancy that studies aviation trends, business jets are now regarded as evil, “right up there with Saddam Hussein”. Companies are now racing to unload these symbols of corporate greed, and sales could fall by as much as 80%, says Mr Boyd.

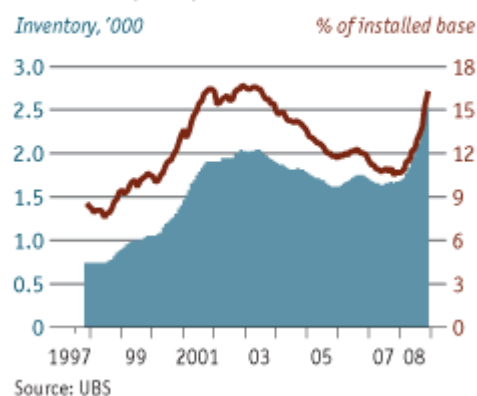
General Motors and Ford have put jets up for sale, as have other companies including Citigroup, AT&T and Time Warner. According to a report from UBS, a Swiss bank, the number of used business jets available worldwide for sale at the end of November had risen by 62% compared with a year earlier, to reach an all-time high. The report includes many gloomy quotes from people in the business-jet industry. “The market is dead,” says one. “Possibly the worst market since 1970,” says another.

If the car executives are to blame, so too is the dire state of the economy. Struggling companies agree with Congress: in hard times an obvious way to save money is to sell the odd jet. (A new one costs \$10m-50m to buy and at least \$2,000 an hour to run.) Other firms are cancelling orders for new jets because they cannot secure financing for them, making dozens of once-coveted delivery slots available. There are few takers.

But not all companies that have put their jets up for sale are cash-strapped. And according to analysts at JPMorgan, asking prices for used jets actually rose by 3.4% in the year to November. Jonathan Breeze, chief executive of Jet Republic, a private-jet operator, suggests that some announcements that firms are selling their jets are “elaborate window dressing”. By putting jets up for sale at a high price that ensures nobody will buy, companies can appear frugal—even as their bosses continue to fly as usual.

For sale, sort of

Used business jets for sale
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PEOPLE

Face value

The enforcer

Jan 8th 2009

From The Economist print edition

Can Neelie Kroes, Europe's competition chief, stand up to governments as well as companies?

Bloomberg



WHEN Neelie Kroes was appointed as Europe's competition commissioner in 2004, big business cheered. A Dutch politician who had served on the boards of more than 20 multinationals and local firms, she was expected to be far more understanding than her predecessor, Mario Monti, who had treated companies in a high-handed manner for five bruising years, blocking mergers and ignoring their lobbying efforts. But Ms Kroes confounded those expectations. She declared war on "fat duck" national champions, imposed unprecedented fines on cartel operators and mounted raids on the offices of dozens of firms suspected of anti-competitive behaviour.

Corporate lawyers have now learnt to fear the approach of her handbag, perfect tailoring and heavily accented English. But lately the loudest howls have come from governments. Politicians trying to prop up banks amid the credit crisis complain that the European Commission's competition directorate, known unattractively as DG Comp, is blocking their efforts. Last month Peer Steinbrück, Germany's finance minister, said several member states were unhappy with DG Comp's process for vetting state aid to banks. Sweden's finance minister added: "We need to call off these legions of state-aid bureaucrats." Ms Kroes responds that she and her team have had to take complex state-aid decisions which would normally take months "over a weekend". Sometimes her intervention has been welcomed, as when Ireland unilaterally extended a deposit guarantee to its banks, putting other countries' banks at a disadvantage. But mostly she is under pressure to relax state-aid rules. As industries falter and unemployment rises, the arm-twisting is likely to intensify.

Competition experts fear that panicked politicians could weaken enforcement of antitrust rules, resulting in lower growth and higher prices in future. Competition law was in effect suspended in America during the Depression, allowing widespread price collusion. Some economists say that prolonged the slump. The British government has

already pushed through the merger of Lloyds TSB with HBOS, a weaker bank, against the warnings of competition authorities, and America's antitrust watchdogs have kept quiet during the recent frenzy of banking mergers.

Ms Kroes, born during the second world war, is instinctively averse to throwing money around. "We weren't used to holidays, but today it is all different," she says. "Everyone is used to more and more, and the whole system needs a catharsis." Even so, she approved nearly all the bank-rescue packages on the basis that each aims to prevent a "serious disturbance" in a European Union (EU) country's economy. Observers agree that she had no choice but to be flexible. "DG Comp did well to keep the commission at the table and to prevent the worst excesses of nationalist actions," says Robert McLeod of MLex, a regulatory-risk consultancy in Brussels. In several cases the directorate insisted that banks pay a higher rate on their state aid than had been proposed in order to maintain a level playing field, for example.

But DG Comp has made concessions, too. In November it at first reportedly refused to let the French government inject capital into the country's six big retail banks in order to shore up their lending, arguing that they were essentially healthy and did not need the money. In the end, however, DG Comp backed down. Competition experts also fault Ms Kroes for failing to lobby effectively against the move to downgrade the status of competition in the Lisbon treaty, a set of changes to the EU's institutional rulebook. Because of a demand from Nicolas Sarkozy, France's president, competition will no longer be one of the EU's main objectives if the Lisbon treaty comes into force. The real test of Ms Kroes's determination to protect the market will come in the spring, as governments submit restructuring plans for banks that want to keep state money. DG Comp will have to distinguish between healthy banks and those which have structural problems (and will be forced to sell large chunks of their business).

The end of the road

Ms Kroes's term ends in the autumn this year, and business will be glad to see the back of her. DG Comp has fined European firms some €8.2 billion (\$10.7 billion) for operating cartels during her tenure, compared with fines of €3.2 billion under her predecessor. The biggest cartel fine, of €896m, went against Saint-Gobain, a French glassmaker found to have colluded on prices for car windscreens. Its chairman, Jean-Louis Beffa, is a friend of Ms Kroes's—but that did not stop her. Bosses say it is unfair to make firms and shareholders pay for the sins of a few rogue salespeople, but Ms Kroes has little time for such arguments. "They say 'But I didn't know of any cartel', and I am starting to laugh," she says. Several chief executives, she says, have told her that after being fined, they told junior managers to clean things up or else.

Rather than breaking with Mr Monti's legacy, as she was expected to do, Ms Kroes has instead built upon it. She famously fined Microsoft €899m for failing to comply with a ruling made in 2004 under Mr Monti. Her actions on cartels—both the higher fines and a proposal to encourage American-style class-action lawsuits against colluding firms—had their origin in Mr Monti's term. DG Comp won new powers in 2003 to undertake inquiries into whole industries, and Ms Kroes has not hesitated to use them, taking on the energy industry and, most recently, the pharmaceuticals industry, which is accused of using unfair tactics to delay the arrival of cheap generic drugs.

Ms Kroes's father owned a road-haulage firm, and as a girl she travelled in lorries to Antwerp and Dusseldorf. "I always noticed that crossing from one country to the next made no difference to the landscape," she says, "and I would ask 'Why are there borders here?'" In her remaining months in office, Ms Kroes is trying to ensure that having relaxed their borders, European countries do not use state aid to re-establish them in hard times.

Emerging markets

Stumble or fall?

Jan 8th 2009 | HONG KONG

From The Economist print edition

Will the global financial crisis halt the rise of emerging economies?

Illustration by S. Kambayashi



NOBODY talks about “decoupling” any more. Instead, emerging economies are sinking alongside developed ones. In 2008 emerging stockmarkets fell by more than those in the rich world, and financial woes forced countries such as Hungary, Latvia and Pakistan to go cap in hand to the IMF. Taiwan’s exports have plunged by 42% over the past year, and South Korea’s by 17%; even China’s have shrunk. Singapore’s GDP fell by an annualised 12.5% in the fourth quarter of 2008, its biggest drop on record. Is this the end of the emerging-market boom?

Over the five years to 2007, emerging economies grew by an annual average of more than 7%. But in the past three months their total output may have fallen slightly, according to JPMorgan, as the fall in exports was exacerbated by a sudden drying up in trade finance. For 2008 as a whole, average growth in emerging economies was still above 6%, but recent private-sector forecasts suggest that this could slip to less than 4% this year. That is grim compared with the recent past, though still robust set against an expected 2% decline in the GDP of the G7 countries.

Short-term pain is only to be expected. But some economists argue that emerging markets’ longer-term prospects have been badly hurt by the global financial crisis. From Brazil to China, they claim, the boom was driven largely by exports to American consumers, easy access to cheap capital and high commodity prices. All three props have now collapsed. In particular, as America’s housing bust causes households to save more, they will import less over the coming years. This could reduce emerging economies’ future growth rates.

Yet emerging economies’ reliance on America is often exaggerated. The surge in their total exports as a share of GDP since 2000 might, on the face of it, suggest that their boom was powered by rich-world demand. But their dependence on exports to developed countries has barely budged, at just under 20% of GDP (see chart 1). Most of the

growth in exports has been within the developing world.

For sure, emerging economies will not return to their exceptional growth rates in 2007 (no bad thing either, since many of them were overheating). But it is equally wrong to assume that they cannot recover until America rebounds. There are good reasons to believe that emerging markets' share of world growth will continue to climb (see chart 2).

Gerard Lyons, chief economist at Standard Chartered, argues that most emerging economies are not plagued by America's deep structural problems, such as an overhang of debt, which could cramp growth for several years. Although 2009 will be a painful year for poorer countries, those with high savings and modest debt could recover fairly quickly. On many measures, such as government and external balances, emerging economies look much sounder than the big rich ones.

Unfortunately, aggregate numbers conceal many horrors, most notably in eastern Europe. Countries such as Hungary, Estonia, Latvia and Turkey have huge current-account deficits and foreign debts. Between 2000 and 2008, the ratio of foreign debt to GDP dropped from 37% to 20% in Latin America and from 28% to 17% in emerging Asia, but jumped from 45% to 51% in central and eastern Europe.

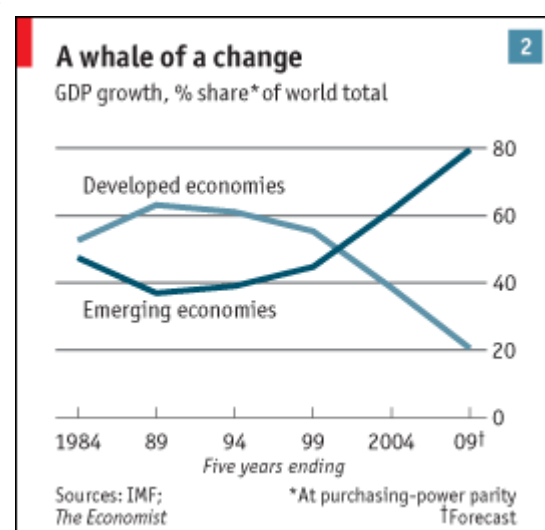
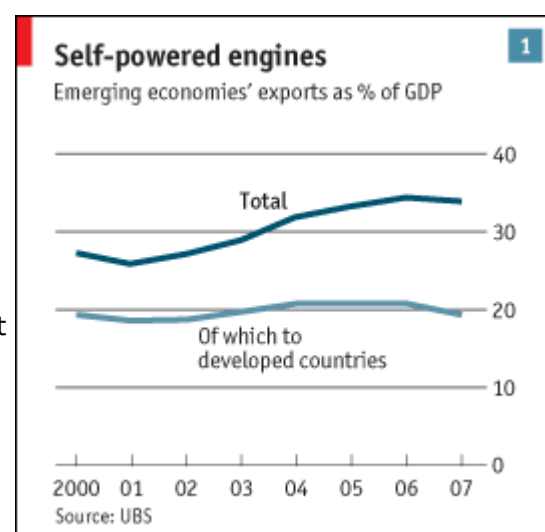
As foreign capital dried up, GDP fell by 4.6% in Latvia and by 3.5% in Estonia in the year to the third quarter of 2008. Capital Economics, a research consultancy, expects another 5% drop this year. Hungary's economy is expected to contract in 2009. Turkey may also be heading for trouble. Its debt-service payments due in 2009 amount to 80% of its foreign reserves, the highest ratio of any big emerging economy.

Russia has run current-account surpluses for many years, yet it has also been badly hit by an outflow of capital and a credit freeze. Banks and companies are finding it hard to roll over their foreign debt. Official reserves have fallen by \$160 billion, or 25%, since August. As a result of lower oil prices, Russia is likely to run its first current-account and budget deficits in a decade, and its economy may well contract in 2009.

Asia's export-led economies have been hurt by the collapse in global demand. Output is already falling in Singapore, Hong Kong and Taiwan. However, current-account surpluses and modest domestic debts mean that most of the region is much less exposed to the credit crunch than eastern Europe is. Asia has two other advantages. First, as a large net importer of raw materials it will benefit from the plunge in commodity prices, unlike Latin America. And second, with the exception of India, Asian countries have low public-debt-to-GDP ratios, giving them more room for fiscal stimulus than other emerging economies. Such policies take time to work, but after a nasty 2009, Asia is well placed to be the first region in the world to recover.

China is crucial to Asia's fortunes. Many economists expect GDP growth to slow to around 7% in 2009, down from almost 12% in 2007 and its slowest rate for almost two decades. Thousands of factories have closed in southern China, triggering concerns that rising unemployment will cause social unrest. This prompted the government to unveil a large fiscal stimulus in late 2008, which should help to boost growth in the second half of this year. With debts of only 18% of GDP, the government has plenty more room to boost spending. And if China has to rely more on domestic demand, this will help to steer it onto a more sustainable path.

A comparison of China with India in any case shows that exports are not the main thing that determines how vulnerable economies are to the global crisis. India's exports as a share of GDP are much smaller than China's, so one might expect it to be holding up better. But a big chunk of Indian investment—the main driver of recent growth—has been financed by overseas borrowing or new equity issuance. Both have dried up. The government's huge budget deficit also limits its room for fiscal easing. On January 2nd India announced its second monetary and fiscal stimulus package within a month, but the extra spending is tiny. Standard Chartered thinks that GDP growth will dip to 5% in 2009, well below its recent 9% pace.



Latin America's prospects lie somewhere between those of Asia and emerging Europe. Weak commodity prices could push the region into running a large current-account deficit, just as private-capital inflows decline sharply. Latin America also has less scope for fiscal stimulus than Asia, because many governments (including Argentina and Brazil) used the windfall from higher commodity prices to boost spending rather than cut debt. Goldman Sachs forecasts that Brazil will grow by only 1.5% in 2009, whereas Mexico's GDP could fall by 0.5% because of its stronger trade links with America. The bank reckons that both should recover fairly quickly. Argentina is another matter. Credit-default-swap spreads on its government debt have surged to horrifying levels, signalling that investors see a high risk of default.

During the past five years virtually all emerging economies boomed. Now their fortunes will diverge much more. The most important factor determining how they cope with the recession in the rich world will be whether they are high savers, able to stimulate their own economies, or big borrowers. If international investors continue to shun risk and rich-world governments swamp markets with their own borrowing, it will be hard for emerging-market governments to issue bonds and for banks and firms to roll over debts. Some developing countries will therefore remain sluggish for longer than others.

Overall, however, their long-term prospects remain good, thanks to structural reforms and better macroeconomic policies over the past decade. In December the World Bank forecast that GDP per head in poorer countries would rise at an annual pace of 4.6% during 2010–15, similar to that during the past decade, and more than twice as fast as in the 1990s. That word "decoupling" may yet get dusted off again.

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Banks and private equity

Roll up, roll up

Jan 8th 2009 | NEW YORK
From The Economist print edition

What does the smart money see in the carcass of IndyMac?

THE failure of IndyMac Bank in July was a pivotal moment in the credit crunch, with images of anxious depositors outside its branches sparking bank runs across America. Now the money is flowing the other way. On January 2nd the Federal Deposit Insurance Corporation (FDIC), which has been running the Californian lender since its collapse, said it had provisionally agreed to sell its remnants to a group of private firms with links to famed investors like George Soros and John Paulson. The consortium is led by Steve Mnuchin of Dune Capital, who reportedly worked so hard on the deal over the holidays that he only bought presents this month.

Such dedication is admirable, but is it wise? What remains of IndyMac's franchise is of questionable value, to put it charitably. It loaded up on dodgy mortgages, and most of its deposits were of the unstable brokered sort (today it has a mere \$6.5 billion). But the deal's terms are suitably sweet. The buyers must absorb the first 20% of losses on the loan portfolio (which is being written down before the deal closes). The government will soak up most of the rest, and also provide financing for the difference between the \$1.3 billion of fresh equity and the overall price tag of \$13.9 billion.

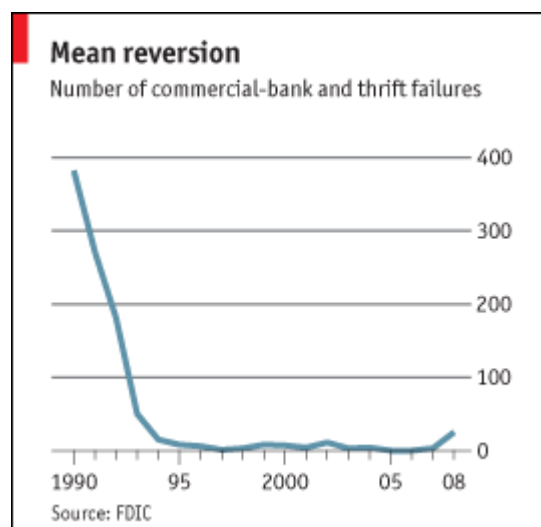
Moreover, IndyMac may be merely a means to a greater end. The plan is to rebrand it, refocus it on sounder mortgages and use it to roll up other troubled banks as they become available. "Now you have a credible vehicle that can participate in rescues over a weekend," says a person close to the buyers, who "can add more capital as they please".

They will not be short of choice. The rate of bank and thrift failures in America began to surge in 2008 after several blissfully quiet years (see chart). Another sharp rise is expected in 2009, towards levels not seen since the early 1990s. Now that sovereign-wealth funds have retreated, hit by investment losses and a sagging oil price, private equity is perhaps the most promising source of private capital.

It, too, has been burned. TPG's \$2 billion investment in Washington Mutual was largely wiped out when the thrift buckled. But the industry's greybeards know that great fortunes can be made by those with the wherewithal to invest during banking busts, when some assets become hugely undervalued. (Witness the deal a few days later for PennyMac, a mortgage-investment firm, to buy \$558m of loans from the FDIC at a hefty discount.) Hence the recent wave of fund-raising: some 60 private-equity funds focusing partly or completely on financial services were set up in 2008, according to Preqin, a research firm. Another 114 are in the works.

For their part, regulators know that beggars can't be choosers. They have relaxed the rules on private-equity ownership of banks in recent months. No longer do private-equity groups have to worry that buying a lender will expose the rest of their operations to scrutiny by bank supervisors.

But they do need to worry about what they buy, and IndyMac is no guaranteed winner. It faces intense competition in its home state, especially for deposits, from the likes of Wells Fargo and Bank of America. The buyers have agreed to continue an experimental loan-modification scheme launched by the FDIC, which could complicate their plans. No one



knows when housing will recover. And all banks face tougher regulation, which will hurt profits.

Still, the deal could prove a template. It suggests private capital will be attracted if the government continues to backstop deals. And where else can private equity get leverage these days apart from in banking, an intrinsically leveraged business?

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Jan 8th 2009

From The Economist print edition

The dilemma facing investors in government bonds

THE most striking thing about financial markets at the start of 2009 is neither the level nor the valuation of stockmarkets, which are well within historical norms. Nor is it oil prices. Had investors been told two years ago that crude would cost around \$50 a barrel, their flabbers would not have been gasted, as Frankie Howerd, a comedian, used to say. What is remarkable is the level of nominal government-bond yields.

Two-year Treasury bonds yield less than 1%. The 30-year bond was, as recently as January 2nd, yielding less than 3%. James Montier of Société Générale cites figures showing that ten-year Treasury yields have averaged just over 4.5% since 1798. Today they offer just 2.5%.

When commentators say that some assets look cheap, they tend to use low government-bond yields as their benchmark. Corporate-bond yields are not that high in historical terms. It is the spread they offer relative to government bonds that is extraordinary. And at 3.3%, the dividend yield on the American stockmarket hardly seems mouthwatering, but it is higher than the long-term Treasury-bond yield for the first time since the 1950s.

All this is occurring when Western governments are conducting an immense economic experiment, with vast fiscal stimuli accompanied by monetary expansion. In the medium term, a sharp rise in inflation is a distinct possibility. Government bonds may be offering "return-free risk", in the neat phrase of Jim Grant, a veteran newsletter publisher.

One warning sign is that real bond yields (as measured by the inflation-linked market) have risen. Some believe this move has been driven by expectations of low inflation (or deflation) in coming years. But it may also suggest investors think the long-term fiscal position of many governments is not sustainable.

Indeed, nominal bond yields have also moved higher in recent days. Ominously, an auction by the German government of ten-year bonds on January 7th failed to attract sufficient buyers to raise the full amount targeted. The auction was the second-worst on record.

In the near term, bond yields are constrained because they reflect expectations of the future level of short-term interest rates. The Federal Reserve has pegged official rates at 0-0.25% and vowed to keep them low. The Fed has also talked about intervening directly by buying Treasury bonds to hold yields down.

Nor is there any immediate inflationary danger. In both America and Britain there is a chance the headline rate will go negative later this year. Many developed economies are in recession and the consensus expects 2009 to see falling output in America, the euro zone, Britain and Japan.

"Global bond yields are sure to be much higher in five years than they are today, but this does not imply that the market currently is in a bubble," says Martin Barnes of Bank Credit Analyst, a research group. "The economic backdrop will remain bond-friendly for at least the next six months."

Illustration by S. Kambayashi



This leaves investors with a dilemma. In the short term, they may like government bonds for the security they offer. Treasury bonds outperformed the S&P 500 index by an incredible 53 percentage points last year. But if yields are heading back to 4-5% (or even higher) by 2011 or 2012, at what point do they sell? The rational investor would want to get out of the asset class before the herd decides to do so. The logical extension of that argument (assuming most investors are rational) is to sell now.

But what if Japan provides the template? Many people thought Japanese bonds were overpriced when yields fell to 1-2% in the late 1990s. They have stayed around that level for the past decade, despite a vast amount of issuance (at \$8.7 trillion, according to Bloomberg, the Japanese government-bond market is the biggest in the world). Even the expected \$2 trillion of American issuance this year will leave its debt well below Japan's.

The crucial difference, however, is that Japan has been running current-account surpluses, not deficits. The Japanese owe the money to themselves whereas the Americans are in debt to foreigners. Such investors could lose twice over: yields could rise and the dollar could depreciate.

For the moment, the balance is maintained by what Nick Carn of Odey, a hedge-fund group, calls "mutually assured destruction". If overseas investors seek to sell their bonds, they will not only ruin the American economy but the value of their existing portfolios as well.

It is a precarious balance. It may well hold through 2009 and even 2010. But at some point, government bonds will surely suffer a horrendous bear market.

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Jan 8th 2009 | HONG KONG

From The Economist print edition

Ending a loophole for insider trading has created a tangle

IT HAS engendered more vitriol, more bitter ferocity, than participants in the Hong Kong markets say they have ever seen. Front-page advertisements have been taken out in the local papers decrying the action. Some 236 companies have signed a letter of protest. David Li, head of the largest local bank and a member of the territory's legislature, has said it is a "stupid" act that will undermine the viability of Hong Kong's market, an opinion echoed by the heads of many large companies. Among the horrors forecast are unwarranted hostile takeovers, corporate exits, the death of stockmarket liquidity and, for the firm that is brave, or loyal, enough to stay on the Hong Kong exchange, managerial flight.

Bizarre, then, that the catalyst for all this outrage is a rule change that is long overdue. Under Hong Kong's stock-exchange rules, listed companies need to report results twice a year and have an inordinately long time to disclose them—three months after the end of the period for the half-year report, four months for the year-end. In contrast, American financial results, which are reported quarterly, must be disclosed within 40 days of a quarter-end and 60 days of a year-end.

The problem is that directors and managers of Hong Kong-listed companies have been permitted to trade shares until a month before results are announced, giving them months of proprietary access to information that could be invaluable in knowing whether to buy or sell shares. Theoretically, some of this disadvantage is offset by a rule requiring companies to announce meaningful events. But such disclosure is intermittent. Recently, Citic Pacific, an investment firm, has come under scrutiny for sitting on news of a \$2 billion currency loss for six weeks before issuing a public statement.

It is a wonder that this information asymmetry has lasted for so long. The issue began to attract more attention thanks to the efforts of David Webb, a rare critic of Hong Kong's interlinked corporations. In January 2008 the listing committee of the Hong Kong Stock Exchange suggested a change, banning insiders from dealing in shares from the end of a financial period until the results are disclosed, a time span that could entail just a few days a year for a company that reported results quickly to as much as seven months for a sluggard that took all the allowed time.

Perhaps because it never occurred to opponents of the measure that it would ever get so far, the response was initially muted. But as the implementation date of January 1st approached, opposition became an all-out roar. The outcry worked. On December 30th, the exchange announced that the change was so dramatic, and the notice so short, that it would delay introduction of the new regime until April 1st. Encouraged, critics of the proposals hope the delay will become permanent.

The exchange says that will not happen. Rightly so. Not only would a reversal show a lack of spine, it would send a jarring message about investor protection. In the words of one observer, the controversy has been "inadvertently revealing" of the incestuous processes that undermine the fairness and efficiency of Hong Kong's public capital markets. Rather than driving good Asian companies and managers from Hong Kong, closing such a loophole would instil greater confidence in minority investors. That should lower the cost of capital for companies and enhance returns—exactly what executives should want, if they are really working for all owners, that is.

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Risk aversion

The bonds of time

Jan 8th 2009 | SAN FRANCISCO

From The Economist print edition

Financial decisions are heavily influenced by early experiences

MANY economists are unsettled by the idea of a generation of “Depression babies”—people who grew up during the Depression and, scarred by the poor stockmarket returns of their formative years, were unusually risk-averse in their investments throughout their lives. Standard models assume that individuals use all available information about the present and past to make financial decisions, not that choices are disproportionately affected by their personal economic experience.

Yet new research from Ulrike Malmendier of the University of California at Berkeley and Stefan Nagel of Stanford University seems to confirm that people born at different times make very different financial choices, even in similar economic environments.

Ms Malmendier and Mr Nagel examined detailed survey data about American households’ finances between 1964 and 2004. Because they knew when the people in the sample were born, they could calculate the average stockmarket returns and inflation that individuals had experienced over the course of their lives. And because the data tracked financial choices over time, they could also control for factors like age, which matters because the composition of people’s portfolios is likely to change as they grow older.

Their work confirmed the Depression babies idea. Under identical market conditions, and controlling for age, people who had experienced lower stockmarket returns over the course of their lives put a smaller fraction of their money into stocks than people who had lived, on average, in times when stocks had done better.

Part of the explanation appears to be that beliefs are disproportionately affected by lived experience. In ongoing work, Ms Malmendier and Mr Nagel also find that people who have lived through periods of high inflation systematically expect future inflation to be higher than those who have not experienced high inflation for themselves.

What is more, the effect of the distant past dissipates much more slowly than the authors had expected, with the impact of events early in life persisting decades into the future. They were also surprised to find that people’s eventual appetite for risk is affected by the economic environment during their childhood, well before financial matters could possibly have been of interest.

Then again, Ms Malmendier’s interest in these questions arose in the first instance not from her own experiences, but from hearing her father, who was born in 1930s Germany, talk about his worries about inflation. Just be careful what you say when you tell the children about today’s crisis.



Economics focus

Drastic times

Jan 8th 2009
From The Economist print edition

Past crises inspire little confidence about the outcome of this one for America

THE good news, said Alan Blinder of Princeton University to a crowded hall on the opening day of this year’s gathering of the American Economic Association (AEA) in San Francisco, is that the stockmarket rallied yesterday. The bad news, he joked, is that it bounced on hopes that the economy’s problems would be solved at the AEA meetings.

No such luck. The prevailing mood at this year’s event was one of despair, not hope. The tone of the three-day conference, which ran between January 3rd and 5th, was set on its first morning when Kenneth Rogoff of Harvard University outlined the results of new research conducted with Carmen Reinhart of the University of Maryland. The paper*, a sequel to work presented at the 2008 conference, looks at the aftermath of past financial meltdowns to gauge just how bad America’s recession might be.

The analysis is based on 14 “severe” banking busts, including the Depression as well as the more recent “big-five” crises in the rich world—Spain in the late 1970s, Norway in 1987, and Finland, Japan and Sweden in the early 1990s. The sample also includes seven emerging-market crises that were left out of the earlier analysis for fear of appearing too alarmist. A year on, the authors have no such qualms. The hubristic belief in America that “we don’t have financial crises” is now obviously false, said Mr Rogoff. In fact the authors find that banking crises have been almost as common in rich economies as developing ones (see table).

The main results of the research make depressing reading. Downturns that follow a financial crisis are typically long and deep (see table). On average, GDP per person falls by more than 9% from its peak and takes almost two years to reach bottom. The misery in the jobs market tends to last far longer. The unemployment rate increases by an average of seven percentage points after severe meltdowns and reaches a peak almost five years after its rise began. If that gauge is accurate, unemployment in America is set to rise to an alarming rate of 11-12% in coming years. The housing bust is unlikely to end quickly either. House prices take an average of five years to reach their nadir and fall by 36% in real terms. Equities take less time to reach rock bottom but lose more than half of their value by the time they get there.

A long, hard slog		
Peak-to-trough changes in severe financial crises*		
	Cumulative change, %	Duration, years
House prices	-36	5.0
Equity prices	-56	3.4
Unemployment†	7.0	4.8
GDP per person	-9.3	1.9
Percentage of years spent in banking crises		
	Advanced economies	Emerging economies
Since 1800 or independence	7.2	8.3
Since 1945 or independence	7.0	10.8
*Argentina (2001), Colombia (1998), Hong Kong (1997), Indonesia (1997), Korea (1997), Malaysia (1997), Philippines (1997), Thailand (1997), Japan (1992), Finland (1991), Sweden (1991), Norway (1987), Spain (1977), US (1929)		
†Excludes Japan ‡Percentage points, trough to peak		
Source: Reinhart and Rogoff, <i>The Aftermath of Financial Crises</i> , 2009		

The most astounding result, said Mr Rogoff, is the effect on public finances. Real government debt rises by an average of 86% in countries afflicted by severe crises. The authors reckon the damage has little to do with the costs of bailing out banks. Rather ballooning debt reflects a collapse in tax receipts as a consequence of recession and, in most countries, a big increase in public spending to shore up the economy. It is chilling that such huge deteriorations in public finances are still not enough to prevent deep and prolonged downturns.

These numbers are not ideal guides to the future, as Mr Rogoff readily acknowledged. One obvious shortcoming is the range of outcomes. Whereas declines in home and equity prices were remarkably uniform after past crises, GDP per person fell—and unemployment rose—by much less than the average in some episodes, and by far more in others. America's recession could be milder than the average post-crisis downturn, but it could also be much deeper. Whatever their flaws, the Reinhart-Rogoff estimates are still likely to be a better guide to the downturn than the numbers spat out by standard forecasting models, which take as given that capital flows smoothly through the economy.

Mr Rogoff assured his audience that he was not trying to win the prize for gloomiest forecaster, and his sobering conclusions were not hotly disputed by delegates. A separate conference panel devoted to the crisis, which included Mr Blinder and Mr Rogoff as well as other heavyweight economists, was uniformly gloomy. Mr Blinder said the recession had barely begun and will be long and deep. Mr Rogoff fretted that "every time I hear a policymaker say 'we're not Japan', I feel it's more like Japan." The most hopeful assessment came from Olivier Blanchard, the IMF's chief economist, although he was hardly upbeat. With the right policies in place, he said, the economy might turn the corner in a year.

Spend to save

Nearly all were agreed that a massive fiscal stimulus was needed to stop a deep recession turning into something worse. But there was not much consensus about the form a package should take. According to Robert Hall of Stanford University, the drawback of tax rebates is that there is no guarantee they will be spent when the economy is at its weakest—indeed, worried consumers are likely to save the proceeds of any tax cuts. Direct government purchases may have a more immediate impact but much of the benefit risks being captured by producers. A reduction in some sales taxes, financed by the federal government, may be better.

If there is debate about the details, it is remarkable how unanimous economists now are that fiscal policy needs to be used actively to boost aggregate demand. One dissenting voice was John Taylor, also of Stanford University, who argued that there was scant evidence that tinkering with tax and spending policies does much to lift the economy. America's 2008 tax rebates are a case in point: they were designed to jump-start spending but had little discernible impact. Economists who believe public spending will have a more powerful effect, said Mr Taylor, are basing their analysis on the same models used to justify the tax rebates.

Mr Taylor's scepticism may well be shared by other academic economists but the scale of the economic meltdown leaves them reluctant to rule out any options. Mr Rogoff likens the situation to that of a terminally ill patient who is offered a risky treatment that may cure the disease but is sure to have nasty long-term side-effects. The patient will always opt for the new drugs, even if they are more likely than not to fail.

* "The Aftermath of Financial Crises", by Carmen Reinhart and Kenneth Rogoff

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Jan 8th 2009

From The Economist print edition

Barack Obama is making good his promise to welcome scientists into his administration

Illustration by David Simonds



ONE of the stranger beliefs of some politicians is that if they treat nature like a troublesome opponent and ignore it, it might go away and stop bothering them. In the opinion of many scientists George Bush, America's retiring president, was just such a politician. It would be one thing, for example, to argue that it is too expensive to stop climate change and that adapting to such change is a better course of action. It is quite another, as White House officials have done in the past, to describe climate change as a liberal cause without merit.

Mr Bush's administration also stands accused of suppressing the publication of research he did not like. In 2007, for example, Richard Carmona, then surgeon general, testified to Congress that Mr Bush's officials had delayed and tried to "water down" a report which concluded that even brief exposure to cigarette smoke could cause immediate harm. It has been criticised, too, for preferring AIDS-prevention techniques based on abstinence (which don't work, but have a moral appeal to Mr Bush and his supporters) to those that use condoms (which do work). His attitude to research on embryonic stem cells did not endear him to many scientists, either, and although the disagreement in this case was about a matter of principle rather than one of scientific truth, the decision to stop funding such research was seen as yet another example of how low the stock of science had fallen in the government.

Well, it is rising now. On December 15th Barack Obama, the incoming president, announced that he was nominating Steven Chu, a Nobel-prize-winning physicist, to be his energy secretary. At the moment, Dr Chu is head of the Lawrence Berkeley National Laboratory, where he has built up a big solar-energy-research project. He is also a strong advocate of research into nuclear power and foresees a world in which fossil fuels are largely replaced by other sources of energy.

On December 20th the president-elect followed Dr Chu's appointment by nominating Jane Lubchenco, a marine biologist at Oregon State University, as head of the National Oceanic and Atmospheric Administration. This is the government agency responsible for studying the climate, and also for keeping an eye on marine life. Dr Lubchenco has been critical of the Bush administration's lack of respect for climate science, and for its inaction on greenhouse-gas emissions. She is also concerned about marine pollution and the appearance in the ocean of oxygen-depleted dead zones caused by such pollution.

On the same day John Holdren, a physicist at the John F. Kennedy School of Government in Harvard, who is an expert in the fields of energy, the environment and nuclear proliferation, was appointed as the new presidential science adviser, and he will enjoy higher authority in that position than his Republican predecessor did. In 2007, when Dr Holdren was president of the American Association for the Advancement of Science (AAAS), he argued publicly for swift action on climate change.

Geneticists, too, get a look in. Two of them—Harold Varmus, a former director of the National Institutes of Health, and Eric Lander, of the Massachusetts Institute of Technology—will be co-chairmen of the president's council of advisers on science and technology. All in all, as Alan Leshner, chief executive of the AAAS, puts it, "we've never had a president surrounded in close proximity with so many well-known, top scientific minds." All of them, he predicts, will have access to the president and influence on policy, or else they would have refused the jobs. Dr Leshner says that Dr Varmus has "no interest in being a potted plant. He is a very competent and smart person with tremendous judgment who would not waste his time."

Obamology

These appointments, therefore, mark a shift in political attitudes towards scientific advice. When he announced his selections Mr Obama said that promoting science is not just about providing resources (though he has promised to double the budget for basic science research over the next decade), but also about promoting free inquiry and listening to what scientists have to say, "especially when it is inconvenient". Remarks such as this are causing excitement among researchers, particularly those who have had difficulty making their voices heard over the past few years.

And it is not only attitudes that are changing. As these appointments suggest, shifts in policy on global warming, energy and the protection of the oceans are also on the way. A straw in the wind here is the administration-to-be's attitude to NASA, America's space agency.

Mr Obama has said he will give NASA an extra \$2 billion to close the gap between the space shuttle, which is due to be withdrawn from service in 2010, and its successor. That sounds like good news for the agency. But according to documents obtained by *Space News*, a specialist newspaper, his people are also asking NASA some ticklish questions.

They want to know how much money could be saved by cancelling parts of the shuttle's successor. They have also asked for an estimate of the cost of carrying out all 15 missions that were recommended in a recent review of the agency's Earth-science programme, which looks at things like the planet's climate. At the moment, there is no money in the kitty for these missions, nor is much progress expected before 2020. The unstated implication of these questions is that someone is considering moving these missions up NASA's priority list.

It is also clear that lifting restrictions on embryonic-stem-cell research will be high on the agenda of the new administration. Democrats are already debating whether to overturn those restrictions through executive order or by legislation when they assume control of the government.

The stem-cell question was one that particularly disturbed Dr Carmona when he was surgeon general. In his evidence to Congress, he reported that he was not allowed to speak, or issue reports, on stem cells. Nor on emergency contraception, sex education, mental health, the health of prisoners or global health. The thousands of scientists who, in 2006, signed a petition calling for the restoration of scientific integrity to federal policymaking will also feel vindicated. "See no evil, hear no evil and speak no evil" may sometimes be a good prescription for day to day life, but it is no basis for policymaking. Mr Bush did not seem to realise that. So far, Mr Obama looks as though he does.

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The environment

Green Bush

Jan 8th 2009

From The Economist print edition

The departing president tries to burnish his environmental halo

AP



Clammed up

IN THE dying days of his administration, George Bush has done something remarkable for a man unlikely to be remembered as a friend of the environment. With an eye, perhaps, on his legacy he has pulled off the largest marine-conservation effort in history.

The ocean is increasingly thought by conservationists to need the equivalent of wildlife parks—areas that are naturally diverse where plants and animals can be allowed to live and breed unmolested by man. But such marine reserves are rare, so conservationists want more of them. In 2006 Mr Bush gave them part of their desire by establishing what was then the world's largest marine protected area—Papahānaumokuākea Marine National Monument, in north-western Hawaii. It is home to some 7,000 species, including the monk seal and spinner dolphins.

Now, with another flourish of the presidential pen, he has done something similar in three new areas in the Pacific Ocean, around the Mariana Islands, Palmyra Atoll and Rose Atoll, totalling more than 500,000 square kilometres. This will protect some stunning areas of pristine reefs containing many large animals (such as reef sharks and giant clams) that are badly depleted elsewhere.

Although the protection is not as extensive as they had hoped, environmental groups are thrilled. And although Mr Bush deserves credit, so too do the green groups that have lobbied for this. Some of them, such as the Pew Environmental Group and the Environmental Defence Fund, are well known. But much of the scientific donkey-work and lobbying behind Mr Bush's reserves was done by a smaller organisation, the Marine Conservation Biology Institute, in Washington. Congratulations.

The Energy Security challenge:



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SCIENCE & TECHNOLOGY

Astronomy

The cosmic boogie-box

Jan 8th 2009

From The Economist print edition

The sky, it seems, is filled with unexpected radio signals

WHISPER it not, but doing science can sometimes be a bit tedious. Traditionally, a researcher postulates an idea, devises an experiment to test it and then reports the results. Sometimes those results confirm the postulate; sometimes they confound it. Occasionally, though, something unexpected happens, and that is when the tedious gets exciting.

One such shock was the discovery in 1964 of the cosmic microwave background, by Arno Penzias and Robert Wilson, a pair of radio astronomers who were testing a receiver they planned to use to search the sky for localised sources of microwaves. The hiss they found at one particular frequency turned out to be evidence for the then-controversial idea that the universe had been born in a Big Bang. A similarly strange result was reported this week by stargazers gathered at a meeting of the American Astronomical Society in Long Beach, California. Some of them reckon that, besides microwaves, the sky reverberates with the din of radio waves as well. If they are right, something very odd indeed is going on in the universe.

The astronomers in question work for NASA, America's space agency. Michael Seiffert is based at the Jet Propulsion Laboratory in Pasadena, California, and Alan Kogut at the Goddard Space Flight Centre in Maryland. The postulate they had planned to test was that the first stars to form after the Big Bang would have left some signs of themselves in the form of radio waves. Their experiment was designed to find these signs. Their search used radio telescopes launched to the edge of the atmosphere on special balloons from a site in Palestine, Texas. The result they got was not, however, what they were looking for.

The microwave background is the earliest snapshot of the universe, taken a mere 300,000 years after the Big Bang and almost 700,000 years before the first stars are thought to have coalesced. It reveals the newborn universe to have been a remarkably uniform fireball. Dr Seiffert and Dr Kogut wanted to identify the point at which things stopped being so smooth and the universe started to develop the structures—galaxies, stars, planets and dust—that fill it today. It was for this reason that they were searching for signs of stars.

What they found, however, was a background hiss of radio noise, reminiscent of the hiss noticed by Dr Penzias and Dr Wilson. After ruling out nearby sources of radio waves, they concluded that their own hiss also comes from beyond the Milky Way and thus constitutes a cosmic radio background. Four papers describing the telescopes, the observations and their possible interpretation have been submitted to the *Astrophysical Journal*.

Why a cosmic radio background should be there remains a mystery. It does not appear to be coming from the primordial stars sought by the astronomers—indeed, it completely drowns out any signs of the early stars that were the object of the original quest. Nor are there enough radio galaxies around to account for it. It looks, therefore, like the sign of a previously unknown phenomenon.

Of course, some as-yet unidentified error could have been made. In that case, it will be back to the tedium. But Dr Seiffert, Dr Kogut and their colleagues are hoping that will not be the case, and that their discovery really will turn out to be worth making a noise about.

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SCIENCE & TECHNOLOGY

Solar energy

Seeing red

Jan 8th 2009

From The Economist print edition

To make solar cells more efficient, sprinkle them with silver

MAKERS of solar cells face a dilemma. Purified silicon, the basic material of such cells, is expensive. The temptation, therefore, is to use less of it. As a result, the makers have developed a generation of cells whose silicon layers are only a micron or two deep, as opposed to the usual thickness of 200-300 microns. The thinner the cell, however, the less efficient it is. In particular, thin cells fail to capture much light at the red end of the spectrum. That means they produce up to 20% less electricity than standard cells of equivalent area. And that negates some of the advantage of their initial cheapness.

To remedy this problem, Kylie Catchpole of the Australian National University in Canberra and Albert Polman of the Institute for Atomic and Molecular Physics in Amsterdam have been trying to redirect the light that falls onto the surface of a cell in such a way that all colours are efficiently absorbed. Their chosen tools for this task are tiny particles of silver.

When struck by light, the electrons in an atom of silver vibrate in a way that causes them to radiate small amounts of light themselves. If the atom in question is in a small particle on the surface of a piece of silicon, the result is what is known as a surface plasmon. This is a type of electromagnetic wave (ie, the same type of wave as a light wave). However, as its name suggests, it runs parallel to the surface of the material that is propagating it, rather than penetrating this material.

By travelling horizontally in this way, a plasmon passes through more of the solar cell's silicon than any incident beam from the sun could. In effect, the cell has been turned on its side and made much thicker. That gives it the opportunity to absorb, and thus convert into electricity, most of the red light falling on it, as well as the blue. Indeed, Dr Catchpole and Dr Polman report in *Optics Express* that their system increases the absorption of red light tenfold—bringing the efficiency of thin cells much closer to that of the traditional sort.

Of course, silver is expensive. But so little is used that the new technique would add only a few cents to the price of a solar panel. And it would bring the day closer when solar electricity is as cheap as that generated from coal.



Neuroscience

Sound and no fury

Jan 8th 2009

From The Economist print edition

It may, in the future, be possible to treat brain diseases with ultrasound

THE idea of treating maladies of the mind by blasting the brain with noise sounds, to the layman, like kicking a television set in order to repair it. It is, however, on the cards.

The noise in question is ultrasound. This has been used for decades to scan human interiors—particularly wombs containing developing fetuses. The ultrasound is reflected from surfaces within the body (such as the skin of a fetus) in the way that audible sound echoes from a cliff face. William Tyler and his colleagues at Arizona State University, however, want to take things a stage further. They think that ultrasound might be used therapeutically as well.

The team knew from experiments done by other groups of researchers that ultrasound can have a physical effect on tissue. Unfortunately, that effect is generally a harmful one. When nerve cells were exposed to it at close range, for example, they heated up and died. Dr Tyler, however, realised that all of the studies he had examined used high-intensity ultrasound. He guessed that lowering the intensity might allow nerve cells to be manipulated without damage.

To test this idea, he and his colleagues placed slices of living mouse brain into an artificial version of cerebrospinal fluid, the liquid that cushions the brain. They then beamed different frequencies of low-intensity ultrasound at the slices and monitored the results using dye molecules that give off light in response to the activity of proteins called ion channels. (An ion channel is a molecule that allows the passage of electrically charged atoms of sodium, potassium, calcium and so on through the outer membrane of a cell.)

The purpose of all this was to coax the cells to release neurotransmitters. These are molecules that carry information from one nerve cell to another. When they arrive, they cause ion channels to open and thus trigger the electrical impulses that pass messages along nerve fibres. When those pulses arrive at the other end of a fibre they, in turn, trigger the release of more neurotransmitters.

Disruption of this system of communication is characteristic of several medical conditions, including Alzheimer's disease, Parkinson's disease, depression and epilepsy. Ways of boosting the release of neurotransmitters may thus have therapeutic value. And the ultrasound did indeed boost their release.

How that came about is not absolutely certain, but Dr Tyler thinks the shaking that his ultrasound gave to the cells in question opened up some of their ion channels. The cells were thus fooled into acting as though an impulse had arrived, and released neurotransmitters as a consequence.

Any medical application of the idea is a long way away. But ultrasound does now offer at least the possibility of manipulating the brains of people suffering from mental illnesses without resorting to drugs or electrodes. And that is certainly a path worth investigating.

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BOOKS & ARTS

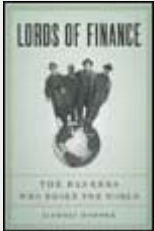
Central bankers

Lords of finance

Jan 8th 2009
From The Economist print edition

The central bankers of the Great Depression were obsessed with a single idea, rather like their successors today

Lords of Finance:
The Bankers Who
Broke the World
By Liaquat Ahamed



Penguin Press; 564 pages;
\$32.95. To be published
in Britain by William
Heinemann in May

Buy it at
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Corbis



CENTRAL bankers were compelling figures in the 1920s, not least because they preferred to operate in secret. The cloak was peculiarly attractive to Sir Montagu Norman, governor of the Bank of England (pictured above, right), who adopted a false identity when he travelled, though this sometimes attracted attention rather than deflecting it. Asked for his reasons for promoting a policy, Norman replied: "I don't have reasons. I have instincts." Benjamin Strong, Norman's principal collaborator, ran the Federal Reserve Bank of New York, which was responsible for America's international financial relationships. In the mid-1920s, Strong decided the American economy was sufficiently prosperous that he could widen his brief to promote economic stability. Liaquat Ahamed suggests that Strong more than anyone else "invented the modern central banker".

Norman and Strong were wedded to the gold standard. Emile Moreau, the less clubbable governor of the Banque de France, was an obsessive hoarder of gold and tended to do his nation's own thing. The arrogant Hjalmar Schacht (above left), a spiky German nationalist who headed the Reichsbank, had, by a remarkable sleight of hand, ended Germany's hyperinflation in 1923, but he was unable to persuade his fellow central bankers to forget reparations, even though they all appreciated that heavy post-war payments were "bleeding Germany white".

The quartet, united by a belief that they knew best, had persuaded the great powers to leave the fate of their economies to the antique workings of the gold standard—"a barbarous relic" in the view of John Maynard Keynes. They had the power, in a legendary phrase, to "crucify mankind upon a cross of gold", and they did so. The problem was that there was not enough gold to finance world trade. Stocks were concentrated in America and France, and countries like Britain, where it was scarce, had to borrow heavily, and to adjust interest rates and government spending at the expense of employment in order to replenish gold reserves.

A loan organised by Strong enabled Norman to get Britain back onto the gold standard in 1926 (it had slipped off during the first world war). Norman's advice helped persuade Strong to lower interest rates in 1927, which only increased irrational exuberance on Wall Street.

These early central bankers were an odd lot. Norman, who dabbled with spiritualism, apparently informed a colleague that he could walk through walls. He suffered regular nervous breakdowns, and was actually on sick leave when Britain left the gold standard again in 1931. Strong suffered from permanent ill health and was often affected by the generous use of morphine to control pain. He died in October 1928 before the Wall Street Crash and the Great Depression, but Mr Ahamed does not appear to believe that things would have turned out any differently had he lived: in a crushing conclusion, he writes that the Great Depression was "the direct result of a series of misjudgments by economic policymakers...by any measure the most dramatic series of collective blunders ever made by financial officials." Looking back in 1948, Norman's judgment was no less harsh. "We achieved absolutely nothing," he said, "except that we collected a lot of money from a lot of poor devils and gave it to the four winds."

Politicians were left to clear up the mess they left. One of them was Hitler, who readily instigated a series of measures to combat German unemployment which were similar to those Gordon Brown is adopting today. (Schacht later joined the anti-Hitler resistance.) Britain's prospects brightened as soon as the gold standard was dropped. The French, less troubled, remained loyal to gold until 1936.

But the most original solution was that of President Franklin Roosevelt, soon after his inauguration in 1933. Mr Ahamed resurrects a 59-year-old agricultural economist from Cornell University by the name of George Warren, whose study of long-term trends in commodity prices led him to believe that, since falling prices were associated with depression, recovery ought to be encouraged by rising prices. The president liked the idea and decided to devalue the dollar—despite vigorous opposition from the gold bugs—simply by increasing the gold price. One of his own economic advisers lamented: "This is the end of Western civilisation." For a number of weeks, the president would consult his advisers over boiled eggs at breakfast and randomly drive up the gold price, beginning at \$31.36 an ounce until it settled at \$35. By then a recovery was under way.

This absorbing study of the first collective of central bankers is provocative, not least because it is still relevant. Mr Ahamed, who was a World Bank economist and now manages investments in America, likens central bankers to Sisyphus. This was the man whom the gods condemned to roll a large stone up a steep hill only for it to roll down again when it reached the peak. These great central bankers were so wedded to a dogma that they were incapable of imagining its failure.

Perhaps this kind of single-mindedness is endemic to central bankers; since the early 1990s the idea of controlling inflation at all costs has been so compelling that central bankers have ignored such unintended consequences as bubbles in the housing and stock markets. But these were big enough, when they burst, to trigger a worldwide slump. Not lords of finance surely; more like high priests.

Lords of Finance: The Bankers Who Broke the World.

By Liaquat Ahamed.

Penguin Press; 564 pages; \$32.95. To be published in Britain by William Heinemann in May

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BOOKS & ARTS

Scotland and England

Unkilling the myths

Jan 8th 2009

From The Economist print edition

MANY countries have a union, or even two, in their history, and for some it occupies a central place. So it is with Scotland and England, yet for much of the union's 300-odd years, most people both north and south of the border have taken it for granted, and the arguments in its favour have largely gone by default. In this book Colin Kidd, professor of modern history at Glasgow University, rescues unionism from both neglect and misunderstanding. His surprising conclusions extend well beyond the narrow topic of the constitutional origins of the United Kingdom, mysterious though those turn out to be.

Asked to summarise the condition of unionism, a reasonably well informed student of British politics might respond that its fortunes have declined with those of the Unionist Party, the name of Scotland's Tories during much of the 20th century, as the vigour of the Scottish National Party has increased. That would be true. But implicit in the answer is the belief that unionism is the antithesis of nationalism, and that the Scottish Tories, as Unionists, took their philosophy from the parliamentary union between Scotland and England in 1707, if not the union of the crowns in 1603. That would not be true.

As Mr Kidd reveals in his subtle and scholarly book, unionism and nationalism are not opposites. For most of modern times, they have been contented bedmates. Moreover, unionism is a long-standing ideology that predates by some 80 years even the union of the crowns; it was originally a Scottish response to claims of English overlordship, not to the controversy that surrounded the Act of Union in 1707. So its antithesis, if anything, was English imperialism, not Scottish nationalism. As for Unionism with a capital U—the credo of the Scottish Tories—the union it championed was a quite different affair, namely the British union with Ireland of 1800, which, paradoxically, was to be a home-rule exercise, if only for Ulster.

The unquestioning acceptance of the union has left its study largely to nationalists, who have—with notable exceptions, such as Sir Neil MacCormick—tended to caricature all unionists as apologists for English colonialism. The reality has been very different. Even the debates that took place before the 1707 union were largely among unionists rather than between nationalists and unionists, as modern nationalist historians would have it.

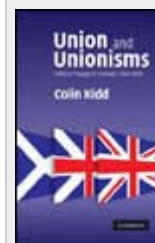
Unionism, however, has taken many forms, not just in politics but also in Scotland's other unique institutions, notably the law and the church. Indeed, the fundamental faultline within the union, says Mr Kidd, has for the most part been religious, not political. Could the established Scottish Presbyterian church be subordinate to an English-dominated United Kingdom Parliament? That question was at the heart of the long 19th-century arguments among Scotland's schismatic pedants.

Many will regard this as a less-than-enticing topic, and some may rate unionism not much racier. Yet the virtue of this book is that it provides a new way of viewing 500 years of Scottish history, debunking many misconceptions and at the same time rescuing the apparently arid subject of unionism from an undeserved quondamnation (the coinage is Mr Kidd's). And now that Scotland has its own parliament, run by Nationalists who seek to scrap the union, the topic is of some moment.

Union and Unionisms: Political Thought in Scotland, 1500-2000.

Union and
Unionisms: Political
Thought in Scotland,
1500-2000

By Colin Kidd



Cambridge University
Press; 312 pages; \$90
and £45

Buy it at
Amazon.com
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By Colin Kidd.
Cambridge University Press; 312 pages; \$90 and £45

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BOOKS & ARTS

Europe's first financiers

The Genoa connection

Jan 8th 2009

From The Economist print edition

An Italian archive yields its treasures

WHO were civilisation's first financiers—the moneymen who could transform one man's deposits into another customer's credit? Perhaps they were the Egibi family in Babylon as early as the 7th century BC, though a more plausible case can be made for Pasion, an Athenian contemporary of Socrates at the start of the 4th century BC, when bankers were already the butt of music-hall humour ("the most pestilential of all trades"). Egyptians were using cheques 70 years before the birth of Christ, but Eurocentric historians look no further back than medieval Europe.

Even then, there is confusion about where the first European bankers banked. For example, Niall Ferguson, in his entertaining British television series, "The Ascent of Money", is so dazzled by the magnificence of the Medici in Florence in the 15th century that he gives them more credit, as it were, than they deserve.

If European banking was invented anywhere, it was probably in Genoa in the 12th century, spurred on by the revival of trade in the Mediterranean. That, at least, is the case convincingly put forward at a [website](#) devoted to the history of the bank of San Giorgio. The site was formally launched at the end of 2008 at the conclusion of a 25-year study of Genoa's early economic history in the voluminous and carefully preserved state archive. The prize possessions are documents from the 12th century describing financial instruments that are commonplace today.

The first recorded public bond is dated January 1150 when the municipality raised 400 lire by granting to investors the tax revenue raised from stallholders in the marketplace. The term was 29 years, and the loans were described as *compere*—or purchases—to evade the church's usury laws. In the 13th century tradable government bonds were issued in Genoa, paying 7% interest. In the 14th century the first sinking funds were organised in Genoa; and, 100 years later, the first lottery. Giuseppe Felloni, a Genovese historian and numismatist, has written a commentary on this impressive list of historical firsts in a 91-page pamphlet, "Genoa and the History of Finance: A Series of Firsts?" A fuller account and the pamphlet itself can be found on Mr Felloni's [website](#).

By the 15th century Genoa's finances were in such a parlous state that in 1407 the municipality established a private bank to consolidate its debts and called it the Bank of Saint George. Commercial moneylenders already operated alongside the bond market (they were known as *banchieri*) but the Bank of Saint George was the first institution in Genoa that could be called a bank. It also operated as a giro bank and it stayed in business for 400 years. It was not the first in Europe; a giro bank in Barcelona beat them to it by six years. The oldest bank still in business is Italian, however. Monte dei Paschi di Siena was founded by the municipality in 1472 to give loans to the poor at better rates than those offered by the moneylenders: a business model that has persisted for half a millennium.

Illustration by Daniel Pudles



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BOOKS & ARTS

Political posters in Lebanon

Clenched fists and AK-47s

Jan 8th 2009

From The Economist print edition

IF THE devil has the best tunes, radicals make the best posters. In Lebanon the propaganda posters of Hizbullah and its allies are a heady mix of bright colour, simple logos and distinctively Arab calligraphy and portraits. The government commissioned Saatchi & Saatchi to make its case in 2006, but its advertising was never as striking as the humblest political placard from the Islamists.

The poster collection in "Off the Wall", comes from the 20-odd factions of Lebanon's 1975-90 civil war and shows that the shifting alliance of leftists and other radicals had artistic flair from the outset. Hizbullah, the Communists, the Syrian nationalists and the PLO, among others, harnessed contemporary graphic design and made it their own: Jerusalem in glowing colours features alongside clenched fists and AK-47s; the four-sided Syrian symbol rises like a sun; car bombs go bang like Roy Lichtenstein paintings.

There is more than art history in this collection. Although exhibitions of images from the civil war are now being put on (Hizbullah shows portraits of its early martyrs in some shows), disagreement over who was to blame for the war means no textbooks have yet been published and the subject is not taught in schools.

Zeina Maasri argues that it is no surprise that radical iconography flourished in Lebanon. After Israel crushed the Arab armies in 1967, Beirut was both the Paris of the east—permissive and cultural—and the home of the PLO's media and fine-arts department. Reeling from defeat, it vigorously promoted Palestinian nationalism with pop-art posters that borrowed from arabesque geometry and Egyptian film posters. Political support from countries like Cuba led to an anti-imperialist lithographic style, while Beirut was teeming with left-wing artists ready to draw for the cause. As the party ethos became specifically Shia, Iranian revolutionary iconography made its way into Hizbullah's posters. The Hizbullah logo—the AK-47 and fist forming the party's name in Arabic—is adapted from the logo of Iran's Revolutionary Guards.

The radicals' posters may have the most impact, but Ms Maasri explores how every side used similar artistic language to reinforce ideas of leadership, commemoration, belonging and martyrdom: posters glorifying individual "martyrs" encouraged others to seek the same glory.

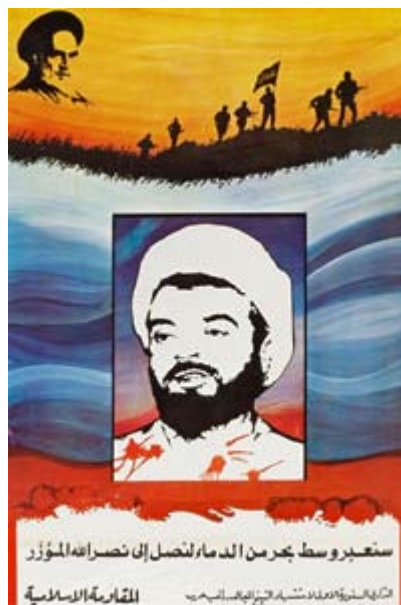
Posters and factionalism did not end when peace came. Last week the Shias' Ashura festival commemorated the martyrdom of Imam Hossein. As Israel bombed Gaza, Hassan Nasrallah, Hizbullah's leader, told a crowd that martyrdom was victory and that it must be prepared to resist with "fearless Hosseini fists raised". Beirut is now dotted with vast red posters reading "Hossein". Bloody intentions still need good art.

Off the Wall—Political Posters of the Lebanese Civil War.

By Zeina Maasri.

I.B. Tauris; 137 pages; \$29.95 and £14.99

Hizbullah Media Office



Colours of glory

Off the Wall:
Political Posters of
the Lebanese Civil
War

By Zeina Maasri



*I.B. Tauris; 137 pages;
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BOOKS & ARTS

Skiing

The white stuff

Jan 8th 2009

From The Economist print edition

"TO SKI, however well or poorly, is a reminder—whatever one may for a long time have suspected—that one is alive, and that living is tremendous fun. There isn't any other game to compare with it in the world." So wrote James Riddell after winning the Kandahar Ski Club's Inferno downhill race in Mürren, Switzerland, in 1929. Riddell went on to become the father of modern ski journalism. Charlie English is his heir in more ways than one.

Mr English, an associate editor of the *Guardian*, is a polymath who wears his learning lightly. His book is a cracking read that deserves to be by the bedside of every keen skier or snowboarder. Indeed, it is the phenomenon of snow, as much as skiing—or boarding, which he prefers—that fascinates him.

He began skiing as a child in the Cairngorm mountains, in central Scotland, and even remembers taking home a Thermos flask of snow as a souvenir. While researching this book Mr English makes a moving return to the Cairngorms, even camping out alone there in the snow. But he also travels more widely, to Washington state to try to ascertain whether Paradise or Mount Baker has the highest annual snowfall in the world, and among the Inuits where he learns to build igloos. In Vienna he goes in search of Bruegel's "The Hunters in the Snow", which he believes to be "the fairest portrait of winter" ever painted.

He describes his (failed) attempt to complete the Haute Route, one of the world's most renowned ski-mountaineering itineraries from Chamonix to Zermatt. Along the way he became afraid and lost his nerve. At the same time his relationship with his French guide, Philippe, became fraught, especially when the guide challenged him: "I think you are dead while you are alive. More and more I think society is made up of people like you. You take risk unconsciously. When you are in the town, or driving your car, you take risk but you don't think about it. Now you are with me, and this is a conscious risk, you say you will not take it. But if you do not come, you will feel bad. Will you take it?"

Mr English hears what he has to say, but opts out all the same. Many off-piste skiers will identify with this situation. This is a well-rounded work by a well-rounded, if snow-obsessed, writer. But then, there are worse obsessions.

The Snow Tourist: A Search for the World's Purest, Deepest Snowfall.

By Charlie English.

Portobello Books; 280 pages; £14.99

The Snow Tourist: A Search for the World's Purest, Deepest Snowfall
By Charlie English



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Henry Moore's fabrics

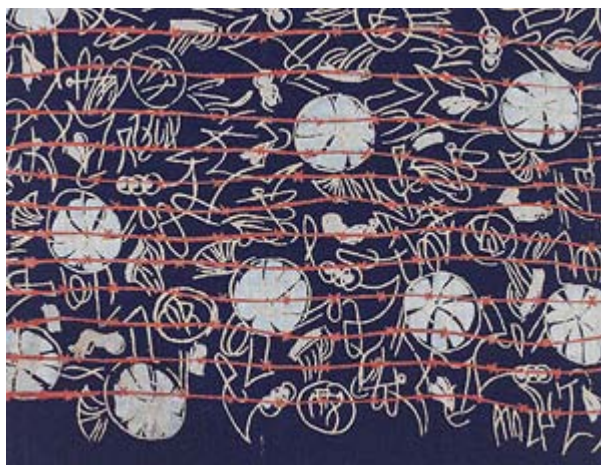
Cloth art

Jan 8th 2009 | EDINBURGH

From The Economist print edition

The textiles of Henry Moore reveal his passion for colour as well as form

Henry Moore Foundation Matt Pia



The sharp end of luxury

HENRY MOORE refused to paint his sculptures, believing that nothing should distract from the essence of form. Little wonder, then, that when he did pick up pen or brush he liked to describe working with colour as “a bit of a holiday”. Moore’s war drawings, which used pastels in contrasting hues to highlight the psychological effects of alienation and devastation, are almost as famous as his monumental sculpture. Less well known, in part because one of his four original notebooks was until recently believed to have been lost, are the designs he made to be printed in colour on fabric.

A new show in Edinburgh proves what a rich seam this was. The exhibition is the first at Dovecot Studios, Britain’s principal tapestry studio, now newly installed in a resplendent renovated swimming baths on the south side of the Scottish capital. Dovecot, with its close connections to the 19th-century Arts and Crafts Movement, makes for a fitting backdrop. Moore’s work in textiles was inspired by his aims as an artist after the second world war, particularly his belief, as a Socialist, that art could be a cohesive force in society, bringing together communities through creative public projects.

Moore began working on designs for fabrics in 1942 or early 1943. Zika Ascher, a Czech textile manufacturer who was honeymooning in Norway when war broke out and set up shop in London, commissioned a number of artists, including Henri Matisse, Howard Hodgkin and Jean Cocteau as well as Moore, to create designs for fabric “squares” or scarves. Produced in cotton, rayon and parachute nylon, as well as silk, the scarves were intended to brighten up post-war wardrobes with bold colours and patterns. In 1947 the Lefevre Gallery in London hung a framed series of these scarves on its walls, and their success as works of art as well as instantly recognisable fashion accessories was assured.

The Ascher commission inspired Moore to expand his designs for fabrics. He created a series of images, inspired by some of his better known iconography—the famed family groups, standing figures and seated mother-and-child—that could be exhibited on walls, like paintings. At the other end of the spectrum, he also began a series of designs for use on mass-produced dress and upholstery fabric.

Long before the 1951 Festival of Britain, Moore's colourful and exuberant imagery led the *Illustrated London News* to predict that women would soon be "blossoming out as walking art galleries". Red, black, tawny yellow, pink and pea-green are the hues of the period. What is more interesting, to modern eyes at least, is the extensive use that Moore made of barbed wire and other images associated with the conflict. Once experienced, he seems to be saying, war can never be completely eradicated from the human psyche.

Anita Feldman, the curator of the Henry Moore Foundation at Perry Green, the artist's home north of London, has created a highly imaginative show that blends pages from Moore's rich and colourful notebooks and examples drawn from the whole range of his designs for textiles to tell the story of his adventure in fabric. Moore's amorphous monumental groups, his reclining figures and his barbed wire—so familiar from his sculpture and his drawings—are brought to life again here in new and subtle ways.

"Henry Moore Textiles" is at Dovecot Studios, Edinburgh, until January 31st. After a tour of Britain, the show will travel to New York and Japan in 2010

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BOOKS & ARTS

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Words of warning

Jan 8th 2009
From The Economist print edition

The financial crisis has revived interest in the writings of J.K. Galbraith

The other J.K.'s bestsellers

1	The Great Crash, 1929 (1955)
2	A Short History of Financial Euphoria (1990)
3	The Affluent Society (1958)
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HE believed that companies use advertising to induce consumers to want things they never dreamed they needed, that easy credit leads to financial catastrophe and that the best way to reinvigorate the economy was by making large investments in infrastructure. Not president-elect Barack Obama, but J.K. Galbraith, the tall, iconoclastic economist, diplomat and adviser to Democrat leaders from John F. Kennedy on. For years Galbraith's most famous book was "The Affluent Society", which came out in 1958. But the financial crisis has revived interest in an earlier work, "The Great Crash, 1929", in which Galbraith showed just how markets become decoupled from reality in a speculative boom.

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PEOPLE
OBITUARY

Helen Suzman

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Helen Suzman, apartheid-fighter, died on January 1st, aged 91

Getty Images



APPEARANCES deceived where Helen Suzman was concerned. The petite and elegant figure, clad in two-pieces or nicely pressed slacks, her hair Thatcher-perfect, was clearly a denizen of the northern suburbs of Johannesburg, where discreet black domestics clipped the acacias and golf was played at weekends. Houghton, rich and Jewish, was indeed her constituency, and privilege was her life. But there the comfortable impression ended. Among the solid and overwhelmingly male Afrikaners in Parliament, "baying like hounds at a meet", she was noisy, rude, contemptuous, "thoroughly nasty when I get going". "A vicious little cat", said P.W. Botha, South Africa's prime minister, who often felt her claws in him. "The honourable member does not like me," he observed once in Parliament. "Like you? I can't stand you," came the spitting reply. Verwoerd, an earlier prime minister, a man she admitted she was "scared stiff" of, fared no better. "I have written you off," he told her. "The whole world has written *you* off," she retorted.

Then there were her questions: as many as 200 of them a year, asked in Parliament and recorded in *Hansard*, on any subject that might embarrass South Africa's white rulers. How many people were being held without trial? How many blacks were arrested each day for violating the Pass Laws? Why were they being forcibly removed to areas with nothing but rows of tin latrines, where only wattles grew in the sand? Why did the police turn up to remove them at four in the morning? Why did they use rubber bullets to disperse protesting crowds? Was it true that prisoners were kept in solitary confinement, beaten with straps, made to sleep on the floor? On, on, on. One National Party MP said she reminded him of "a cricket in a tree when it is very dry in the bushveld. His chirping makes you deaf but the tune remains the same." Botha said her "chattering" was like water dripping on a tin roof. Mrs Suzman was delighted to annoy them in the cause of justice.

Good liberal instincts

In a parliamentary career of 36 years, she spent only six in a party of any size. She quit the paternal United

Party in 1959, frustrated that it was so wobbly against apartheid, to join a Progressive Party of 12 members that was wiped out in an election two years later. She was the sole survivor, for 13 years a one-woman opposition to the relentless consolidation of white rule. The small but determined voice of the “neo-communist” and “sickly humanist” would call out “No”—to the Sabotage Act, the Terrorism Act, the Ninety-Day Detention Law—and she would be left sitting alone in a sea of empty green benches.

Her strength was that she knew the facts, and knew her rights. South Africa’s devotion to the Westminster parliamentary system, a figleaf of democracy over barbarism, meant that the Speaker was bound to let this “lone Prog” speak, and ministers had to answer her questions. She was allowed to bring one Private Member’s Motion a year, so she would try single-handedly to repeal the Prohibition of Mixed Marriages Act, or propose a minimum wage for blacks. As an MP, she could also visit prisons and “black spots” barred to the public; which was how she found herself talking to Nelson Mandela in his cell on Robben Island in 1967, or tramping through squatters’ camps of plastic sheets and corrugated iron. She was a precious mouthpiece to the world, as she was also the first resort for communists, Jehovah’s Witnesses, banned people, Coloureds resentful of their racial classification, and all the “sad harvest of the seeds of apartheid” that drifted through her office.

Did it make any difference? By 1974, after 20 years in Parliament, Mrs Suzman felt she had achieved little except identity-numbers for policemen, “because it helps to know who is beating you round the head”. She had stopped no law, and white rule was to run on for 20 more years. Her critics on the left always said far more force was needed to remove it. But she did not believe in force. Outsiders thought economic sanctions were the answer: but she did not believe in those, either. Her principles, to which she was always truthful, were those of a good old-fashioned liberal. Free markets, capitalism, the paramountcy of democracy and civil institutions, equal opportunity. She had always argued with her father, Sam Gavronsky, who had emigrated from Lithuania and made a success of the leather-and-soap trade, that blacks were oppressed rather than lazy, and couldn’t build a new life as readily as he had done. But when the African National Congress, once in power, began to impose quotas for blacks in jobs, she naturally and ferociously opposed it.

In many ways black rule proved “a huge disappointment” to her: corrupt, spendthrift, anti-white, and doing little to help the millions of poor blacks whose lot she had tried to improve. Thabo Mbeki’s wilful ignorance over AIDS appalled her. She spoke out about all of it, though the ANC seldom deigned to notice or reply. She was the past. In old age she sometimes seemed just another rich white suburbanite, comfortably behind her security fence, sighing over her whisky and soda about “that president of ours”. But the claws on her “pretty little pink hands” had drawn blood, and they were never retracted.