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AN EXCLUSIVE REPORT FROM LHASA

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WALL STREET

A TEN-PAGE SPECIAL REPORT ON THE CRISIS

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Politics this week

Mar 19th 2008
From The Economist print edition

AFP

China suppressed the worst outbreak of violence in **Tibet** since 1989 and perhaps since 1959 (when Tibet's spiritual leader, the Dalai Lama, was forced into exile). The violence spread from the Tibetan capital, Lhasa, to other areas of the region. China blamed the Dalai Lama for fomenting the violence even though he called for an end to it. See article

China's annual session of parliament ended with the appointment of Li Keqiang as vice-prime minister. Mr Li is tipped as a candidate for the top when the current generation of leaders retires. See article

Still smarting from an electoral rebuff, **Malaysia's** prime minister, Abdullah Badawi, shuffled his cabinet, removing several scandal-tainted ministers and promoting a prominent judicial reformer. See article

Something for everyone

A meeting of foreign ministers of the **Organisation of American States** “rejected” Colombia's recent raid on a FARC guerrilla camp just inside Ecuador. But it also committed member countries “to combat threats to security caused by...irregular groups or criminal organisations”.

Five women whose missionary husbands were abducted and killed by the FARC guerrillas in **Colombia** in the early 1990s filed a civil suit in a Miami court for compensation against Chiquita Brands International, an American banana company that has admitted paying protection money to the FARC and right-wing paramilitaries.

In another of a series of cautious economic reforms, **Cuba's** government said it would allow private farmers to buy supplies from hard-currency shops rather than directly from the state. The government is also to relax curbs on the purchase of computers and other electronic gadgets. See article

In **Mexico**, Alejandro Encinas, an ally of Andrés Manuel López Obrador, the narrow loser of the last presidential election, won a ballot for the leadership of the left-wing Party of the Democratic Revolution, the main opposition. His victory means that his party is likely to adopt a more intransigent stance towards the government of Felipe Calderón. See article

A British judge lifted a freeze on $12 billion of the assets of **Venezuela's** state oil company, quashing an order granted to Exxon Mobil in January as part of its bid for compensation for the takeover of a heavy-oil project.

Wright and wrong

AP

Barack Obama made a big speech on race that tackled head-on his relationship to Jeremiah Wright, a former pastor at the church Mr Obama attends in Chicago. Many moderates took umbrage after videos were broadcast of Mr Wright's sermons, in which he raged against “white” America. Mr Obama said Mr Wright had “expressed a profoundly distorted view” of America, but backed away from disowning his former mentor. See article

Democrats in **Florida** floated and quickly abandoned a plan to re-stage their primary election in June. The national party nullified the state's January primary because it jumped the election calendar, but with the nomination still up for grabs an argument is raging in the party about whether to count Florida's delegates. The state party's chairman said she had received little support for a re-vote.

David Paterson was sworn in as **New York state's** governor after Eliot Spitzer's recent resignation amid revelations about his sexual dalliances with a prostitute. Mr Paterson, who was Mr Spitzer's deputy, is the Empire State's first black governor (and only America's third since Reconstruction). He is also blind. See article

The Supreme Court heard arguments in the biggest **gun-rights** case to come before it in decades. At issue is a ban on the ownership of handguns in Washington, DC. The justices will give their verdict in June. See article

The clerics still rule

Iran's conservatives, who call themselves "principlists" for their devotion to the Islamic Republic's ideals, performed well in the first round of elections for the *majlis*, the country's parliament. Although many would-be reformists were barred from competing, the controversial president, Mahmoud Ahmadinejad, could yet face strong opposition if he stands for the job again next year. See article

In Baghdad, a conference to conciliate **Iraq's** rival political parties fell apart. Sunni and Shia groups walked out soon after Dick Cheney, America's vice-president, lauded political and security improvements in the country as "phenomenal". Mr Cheney was on a visit to mark the fifth anniversary of the American-led invasion.

A poll by a respected **Palestinian** firm, PSR, found that Hamas's Ismail Haniyeh would beat Fatah's Mahmoud Abbas in a presidential election. It was PSR's first such finding since the Islamists of Hamas won a parliamentary election two years ago, and a blow to American and Israeli efforts to weaken the party and boost the more accommodating Mr Abbas.

In **Kenya**, Parliament debated amendments to the constitution that would entrench a new power-sharing arrangement agreed between the president, Mwai Kibaki, and his main rival, Raila Odinga. Both sides also agreed to set up a commission of international experts to examine December's disputed election.

Soldiers from the African Union prepared to invade Anjouan, one of the **Comoro Islands** off the coast of Mozambique. Troops loyal to the Comoros' president have already clashed with supporters of the renegade leader of Anjouan, Mohamed Bacar, who took power last July after winning an election that the president declared illegal. See article

Sour Serbs

As long feared, newly independent **Kosovo** saw an outbreak of violence as United Nations forces tried to take back control of a courthouse in north Mitrovica from Serbs. One UN policeman was killed. See article

The ruling centre-right UMP party did badly in **France's local elections**, losing several cities and lots of council seats to the Socialists. But President Nicolas Sarkozy vowed to press on with his reforms. See article

Angela Merkel became the first **German** chancellor to address **Israel's** parliament. She spoke of Germans' shame over the Holocaust and promised to be a true friend and partner of Israel. The German cabinet also held a joint session with the Israeli cabinet. See article

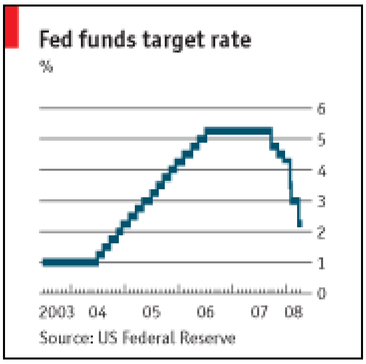
EPA

Business this week

Mar 19th 2008
From The Economist print edition

Financial markets endured another tumultuous few days, starting with a run on **Bear Stearns**, a venerable Wall Street bank, amid rumours of its imminent collapse. The **Federal Reserve** led a rescue by assuring $30 billion of the bank's assets and engineering its takeover by **JPMorgan Chase**. At the same time it said it would accept investment banks' collateral. The action was praised for halting Bear Stearns's complete meltdown. The deal values the investment bank at just $2 a share: in January 2007 its shares traded for over $170. See article

The Fed also made an emergency cut of one-quarter of a percentage point to its discount rate (which it charges commercial banks), to 3.25%, and extended the rate to securities firms. At its regular meeting, the **Federal Open Market Committee** reduced the federal funds rate by a further three-quarters of a percentage point, to 2.25%.



Small mercies

Lehman Brothers sought to reassure jittery investors after it saw 20% wiped off its market value on March 17th. Its share price stormed back after it reported a quarterly net profit of $489m, 57% less than in the same period a year ago but better than had been expected. **Goldman Sachs** also posted a much-reduced quarterly profit, of $1.51 billion, stemming from losses in mortgages and securities.

In a week when the markets were highly agitated, **Visa** managed to raise $17.9 billion from its initial public offering, the world's second-biggest (behind Industrial & Commercial Bank of China in 2006). The flotation will provide some much-needed cash to Visa's shareholders, the banks that issue credit cards.

Siemens issued a surprise profit warning because of delays to projects and contract cancellations, which will drag down its quarterly earnings by *euro*900m ($1.4 billion). The German engineering giant stressed that its problems had nothing to do with the present market turmoil. The news was a blow to Peter Löscher, Siemens's boss, who has begun a big clean-up at the company following a bribery scandal.

The dragon catches a cold

China's prime minister, Wen Jiabao, said his government would take “forceful” steps to dampen inflation, which is running well above official targets. Soon after Mr Wen spoke, China's reserve ratio was increased for the second time this year, with lenders ordered to place 15.5% of deposits with the central bank. See article

A federal appeals-court threw out the conviction handed down last year to **Joseph Nacchio** and ordered a retrial. Mr Nacchio was sentenced to a six-year prison term (though he remains free on bond) for insider-trading while chief executive of Qwest Communications. The appeals court said the conviction was unsound because testimony had been barred from an expert witness deemed crucial to Mr Nacchio's defence.

Responding to recent speculation, **BNP Paribas**, France's biggest bank, said it would not make a takeover bid for **Société Générale**, which in January unveiled a *euro*4.9 billion ($7.2 billion) loss that stemmed from a rogue-trading scandal.

CME Group made formal its agreement to buy the **New York Mercantile Exchange** for $9.4 billion. CME, created when the Chicago Mercantile Exchange and the Chicago Board of Trade combined last year, began negotiations with Nymex in January.

International Paper said it would buy **Weyerhaeuser's** packaging and recycling business in a deal valued at $6 billion. Because the offer is for assets and not stock, IP should reap a tax benefit worth around $1.4 billion, reducing the net purchase price accordingly. On either measure, it is one of the biggest deals in the timber-products industry in recent years.

Piping hot

Evraz, a Russian steelmaker part-owned by Roman Abramovich, agreed to buy the Canadian pipemaking business of Sweden's **SSAB** for $4 billion. Evraz then sold some of the division's assets to **TMK**, its compatriot. Demand is strong for steel piping in the North American oil and gas industry, but regulators will study the deal to see if there are any implications for energy security.

Air France-KLM cemented its offer to buy **Alitalia**, valuing the equity of Italy's loss-making state airline at just *euro*139m ($217m). The Italian government has been trying to offload the carrier for more than a year (several potential buyers pulled out of an auction last summer). It recommended Air France's offer, as did Alitalia's management. The airline's powerful unions, however, remain hostile, as are opposition politicians, one of whom invoked the battle of Caporetto—Italy's biggest defeat in the first world war. See article

KAL's cartoon

Mar 19th 2008
From The Economist print edition

Illustration by Kevin Kallaugher

Economist.com OPINION LEADERS

Wall Street

Wall Street's crisis

Mar 19th 2008
From The Economist print edition

What went wrong in the financial system—and the long, hard task of fixing it

THE marvellous edifice of modern finance took years to build. The world had a weekend to save it from collapsing. On March 16th America's Federal Reserve, by nature hardly impetuous, rewrote its rule-book by rescuing Bear Stearns, the country's fifth-largest investment bank, and agreeing to lend directly to other brokers. A couple of days later the Fed cut short-term interest rates—again—to 2.25%, marking the fastest loosening of monetary policy in a generation.

It was a Herculean effort, and it staved off the outright catastrophe of a bank failure that had threatened to split Wall Street asunder. Even so, this week's brush with disaster contained two unsettling messages. One is analytical: the world needs new ways of thinking about finance and the risks it entails. The other is a warning: the crisis has opened a new, dangerous chapter. For all its mistakes, modern finance is worth saving—and the job looks as if it is still only half done.

Rescuing Bear Stearns and its kind from their own folly may strike many people as overly charitable. For years Wall Street minted billions without showing much compassion. Yet the Fed put $30 billion of public money at risk for the best reason of all: the public interest. Bear is a counterparty to some $10 trillion of over-the-counter swaps. With the broker's collapse, the fear that these and other contracts would no longer be honoured would have infected the world's derivatives markets. Imagine those doubts raging in all the securities Bear traded and from there spreading across the financial system; then imagine what would happen to the economy in the financial nuclear winter that would follow. Bear Stearns may not have been too big to fail, but it was too entangled.

Gordian conduits

As the first article in our special briefing on the crisis explains, entanglement is a new doctrine in finance (see article). It began in the 1980s with an historic bull market in shares and bonds, propelled by falling interest rates, new information technology and corporate restructuring. When the boom ran out, shortly after the turn of the century, the finance houses that had grown rich on the back of it set about the search for new profits. Thanks to cheap money, they could take on more debt—which makes investments more profitable and more risky. Thanks to the information technology, they could design myriad complex derivatives, some of them linked to mortgages. By combining debt and derivatives, the banks created a new machine that could originate and distribute prodigious quantities of risk to a baffling array of counterparties.

This system worked; indeed, at its simplest, it still does, spreading risk, promoting economic efficiency and providing cheap capital. (Just like junk bonds, another once-misused financial instrument, many of the new derivatives will be back, for no better reason than that they are useful.) Yet over the past decade this entangled system also plainly fed on itself. As balance sheets grew, you could borrow more against them, buy more assets and admire your good sense as their value rose. By 2007 financial services were making 40% of America's corporate profits—while employing only 5% of its private-sector workers. Meanwhile, financial-sector debt, only a tenth of the size of non-financial-sector debt in 1980, is now half as big.

The financial system, or a big part of it, began to lose touch with its purpose: to write, manage and trade claims on future cashflows for the rest of the economy. It increasingly became a game for fees and speculation, and a favourite move was to beat the regulator. Hence the billions of dollars sheltered off balance sheets in SIVs and conduits. Thanks to what, in hindsight, has proven disastrously lax regulation, banks did not then have to lay aside capital in case something went wrong. Hence, too, the trick of packaging securities as AAA—and finding a friendly rating agency to give you the nod.

That game is now up. You can think of lots of ways to describe the pain—debt is unwinding, investors are writing down assets, liquidity is short. But the simplest is that counterparties no longer trust each other. Walter Bagehot, an authority on bank runs, once wrote: “Every banker knows that if he has to prove that he is worthy of credit, however good may be his arguments, in fact his credit is gone.” In our own entangled era, his axiom stretches to the whole market.

A question of priorities

This mistrust is enormously corrosive. The huge damage it could do to the world economy dictates what must now be done first. No doubt, there are many ways in which financial regulation needs to be fixed; but that is for later. The priority for policymakers is to shore up the financial system. That should certainly be done as cheaply as possible (after all, the cash comes from the public purse); and it should avoid as far as possible creating moral hazard—owners and employees should bear the costs of their mistakes. But these caveats, however galling, should not get in the way of that priority.

To its credit, the Fed has accepted that the new finance calls for new types of intervention. That is the importance of its decision on March 16th to lend money directly to cash-strapped investment banks and brokers and to accept a broader array of collateral, including mortgage-backed and other investment-grade securities. If investment banks can overcome the stigma of petitioning the central bank, this will guard them against the sort of run that saw Bear rejected by lenders in the short-term markets. Henceforth, the brokers will be able to raise cash from the Fed. The Fed is now lender-of-last-resort not just to commercial banks but to big investment banks as well (a concession that will surely in time demand tighter regulation).

Even if that solves Wall Street's immediate worries over liquidity, it still leaves the danger that recession will lead to such big losses that banks are forced into insolvency. This depends on everything from mortgages to credit-card debt. These, in turn, depend on the American economy's likely path, the depth to which house prices decline and the scale of mortgage foreclosures—and none of these things is looking good. Goldman Sachs's latest calculations, which suppose that American house prices will eventually fall by 25% from their peak, suggest that total losses will reach just over $1.1 trillion. At around 8% of GDP that is not to be sniffed at. But it includes losses held by foreigners, and “non-leveraged institutions” such as insurers. Goldman expects eventual post-tax losses for American financial firms to be around $300 billion, just over 2% of GDP, or about 20% of their equity capital.

The rebuilders' dilemma

That suggests a serious problem, but not a catastrophic banking crisis. And with the world awash with savings, banks ought to be able to raise new capital privately and continue lending. Unfortunately, things are not quite so simple. It would not take many homeowners to walk away from their debts for the losses to grow rapidly. Also, bank shareholders may prefer to cut back on lending rather than raise new equity. That would suit them, as equity is expensive and dilutes their stake. But it would not suit the economy, which would be pushed further into recession by sudden cuts in leverage.

By lending money to more banks for longer against worse collateral, the Fed hopes to stem panic and buy time. It wants Wall Street's banks to assess their losses and strengthen their balance sheets without the crippling burden of dysfunctional markets. And it hopes that cheaper money will ease that recapitalisation, inject confidence and cushion the broader economy. But that lingering risk of insolvency means that the state needs to be ready to take yet more action.

One option is to keep on intervening as events unfold. The other is to shock the markets out of their mistrust by using public money to create a floor to the market, either in housing or in asset-backed securities. For the moment, gradualism is the right path: it is cheaper and less prone to moral hazard (ask investors in Bear Stearns). Yet it is not easy to pull off—again, ask Bear Stearns's backers, who could possibly have been saved had the Fed begun lending to brokers sooner. If the crisis drags on and claims more victims, gradualism could yet become more expensive than a more ambitious approach.

Something important happened on Wall Street this week. It was not just the demise of a firm that traded through the Depression. Financiers discovered that they had created a series of risks that the market could not cope with. That is not a reason to condemn the whole system: it is far too useful. It is a sign that the rules need changing. But, first, stop the rot.

Economist.com OPINION LEADERS

Tibet

A colonial uprising

Mar 19th 2008
From The Economist print edition

The Dalai Lama is China's best hope of winning Tibetan acceptance

GEORGE ORWELL would have understood Chinese attitudes to Tibet. In “1984” he coined the term “doublethink”, or the ability to believe contradictory things. Thus Chinese leaders profess to believe both that traditional Tibetan culture is repugnant, full of superstition and cruelty, and that Tibet is an “inalienable part of China”. They also claim that the Dalai Lama, Tibet's spiritual leader, is becoming irrelevant, yet insist he managed to foment the latest outpouring of anti-Chinese resentment seen in Tibet (see article).

The Dalai Lama is a constant irritant in China's efforts to achieve full international respectability. His stature and access to world leaders keep the issue of Tibet alive, though no country recognises his government-in-exile. And, as Chinese leaders must grudgingly acknowledge, he retains the loyalty of many Tibetans. In 2005 conservationists, alarmed at the threat to endangered wildlife posed by a Tibetan fad for wearing tiger and other skins, asked the Dalai Lama to denounce the practice. He did, and Tibetans lit bonfires of the pelts.

So China persists in seeing the Dalai Lama as the embodiment of its “Tibet problem”. In fact, he offers the only plausible solution to it. China's strategy for dealing with him is to wait for his death, and install a pliable successor. Last year it even passed an edict giving the government a role in approving new incarnations of such “living Buddhas”. But this strategy is doomed. No successor will command such veneration. And so none will be as persuasive an advocate of non-violence and of a “middle way” for Tibet, short of the full independence many Tibetans believe is their birthright.

The fury, arson, vandalism and bloodshed seen in Lhasa in recent days were not instigated by the Dalai Lama. They erupted in spite of his frequent calls for restraint, and were in part a consequence of China's refusal to engage in more than desultory talks with his representatives. It could be far worse: to their great credit, Tibetan nationalists have hardly ever resorted to terrorist tactics, though exiled activists point out that the railway that opened in 2006 linking Tibet and China offers an obvious target.

Serious talks with the Dalai Lama, and the possibility of his returning home for the first time since fleeing to exile in India after an uprising in 1959, might help assuage Tibetan anger. It would also help vindicate those who argued that the staging of the Olympic games in Beijing would make China less repressive. It would give China the chance, belatedly, to honour the promise of autonomy it gave Tibet in 1951, in an agreement foisted on the young Dalai Lama. It would boost its image around the world, and even in Taiwan, which might become less averse to the idea of Chinese sovereignty.

A boot in the face

Yet China shows no sign of being swayed by these arguments. Rather it seems intent on using the Olympics to flaunt its control of Tibet, as the flame is paraded in Lhasa. As elsewhere in China, it hopes that economic advance will soften calls for political freedom. And as in other areas where ethnic minorities have been restive—Inner Mongolia and, especially, Xinjiang—it hopes immigration by the majority Han Chinese will swamp nationalist sentiment. Unless and until that happens, there is always sheer force. That has been used this time with more discretion than in the past. But it is nevertheless the means China seems to have chosen to rule Tibet. As in Orwell's dystopia, its picture of the future seems to be of a boot stamping on a human face, for ever. It need not be that way.

Economist.com OPINION LEADERS

Elections in Iran

Conservative or conservative?

Mar 19th 2008
From The Economist print edition

A pitiful narrowing of choices for Iranians—and for the outside world

Reuters

Get article background

IT IS hard to remember now, but just over a decade ago the Islamic Republic of Iran passed through a thrilling “Tehran spring”. In presidential elections in 1997, and again in 2001, voters elected a moderate, mild-mannered cleric, Muhammad Khatami, who advocated a “dialogue of civilisations” with the West and a big expansion of personal and political freedoms at home. Iran, it seemed, was mellowing. The revolution inspired by Ayatollah Khomeini in 1979 was losing its harder edges. Bitter memories of the eight-year war against Iraq started to give way to thoughts of a brighter future. Some academics in the West went so far as to see in Iran a model of how theocracy and democracy might co-exist in a single state.

How things have changed. The first-round election for the *majlis*, Iran's parliament, on March 14th was a parody (see article). The problem was not so much the stuffing of ballot boxes or a rigged count as the disqualification of hundreds of reformist candidates under a system of double vetting by the interior ministry and the Council of Guardians, an unelected body empowered to inspect the religious credentials of those wishing to stand. Although some reformers were allowed to slip through the net and went on to win seats, the pre-election vetting was plainly designed to put a ceiling on their numbers. So although a real political competition is taking place in the *majlis*, this is no longer between conservatives and reformers, as it was in the 1990s. Iranian voters are nowadays allowed to choose only between different flavours of conservatism.

What is at stake in this fight between conservatives? Less, alas, than many outsiders hope. The *majlis* elections are a foretaste of the bigger political dust-up that will come in 2009 when Mahmoud Ahmadinejad comes up for re-election as president. At present, he is the big-talking standard-bearer of the ultra-conservatives, the so-called “men of principle” who hope to keep the flame of revolution burning through rigid enforcement of Islamic rules at home and shrill confrontation with Satanic foes such as America and Zionism abroad. Ranged against him are the people the West habitually labels the “pragmatic” conservatives, grouped loosely around the familiar figure of Akbar Hashemi Rafsanjani, a former president Mr Ahmadinejad routed in the presidential election of 2005.

The limits of change

The final balance will not be clear until the second round. But even if the pragmatists prevail in parliament and win the presidency in 2009, Iran's posture in the world might not change. The three likeliest presidential challengers—Mohsen Rezai, Ali Larijani and Mohamed Baqer Qalibaf—differ from Mr Ahmadinejad in tone and on economics, but not much on the substance of foreign policy. All hail from the ideological Revolutionary Guards and seem no less eager than he is to assert Iran's nuclear “rights” or turn Iran into the great power that bested America. Besides, the presidency is the junior position in Iran. Towering over the president and *majlis* alike is Ayatollah Ali Khamenei, the supreme leader (pictured), who shows every sign of having approved of the freezing of the Tehran spring and none, yet, of wanting to reach out to Iran's foes.

Iranians may have a new president next year; Americans certainly will. That could offer the chance of an historic rapprochement. But if the new occupant of the White House thinks all it will take is to put on a friendlier face than George Bush's, he—or she—could be in for an unpleasant surprise.

Zimbabwe

Time for the rescue

Mar 19th 2008
From The Economist print edition

How to help Zimbabwe, if Robert Mugabe really gives up power at last

EPA

Get article background

FOR the first time in 28 years of increasingly reckless and vile rule, Zimbabwe's Robert Mugabe looks as if he may go (see article). But only may. He has rigged elections before the one on March 29th. He has ruined his country. He has the ruthless, delusional fanaticism of a clever man who is frightened of being toppled—and perhaps put on trial for his copious human-rights abuses. But this time there is at least a chance he may quit. And if he does, the West, along with Zimbabwe's comparatively very rich big neighbour, South Africa, and its increasingly prosperous small one, diamond-wealthy Botswana, should get together, with institutions such as the IMF and the World Bank, to pile in as generously as possible with advice, cash and, of course, some minimal conditions.

When inflation is running at more than 100,000% a year, even the cleverest economists are hard put to know what to do. In Zimbabwe, the black-market exchange rate is nearly ten times the official one. Much of the economy is now informal. Some 80% of the people are no longer in officially counted jobs. To an extent, the economy is already becoming dollarised. Any workable reform would start with a fiscal stabilisation, halt the furious printing of money, let a new currency float down to the unofficial rate, then probably peg it to a (relatively) solid currency, perhaps the South African rand. There would be much pain. At the least, generous outsiders would need to provide a welfare safety-net.

But first things first. Mr Mugabe is still there. If he merely stepped aside to let one of his fellow villains in his corrupt and vicious ZANU-PF party take over, leaving the apparatus of misrule untouched, the West would be foolish to rush in with misplaced kindness. Above all, it would be unfair on the wretched Zimbabweans, for the cash would go not to them but to the fat cats and thugs who have plundered the country.

No one knows how the coming elections will play out. But there is a fair chance that the presidential contest will go to a second round, which should boost a challenger's chances, were he to run off against the incumbent. Cracks have opened in Mr Mugabe's party since he has been tackled by an insider, Simba Makoni, a decent technocrat whom many in the West and in South Africa would love to see running a revamped Zimbabwe. Unfortunately, he looks unlikely to win, even if Mr Mugabe were to give him a fair chance of doing so. The opposition party that carries more brawn and more voters may still be the one led by Morgan Tsvangirai, a courageous but less erudite trade unionist whose skull Mr Mugabe's policemen broke only a year ago. Mr Mugabe would be even more loth to let Mr Tsvangirai win—and could well stop him with violence or prison.

The ideal would be a government of national unity, with Messrs Tsvangirai and Makoni at the head, perhaps with a clutch of Mr Mugabe's cannier friends switching sides with some of their machinery of government. Mr Makoni says he would afford Mr Mugabe a peaceful retirement.

Mr Mugabe's intemperate expulsion of the white farmers was what sent his economy into a tailspin, for Zimbabwe's manufacturing, now decayed, was largely linked to their output. No Zimbabwean government can reverse that action, disgraceful though it was; the land issue is far too sensitive. But any sensible new administration must first carry out a land audit, give decent compensation, then arrange for leaseholds, management contracts, surety of tenure and individual title deeds across the land, including the communal areas. Most white farmers, though sorely needed, will not return.

Bobbing away

As the 84-year-old Mr Mugabe enters his last lap, Western governments, particularly those of Britain and America, would be wise to hold back from overtly backing either of his challengers. But that does not mean outsiders should be completely silent. For too long the West has left the diplomacy to South Africa's now lame-duck president, Thabo Mbeki. It should now make it clear that once a new Zimbabwean government shows a willingness to respect property, human rights and the rule of law, the West and its friends in southern Africa will be more generous than ever. There is no time to lose; Zimbabwe and Zimbabweans are dying. It is a tragedy that has gone on for far too long.

Economist.com OPINION LEADERS

Internet communities

Break down these walls

Mar 19th 2008
From The Economist print edition

History suggests that open standards will once again trump "walled gardens" on the internet

Illustration by David Simonds

"THE farther back you can look, the farther forward you are likely to see." Apply Winston Churchill's aphorism to the internet, and about the farthest back you can look is 1994, when the previously obscure computer network first became known to a wider public. Many people first ventured onto the internet from AOL, CompuServe and Prodigy, which were subscription-based online services that offered e-mail, chatrooms, discussion boards and so on. Having provided their users with access to the internet, however, these venerable digital communities were undermined by it.

Why stay within a closed community when you can roam outside its walled garden, into the wilds of the internet proper? Admittedly, it took a while for open and standardised forms of e-mail, discussion boards and file downloads—not to mention a new publishing technology called the world wide web—to match the proprietary, closed versions that preceded them. Today only AOL survives, and in a very different form: as an open web portal supported by advertising.

Now history seems to be repeating itself. Two of the biggest online phenomena of the past couple of years—social networks such as Facebook, and virtual worlds such as Second Life—look an awful lot like AOL did in 1994. They are closed worlds based on proprietary standards. You cannot easily move information in and out of them: try shifting your Facebook profile to MySpace, or moving a piece of clothing or furniture from Second Life to Entropia Universe. True, the walled-off nature of these communities is part of their charm. And their proprietary nature is also inevitable: only when a technology is established do standards emerge. But that is now starting to happen with social networks and virtual worlds.

The gate in the corner and the meadow beyond

Just as the web's open standards, embodied in the Netscape browser, displaced AOL and its ilk, so Netscapisation awaits Facebook and Second Life. As new standards make it easier to pipe data in and out of social networks, the need to visit a particular website to catch up with friends may come to seem as quaint as AOL's "You've got mail" alert (see article). Similarly, work is under way to allow links, akin to those between websites, to be set up between virtual worlds based on open standards and hosted on different machines. Why bother with an island in Second Life when you can build your own world?

Marc Andreessen, Netscape's co-founder, now runs Ning, a start-up that lets people set up their own social networks; and Multiverse, founded by several Netscape veterans, is one of several firms providing virtual-world construction tools. The question for Facebook, Second Life and the rest is how fast they can adapt. Philip Rosedale, Second Life's creator, is keenly aware of the historical precedent and scans old news reports about AOL in an effort to avoid a similar fate. Facebook, a little reluctantly, is starting to open up. Most curious of all is AOL's acquisition of Bebo, an up-and-coming social network, earlier this month. Has AOL forgotten the lessons of history—or might it just be uniquely well-placed to apply them?

Economist.com OPINION LETTERS

On Colombia, asset management, Iraq, India, populism, old age

Mar 19th 2008
From The Economist print edition

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Colombia's army

SIR – I read your article on Colombia's recent action against rebel units with interest and found your coverage to be largely accurate ("On the warpath", March 8th). However, you stated that Colombian troops "left three wounded women guerrillas unattended" after the engagement. For the record, that was not the case. The operation was conducted with strict adherence to the rules of international humanitarian law.

Our troops are well trained in such protocols. As the video of the operation proves, our security forces not only respected the survivors but also provided first aid. In addition, our forces gave the exact co-ordinates to the Ecuadorian army so it could provide further assistance to the wounded as soon as possible.

Colombia, with the help of Britain, has developed procedures and training pertaining to human rights in combat-operation situations and the Colombian Ministry of Defence maintains a comprehensive human-rights policy that forms the basis of the national security forces' conduct when they carry out their actions.

Juan Manuel Santos
Colombian minister of defence
Bogotá

Looking after your money

SIR – Your special report on asset management (March 1st) skimmed over a big problem in the industry: the woeful lack of knowledge about finance, not only among the public, but also among professionals. The second statutory objective of Britain's Financial Services Authority is to promote public understanding of the financial system. There is precious little evidence of this happening, which is probably because the majority of the FSA's funding comes from established companies that have no interest in getting the public to ask searching questions about fees and performance.

Few salesmen are encouraged to explain information ratios so that investors can understand what risks are incurred to beat the market. When it comes to technical products like cars and phones, the public quickly learns to understand horsepower, fuel consumption, 3G, battery life and the trade-offs between them. Why not with finance?

Robert Davies
Managing director
Fundamental Tracker
Investment Management
Glasgow

Easter message

SIR – You say that "more kindness from a few more countries wouldn't go amiss" in relation to the 4m Iraqis displaced since the American-led invasion of Iraq began five years ago ("Less than generous", February 23rd). Your tone suggests that succour, compassion and kindness towards the Iraqis should now be offered by rich countries. However, the desperation of more than 2m Iraqi refugees along with the murder and mayhem that continues to displace another 2m demands justice, not simply charity.

Amends must be made by America and its coalition partners (including Britain, Australia and others) for the enormous damage done.

Sister Antoinette Harris
Rome

Yes, prime minister

SIR – Your briefing on India's civil service ("Battling the babu raj", March 8th) highlights how the country still retains the legacy of the raj, whereby an elite generalist civil service dominates the top public jobs, but with little expertise in most areas. To change this, Manmohan Singh, the prime minister, is urging "lateral entry" from non-government backgrounds into the civil service's senior posts in order to inject some fresh thinking and innovation into the system.

M. Shamsur Rabb Khan
Delhi

SIR – Battling the babu raj is more arduous than eliminating poverty in India. Prime ministers have come and gone pledging enthusiastically to shake up the bureaucracy. Not one of them ever succeeded. I had my own run-ins with senior civil servants when I was an urban planner.

One of the favourite phrases my bosses used when they wanted to stall a proposal was that the project was "not financially feasible", even though they had not looked at the financial implications. I once came up with a plan to conduct a detailed ecological survey. My boss listened patiently to my presentation but it made no sense to him at all. He suggested, sarcastically, that we would have to count the leaves on all the trees. Out of frustration, I quit my job and moved to America, along with many qualified engineers, scientists and doctors.

Ram Setya
Mission Viejo, California

A popular subject

SIR – Despite my recent letter (February 23rd) you still throw the term "populist" around with abandon. Your leader ("Hope and fear", March 1st) used the term "populist" or "populism" no fewer than five times in describing the Democratic Party's candidates.

But when we turn to your article on John McCain ("No country for old men", March 1st) it is a completely different story. Here we read: "Mr McCain sells himself as a scourge of special interests and hammer of lobbyists. He also styles himself a hands-on reformer who has tried to fix America's campaign-finance system." Is this not populism? If not, why not? If so, why is the word so conspicuously avoided?

Stephen Morris
Coorparoo, Australia

SIR – Populism in America reached its height in the late 19th century and was embodied in the Populist Party, which proposed policies such as nationalising the railroads and enforcing limitations on private property. Since the party's decline the term "populist" generally refers to candidates who market themselves as the representative of "the common man". Such candidates are usually isolationist, desire heavier government regulation of the economy and subsidies for the poor.

Examples range from William Jennings Bryan, a Populist presidential aspirant, to Huey Long, and presently to John Edwards and Mike Huckabee. Populist candidates are antagonistic to free trade on some level and usually do not have a grasp of basic economics. It neither surprises nor perturbs me that *The Economist* does not like populist politicians.

Aaron Mowery
Dayton, Tennessee

That 70s show

SIR – You really shouldn't be surprised that the late paintings of Titian are "among his finest" and not "an old man's doodles" ("Worth waiting for", March 8th). Lots of studies have shown that the positive attributes of ageing—wisdom, perspective and experience, to name but a few—contribute to an often radical enrichment of the output of older artists. This is seen in painting (Hokusai, Kandinsky, Matisse, Rembrandt); sculpture (Michelangelo, Henry Moore); architecture (Frank Lloyd Wright, Sir Christopher Wren); literature (Beckett, Tennyson, Yeats); and music (Haydn, Janacek). William Carlos Williams, a poet and a doctor, spoke eloquently of an "old age that adds as it takes away".

Professor Desmond O'Neill
Department of medical gerontology
Trinity College
Dublin

A week in Tibet

Trashing the Beijing Road

Mar 19th 2008 | LHASA
From The Economist print edition

Our Beijing correspondent happened to be in Lhasa as the riots broke out. Here is what he saw

ETHNIC-Chinese shopkeepers in Lhasa's old Tibetan quarter knew better than the security forces that the city had become a tinder-box. As word spread rapidly through the narrow alleyways on March 14th that a crowd was throwing stones at Chinese businesses, they shuttered up their shops and fled. The authorities, caught by surprise, held back as the city was engulfed by its biggest anti-Chinese protests in decades.

What began, or may have begun (Lhasa feeds on rumour), as the beating of a couple of Buddhist monks by police has turned into a huge political test for the Chinese government. Tibet has cast a pall over preparations to hold the Olympic games in Beijing in August. Protests in Lhasa have triggered copycat demonstrations in several monasteries across a vast swathe of territory in the “Tibet Autonomous Region” of China and in areas around it (see map). Not since the uprising of 1959, during which the Dalai Lama, Tibet's spiritual leader, fled to India, has there been such widespread unrest across this oxygen-starved expanse of mountains and plateaus.

Years of rapid economic growth, which China had hoped would dampen separatist demands, have achieved the opposite. Efforts to integrate the region more closely with the rest of China, by building the world's highest railway connecting Beijing with Lhasa, have only fuelled ethnic tensions in the Tibetan capital. The night before the riots erupted, a Tibetan government official confided to your correspondent that Lhasa was now stable after protests by hundreds of monks at monasteries near the city earlier in the week. He could not have been more wrong.

It was, perhaps, a sign of the authorities' misreading of Lhasa's anger that a foreign correspondent was in the city at all. Foreign journalists are seldom given permission to visit. In January 2007, in preparation for the Olympics, the central government issued new regulations that supposedly make it much easier for them to travel around the country. Travel to Tibet, however, still requires a permit. *The Economist*'s visit was approved before the monks protested on March 10th and 11th, but the authorities apparently felt sufficiently in control to allow the trip to go ahead as planned from March 12th. As it turned out, several of the venues on the pre-arranged itinerary became scenes of unrest.

Rioting began to spread on the main thoroughfare through Lhasa, Beijing Road (a name that suggests colonial domination to many a Tibetan ear), in the early afternoon of March 14th. It had started a short while earlier outside the Ramoche Temple, in a side street close by, after two monks had been beaten by security officials. (Or so Tibetan residents believe; the official version says it began with monks stoning police.) A crowd of several dozen people rampaged along the road, some of them whooping as they threw stones at shops owned by ethnic Han Chinese—a group to which more than 90% of China's population belongs—and at passing taxis, most of which in Lhasa are driven by Hans.

The rioting quickly fanned through the winding alleyways of the city's old Tibetan area south of Beijing Road. Many of these streets are lined with small shops, mostly owned by Hans or Huis, a Muslim ethnic group that controls much of Lhasa's meat trade. Crowds formed, seemingly spontaneously, in numerous parts of the district. They smashed into non-Tibetan shops, pulled merchandise onto the streets, piled it up and set fire to it. Everything from sides of yak meat to items of laundry was thrown onto the pyres. Rioters delighted in tossing in cooking-gas canisters and running for cover as they exploded. A few yelled "Long live the Dalai Lama!" and "Free Tibet!"

For hours the security forces did little. But the many Hans who live above their shops in the Tibetan quarter were quick to flee. Had they not, there might have been more casualties. (The government, plausibly, says 13 people were killed by rioters, mostly in fires.) Some of those who remained, in flats above their shops, kept the lights off to avoid detection and spoke in hushed tones lest their Mandarin dialect be heard on the streets by Tibetans. One Han teenager ran into a monastery for refuge, prostrating himself before a red-robed Tibetan abbot who agreed to give him shelter.

The destruction was systematic. Shops owned by Tibetans were marked as such with traditional white scarves tied through their shutter-handles. They were spared destruction. Almost every other one was wrecked. It soon became difficult to navigate the alleys because of the scattered merchandise. Chilli peppers, sausages, toys (child looters descended on those), flour, cooking oil and even at one spot scores of small-denomination bank notes were ground underfoot by triumphant Tibetan residents into a slippery carpet of filth.

During the night the authorities sent in fire engines, backed by a couple of armoured personnel-carriers laden with riot police, to put out the biggest blazes. By dawn they had also sealed off the Tibetan quarter with a ring of baton-carrying troops and stationed officers with helmets and shields in the square in front of the Jokhang temple, Tibet's most sacred shrine, in the heart of the old district. But they did not move into the alleys, where rioting continued for a second day. Residents within the security cordon attacked the few Han businesses left unscathed and set new fires among the piles of debris.

The risks of crackdown

Han Chinese in Lhasa were baffled and enraged by the slow reaction of the security forces. Thousands of people probably lost most, if not all, of their livelihoods (the majority of Lhasa's small businesses have no insurance, let alone against rioting). But the authorities were clearly hamstrung by the political risks involved. Going in with guns blazing—the tactic used to suppress the Tiananmen Square protests of 1989 and the last serious outbreak of anti-Chinese unrest in Lhasa earlier that year—would risk inciting international calls for a boycott of the Olympic games. Instead they chose to let the rioters vent their anger, then gradually tighten the noose.

On March 15th occasional rounds of tear-gas fired at stone-throwing protesters eventually gave way to a more concerted effort to clear the streets. Paramilitary police began moving into the alleys, firing occasional bullets: not bursts of gunfire, but single deliberate shots, probably more in warning than with intent to kill. They also moved from rooftop to rooftop to deter residents from gathering on terraces overlooking the alleys. Rumours abounded of Tibetans killed by security forces in isolated incidents during the earlier rioting, but not during the final push to reassert control over the city. By Chinese standards (not high when it comes to riot control), that effort appeared relatively measured.

By late on March 15th the alleys were quiet. Patrols firing the odd bullet kept most of them deserted the next day, too. A Western student said she saw six Tibetan boys hauled out of their homes by troops, pushed to the ground, kicked and beaten with batons. The boys were then bundled into a bus and driven away. Troops covered up the bloodstains on the road with a white substance, she said. The Tibetan quarter is now gripped by fears of widespread and indiscriminate arrests as the authorities attempt to find “ringleaders”. China's official news agency says 105 rioters have surrendered to the police.

When residents began venturing out more normally on March 17th, the extent of the rioting became clear. Numerous Han Chinese-owned premises well beyond the Tibetan quarter had been attacked. Several buildings had been gutted by fire. The gate of the city's main mosque was charred, and the windows of the guard-house of the *Tibet Daily*, the region's Communist Party mouthpiece, had been smashed.

The city was under martial law in all but name. The government said that only police were involved in the security operation, but there were many military-looking vehicles on the streets with their tell-tale licence-plates covered up or removed. Some troops refused to say what force they belonged to. Two armoured personnel-carriers were parked in front of the Potala Palace, Lhasa's most famous tourist attraction on the side of the hill overlooking the city, which is now closed. Troops with bayonets were deployed along roads leading to the city's main monasteries, which have been sealed off by police. The rioting on March 14th and 15th involved mainly ordinary citizens, but monks are often at the forefront of separatist unrest in Tibet.

The approaching flame

The government's decision not to declare martial law, or any emergency restrictions, reflected its concern about the Olympics. In March 1989 the authorities imposed martial law in Lhasa to quell separatist unrest. Its measures were barely distinguishable from those now in force in the city. The old Tibetan area has been sealed off by gun-carrying troops, but officials prefer to refer euphemistically to “special traffic-control measures”. This time foreign tourists in Lhasa have been “advised” rather than ordered to leave. On March 18th police and troops began moving the 100 or so remaining tourists to hotels far from the site of the riots. In 1989 foreign journalists were expelled from Lhasa. This time your correspondent was allowed to stay, but only until his permit expired on March 19th. No others were allowed in.

For all the government's attempts to appear unruffled, the recent unrest in Tibet exceeds the challenge it faced in 1989. Since March 10th protests have been reported not only in Lhasa's main monasteries (Drepung, Sera and Ganden), but also at Samye Monastery about 60km east of Lhasa, Labrang Monastery in Gansu province, Kirti Monastery in Sichuan province and Rongwo Monastery in Qinghai province. Tibet's traditional boundaries stretch into these provinces. Outside Labrang Monastery Tibetans attacked Han Chinese shops on March 15th. TibetInfoNet, a news service based in Britain, reported several protests in various parts of Gansu on March 16th. Unlike in the ethnic violence in Lhasa, it said, the protesters' main targets were symbols of state power and government-owned properties.

The challenge is partly a security one. The martial-law regulations imposed in Lhasa in March 1989 were not lifted until May the following year. This time China will need to move faster to restore a semblance of normality. On June 20th the Olympic flame, having been carried up the Tibetan side of Mount Everest the previous month, is due to arrive in Lhasa, where a big ceremony is planned. Barring journalists and flooding Lhasa's streets with troops would be embarrassing. More so would be cancelling the event.

But easing the clampdown would be risky. Many Tibetans see the Olympics as a golden opportunity to bring the world's attention to their problems under Chinese rule. Tibetans living outside China, particularly in India, have been taking advantage of the Olympics to step up their publicity efforts. This is an annoyance to India, which does not want to disrupt relations with China by appearing to condone efforts to disrupt the games. Indian police have blocked efforts, launched on March 10th by hundreds of dissident Tibetans, to stage a march across the mountains into their homeland.

China worries too about the possibility that other ethnic minorities in China, particularly Muslim Uighurs in the far western region of Xinjiang, may be emboldened by Tibetan activism if it is left unchecked. The Chinese authorities have played up reports about recent alleged terrorist activities in Xinjiang (as an excuse to suppress peaceful dissent, say sceptics), including what officials say was an attempt by a Uighur woman to start a fire on board a flight bound for Beijing on March 7th.

Richer, but not happier

The longer-term challenge for China is to rethink its Tibet policy. One reason why Chinese officials appeared so surprised by the unrest is that Tibet has not behaved like the rest of China, where rapid economic growth appears to have staved off a repeat of Tiananmen-style protests. A surge of government spending on infrastructure in recent years and strong growth in Tibet's tourism industry (made easier by the new infrastructure, especially the rail link, which was opened in 2006) have helped the region's GDP growth rate stay above 12% for the past seven years. In 2007 it was 14%, more than two points higher than the national rate.

Incomes have been rising fast too. Officials predict a 13% increase this year for rural residents, a sixth straight year of double-digit growth. Urban residents enjoyed a 24.5% increase in disposable income last year. Robbie Barnett of America's Columbia University says a new middle class has emerged in Lhasa in recent years. But, he says, this has made very little difference to what Tibetans think about politics.

AFP

A man not easily angered

In the old Tibetan quarter, many see the Han Chinese as the biggest beneficiaries of economic growth. Hans not only run most of the shops, but are moving into the Tibetan part of the city. Some Tibetans believe Han Chinese now make up around half of the city's population, with the railway bringing in ever more. (An official, however, points out that it is now also easier for Tibetans to reach Lhasa from distant parts of the plateau.)

The economic statistics may be misleading. Incomes may have been growing fast on average, but in the countryside averages have been skewed by soaring demand in the rest of China for a type of traditional medicine known as caterpillar fungus. Tibetans in rural areas where this fungus grows have seen their incomes rocket (and fights have broken out among them over the division of fungus-producing land). In the cities, many complain about fast-rising prices of goods imported from other parts of China. Inflation is a big worry elsewhere in China too, but Tibetan bystanders watching the riots said that Chinese officials had promised the rail link would help bring prices down. The near-empty expanse of the Lhasa Economic and Technological Development Area suggests that officials are having trouble replicating in Tibet the manufacturing boom seen elsewhere in China.

Tibetans also resent the hardline policies of Tibet's party chief, Zhang Qingli. Mr Zhang, who is a Han (China apparently does not yet trust Tibetans to hold this crucial post), was appointed in 2005 after a spell spent crushing separatism in Xinjiang. When he took charge, neglected rules banning students and the families of civil servants from taking part in religious activities began once more to be rigorously enforced. Mr Zhang also stepped up official invective against the Dalai Lama, who is widely revered. (Many Tibetans in Lhasa defiantly hang portraits of him in their homes, or did until the troops moved in.) Mr Zhang urged more “patriotic education” in monasteries, part of which involves denouncing the Dalai Lama. He banned the display of portraits of the Karmapa Lama, who fled to India in 1999 and enjoys a devoted following in Tibet.

The Dalai Lama's role

Chinese officials have been divided over whether greater contact with the Dalai Lama would help to pacify Tibet. Between 2002 and July last year Chinese officials held six rounds of talks with the Dalai Lama's representatives. Laurence Brahm, an American author who has tried to mediate, says the discussions reached a high point in 2005 when the Chinese appeared to recognise that the Dalai Lama was crucial to resolving Tibet's tensions. At one stage the Chinese even considered allowing the Dalai Lama to visit Wutai Mountain in Shanxi province as a confidence-building measure, but they got cold feet. Talks eventually foundered over China's refusal to accept the Dalai Lama's statements that all he wants is Tibet's autonomy within China.

With troops on the streets, dialogue looks unlikely in the near future. China has accused the “Dalai Lama clique” of organising the riots. The Dalai Lama has denied involvement and has accused the Chinese of carrying out “cultural genocide” in his homeland. But he also needs to worry about the future of Han Chinese in Tibet. Many Han business people in Lhasa say they are planning to leave. Tourism from the interior, crucial to Lhasa's economy, is likely to be hard hit too. In the end, China may have a point with its obsession about economics. The recent boom has not won the loyalty or affection of Tibetans, but a slump would make them all the more angry.

The Jeremiah Wright affair

The trouble with uncles

Mar 19th 2008 | WASHINGTON, DC
From The Economist print edition

AP

Barack Obama is having the worst fortnight of his campaign

Get article background

REALISTS (there are a few) within the Clinton campaign must have asked themselves, over the past dismal months, whether the war was worth the fighting. Hillary Clinton has no reasonable chance of catching up with Barack Obama's lead in elected delegates. Only this weekend Mr Obama added another nine delegates to his tally in Iowa's spring convention, putting him just under 170 clear of Mrs Clinton. Even when you add in the superdelegates, where Mr Obama has trailed Mrs Clinton, the totals are still 1,627 to 1,494: an Obama lead of 133.

But if Mrs Clinton cannot win the nomination, perhaps Mr Obama can lose it. That is the hope that has kept Mrs Clinton alive. And it is a hope that has come a bit closer to being realised in recent days.

The Obama campaign has been topsy-turvied by revelations about the eccentric views of his pastor, Jeremiah Wright. Mr Wright has been shown on video urging his congregation to sing “God damn America” rather than the usual version, and referring to America as “the US of KKKA”. This was not a momentary aberration but part of a pattern of incendiary rhetoric.

Mr Wright believes that September 11th 2001 was “chickens coming home to roost”. He accuses the American government of manifold evils, from manufacturing the AIDS virus in order to kill blacks and grinding the faces of the world's poor (“America is still the number-one killer in the world”). Mr Wright is an admirer of both Louis Farrakhan, the leader of the Nation of Islam, and Muammar Qaddafi, the president of Libya.

Mr Obama has spent the past few days on the television responding to endless replays of his pastor's greatest hits. He likened Mr Wright (who has recently retired) to “an old uncle who says things I don't always agree with,” and claimed that he had not been present when any of the incendiary sermons were delivered.

Mr Obama also used the opportunity to dump some more bad news. He told reporters that his relationship with Tony Rezko, a Chicago property developer and former Obama fund-raiser who is on trial in federal court, was closer than he has said, and that his campaign has received more money from him than it had admitted ($250,000 rather than $150,000).

None of this is very convincing. Mr Wright was not an uncle but the man who brought Mr Obama to God. Mr Obama has been a member of his Trinity United Church of Christ for 20 years. Mr Wright presided at his wedding and baptised his children. Mr Obama even borrowed the title of his bestselling autobiography, “The Audacity of Hope”, from one of Mr Wright's sermons.

Mr Obama addressed his “Wright problem” at greater length in a speech in Philadelphia on March 18th. He made no attempt to distance himself from Mr Wright (“I can no more disown him than I can disown the black community”). But he argued that there is more to the reverend than a handful of noxious remarks: his church has been doing good works in Chicago for 30 years. Then he turned his speech into a broad discussion of race—a subject that he has hitherto touched on only lightly in his campaign.

He argued that the original sin of slavery and segregation has left deep scars on black America. Mr Wright's anger is shared by many black Americans who were born in a country that denied them basic rights. But he softened this with a more ecumenical message. He argued that blacks bear some responsibility for their plight. He sympathised with white voters who feel short-changed by affirmative action. And he argued that America is making strides in addressing the racial divide. Mr Wright's mistake was not his anger at America's past sins but his failure to understand that the country is evolving beyond them. Mr Obama's message, in the end, was that his own presidential campaign is the solution to the resentments his pastor expressed.

This was extremely well done, a speech that challenged Americans' intelligence rather than insulting it. Mr Obama went some way towards addressing the criticism that his association with Mr Wright undercuts his message of racial reconciliation. He also demonstrated that he can use his formidable rhetorical powers to address difficult subjects rather than simply to rev up a sympathetic crowd.

But the Wright affair could still cause problems with white voters, particularly the white working-class voters whom Mr Obama has had trouble with in the past, most recently in Ohio. There are two things that annoy these people more than anything else—insulting America and playing the victim card. Mr Wright did not just argue that America's past is imperfect; he blamed it for mass-murder. He did not just complain about slavery; he said that whites are continuing to oppress blacks.

A recent poll suggests the affair could end up costing Mr Obama votes: 56% of all voters and 44% of Democratic voters said that Mr Wright's comments made them less likely to vote for Mr Obama (though 11% of voters said they made them more likely to vote for him). But pundits will have to wait for the Pennsylvania primary, on April 22nd, to see whether this is a blip or a longer-term problem. A new Quinnipiac University poll shows Mrs Clinton increasing her lead among white voters in Pennsylvania from 56% to 37% on February 14th to 61% to 33% on February 27th.

Mr Obama's association with the likes of Messrs Wright and Rezko also raises doubts about his judgment, a virtue that he has stressed, particularly over the Iraq war, to trump Mrs Clinton's claim to experience. There is not only the question of why he associated with Mr Wright in the first place (arguing that he represents the “black church” is rather like arguing that Al Sharpton represents the black civil-rights movement). There is also the question of why Mr Obama waited for the recent media firestorm to distance himself from the reverend. Questions about his judgment take on a particular significance at a time when the economy is in trouble, and people are looking for steady leadership.

Mr Obama is not the only candidate with rattling skeletons. Mrs Clinton has refused to release her recent tax returns (as Mr Obama has done) and given everybody the run-around on the question of her White House records. But one thing is clear: the row and the Democratic deadlock are wonderful for John McCain, who is looking like the luckiest man in American politics.

The Democrats

Inside the minds of the superdelegates

Mar 19th 2008 | WASHINGTON, DC
From The Economist print edition

Hillary Clinton wants party grandees to give her the nomination

Get article background

THE rules governing the selection of a Democratic presidential nominee are strangely complex. The formulae by which primary or caucus votes translate into delegates vary so much from state to state that experts can only estimate the size of Barack Obama's lead. He has some 1,414 “pledged” delegates (ie, ones elected by ordinary Democrats) to Hillary Clinton's 1,246, with 2,025 needed to win. Mrs Clinton is highly unlikely to overtake him, so she needs to persuade most “superdelegates” to back her.

These are party bigwigs: members of Congress, sitting governors, former presidents and the like. There are some 800 of them—a fifth of the total number of delegates. Their role in the nomination process dates back to the 1980s, when party bosses decided that people such as themselves should be empowered to break a tie or stop the great unwashed from picking someone unsuitable.

Over half of the superdelegates have already endorsed a candidate, but they can change their minds, and several have recently switched to Mr Obama. The rest are undecided. Both sides are frantically wooing them all.

The Obama camp says the superdelegates are morally obliged not to overturn the will of the people. If so, Clintonites retort, what is the point of having superdelegates? Their pitch is that no matter what the polls say, Mr Obama cannot win a general election.

He is too green, they say, to survive the Republican attack machine. Mrs Clinton has won nearly all the big states, they note, and crucial swing states such as Ohio and (next month, they hope) Pennsylvania. No Democrat can win the White House without Pennsylvania and Ohio, they insist. The flaw in this argument is that winning a Democratic primary is quite different from winning a general election.

Uncommitted superdelegates are either enjoying the attention or hiding under tables. In theory, they have the power to pick the nominee. But most will be reluctant to snub the party's rank-and-file. Chris Van Hollen, a congressman from Maryland who has remained neutral because he is the chairman of the Democratic Congressional Campaign Committee, argues that superdelegates should not overturn the will of elected delegates unless “some totally unpredictable event”, like a scandal, renders the leading candidate unelectable. Mrs Clinton's supporters may try to argue that the Jeremiah Wright affair does just that. The *Daily Kos*, a multi-author lefty blog, accuses Mrs Clinton of “fomenting civil war” among Democrats and plotting a “coup by superdelegate”. If that happens, the backlash from Mr Obama's supporters could be fearful.

Some Democrats think their party's agonising selection process will produce a battle-hardened nominee backed by legions of fired-up supporters. Others are less sanguine. Many Obama supporters fear that so much mud will be thrown that their man could lose in November.

Handgun bans

Whose right to bear arms?

Mar 19th 2008 | WASHINGTON, DC
From The Economist print edition

The Supreme Court hears a crucial case

GUN laws are a matter of life and death, reckoned both groups of protesters outside the Supreme Court on March 18th. One side argued that sensible curbs on gun ownership save lives. The other side retorted that if you outlaw guns, only criminals will carry them. Plus the police, of course, but gun-lovers don't find that terribly reassuring. “When seconds count, the police are only minutes away,” read one placard.

The oddly punctuated second amendment to America's constitution says: “A well regulated Militia, being necessary to the security of a free State, the right of the people to keep and bear arms, shall not be infringed.” Does this mean that all Americans may own guns, or only those who serve in a militia? Oddly, given how emotive this dispute is, the Supreme Court has never settled it. But the case of *District of Columbia v Heller*, which was argued this week, gives it a chance to do just that.

At issue is the near-total ban on handguns in Washington, DC. Dick Heller, a federal security guard who carries a gun while protecting his fellow citizens, wants one at home to protect himself. The city says he can't have one. Handguns are easy to conceal and can be brought into schools. If Mr Heller wants to defend his home, he can buy a rifle or a shotgun—though these must be kept disassembled and unloaded, or trigger-locked.

Chief Justice John Roberts asked the city's lawyer how long he needs to switch off his trigger lock (which requires entering a three-digit code) when a criminal is climbing through the window. About three seconds, was the answer. Presumably, said Mr Roberts, you must first turn on the lamp and pick up your reading glasses? The gallery seemed to find this most amusing.

But the case will turn on something more fundamental. The city wants the court to rule that Americans have a right to bear arms only in service of a government militia. This would upend the law and drive the gun lobby bonkers. Failing that, Washington wants its ban on handguns to be accepted as reasonable. Neither verdict, however, is likely.

One can rarely be sure what the nine Supreme Court judges are thinking, but there were several hints that at least some of them think the second amendment protects what Anthony Kennedy, who is often the swing vote, calls “a general right to bear arms”. If a majority agrees, the DC gun ban, which is the nation's strictest, will probably be struck down.

But the court's ruling, which may not come for weeks, will probably be quite narrow. Mr Roberts, for one, prefers to rule narrowly whenever possible. Too wide a decision would threaten every gun curb in the country, perhaps even the national ban on machineguns. But even a narrow ruling could affect similar bans in other cities, like New York.

Virginia's exurbs

Paint them blue

Mar 19th 2008 | LEESBURG, VIRGINIA
From The Economist print edition

The people to woo in this presidential election

DRIVE westwards on Virginia's Route 7 out of Washington, DC, and you will see acres of brand-new gated communities spreading towards the rolling hills of horse country. Eastern Loudoun is about a 40-minute trip from the capital and the county's population is one of the fastest-growing in America. Its vast expanses are relentlessly being tamed and subdivided into plots for family homes, as couples seek inexpensive property and good schools near the city. And it is on this urban fringe, and others like it, that the presidential election may hinge.

America's suburbs used to be bastions of Republicanism. No longer. Robert Lang of the Brookings Institution, a think-tank, examined the voting behaviour of metropolitan counties and found that close-in suburbs now reliably vote for Democrats. That should be expected: as they become more urban, their residents care more about public transport, schools and other government-sponsored activities—and they attract more city types, often of a liberal bent, from the urban centres.

So emerging suburbs and exurbs, the farthest-out among them, are the new political battleground. George Bush poured resources into this urban fringe in 2004, says Mr Lang, running up larger margins there than when he lost the popular vote in 2000. The result was Mr Bush's more impressive re-election.

His opponents are now starting to close in. When the Democrats took back Congress at the 2006 mid-terms, they increased their vote everywhere from centre to exurb; but the movement was most pronounced in the outermost communities. If the Democrats can consolidate their gains in the inner suburbs and stay competitive in the outer ones, Mr Lang calculates, they will win the 2008 election.

Democrats will get some help from rapid change at the very edges of America's cities. A rapid influx of voters has thrown Loudoun county's politics into disarray. The county narrowly plumped for Jim Webb, now Virginia's Democratic senator, in 2006 after years of Republican domination in the area. Tim Buchholz, Loudoun's Democratic committee chairman, says his party held just three of 29 elected county offices in 2003. Now they are running even with the Republicans.

Not only have more Democrats moved in from bluer cities but, critically, more independents have come, too. Now Loudoun politicos say the county comprises roughly one-third Democrats, one-third Republicans and one-third independents. Voting in Loudoun now closely mirrors that of the state at large, which is increasingly competitive because of the population spike around Washington: the Republicans, in other words, can no longer depend on what was once a solid vote for them. Fast-growing exurbs are particularly exposed to the subprime crisis, which will focus minds on economic matters rather than security—John McCain's strength.

If the eventual Democratic nominee is able to appeal to Loudoun's swing voters, he or she has a good shot at taking once deep-red Virginia. Repeat that in exurbs across the country, and the Democrats' chances look good.

Economist.com WORLD UNITED STATES

Rehabilitating prisoners

A new deal

Mar 19th 2008 | CLEVELAND, TEXAS
From The Economist print edition

Finding promise in prisoners

SAM AMAYA was six years old when he first pulled a gun on another person—his father, who was beating his mother. At eight he would produce the gun when he wanted his sister to change the channel from a soap opera to a cartoon. At 13, after a fight with his father, he fled from his house to his school's playground, where some members of the Two-Six gang were meeting. He was initiated later that afternoon. He began running drugs as a teenager, picking up consignments of marijuana and cocaine near the border with Mexico and selling them around Texas.

With such a background, it is perhaps not surprising that Mr Amaya was arrested after pistol-whipping a girlfriend and is today, at 28, about to finish a long sentence for aggravated assault. Statistics would suggest that he will be back before too long: according to the Pew Centre on the States, more than half of released offenders return to prison within three years, and Texas has the country's second-highest rate of incarceration. In fact, Mr Amaya's future should be more cheerful than those numbers suggest.

Just before he is released on June 23rd, if all goes to plan, Mr Amaya will graduate from the Prison Entrepreneurship Programme (PEP), a remarkable effort to prepare some of Texas's harder cases for their transition back to freedom. The programme was founded in 2004 by Catherine Rohr, a venture capitalist who changed careers after visiting several Texas prisons.

Her premise is that many criminals are intelligent people with good heads for business and healthy appetites for risk, and that these traits can be put to productive use. She is particularly interested in people who have already demonstrated these skills—for example by running a successful drug business or achieving a high rank in a gang.

During the past four years PEP has put more than 300 inmates through four months of business classes and study. They meet MBA students to develop business plans, and hundreds of businessmen have taken part in special events at the prison. About 40 graduates already have businesses up and running. The vast majority are employed. Fewer than 5% have reoffended. The programme is privately funded, and that success rate has helped it grow. In 2004 Ms Rohr used her savings to get things going; this year the operating budget is $3.2m.

PEP's success is partly due to the fact that the programme takes only the most serious applicants. Prospective participants first fill out a lengthy questionnaire. Those that pass have an interview, where Ms Rohr claims she rumbles the fakers. Once selected, a participant can be booted out at any time for a variety of infractions, such as cheating or maintaining gang membership. The current class started with 87 members and is down to 39.

Participants say that PEP provides male role models, and helps them have hope for the future. Ms Rohr considers it her job to build character. “They're not in here because they were bad businessmen,” she says. “They're in here because they were lacking moral values in their lives.” She assigns them ethical case studies and leads discussions on everything from honesty to sexual relationships.

Texas is making its own efforts to improve results for released offenders, but released prisoners typically get just $100 and a bus ticket to Houston or Dallas. PEP picks up its graduates at the gate with packages of sheets, toiletries and business suits. It helps them find work and housing, and even offers a free trip to the dentist. According to Gregory Mack, a participant, all this makes a big difference. Mr Mack has been in and out of prison on drug charges for the past two decades. He completed a behaviour-modification programme in 2002 as a condition for parole, but its value was limited. “They really had nothing to offer outside the walls,” he explains. By 2005 he was behind bars again. Mr Amaya now has a chance to avoid that fate.

David Paterson

New York, new governor

Mar 19th 2008 | NEW YORK
From The Economist print edition

A return to civility in Albany

ELIOT SPITZER'S campaign slogan was “Day One, Everything Changes”. On Day 439, everything finally did. The famously self-righteous Mr Spitzer stepped down as governor of New York because of allegations that he had had sex with expensive prostitutes and was possibly facing federal charges. David Paterson, his lieutenant, was sworn in as the state's first black governor on March 17th.

Mr Paterson is nothing like his steamrollering ex-boss. He is unabashedly candid: he and his wife, he said, have had affairs and, when asked whether he had ever employed a prostitute, he smiled and said: “Only the lobbyists.” He is self-effacing about himself, even his blindness. His swearing-in speech to the state Assembly and Senate demonstrated this; it was humorous, full of gentle jibes and calls for compromise. He joked that when Joe Bruno, the formidable majority leader of the state Senate, invited him to dinner he accepted, but vowed to take a food-taster with him.

New Yorkers elected Mr Spitzer, an Albany outsider, on a mandate to battle corruption and to clean up state affairs. Mr Paterson, by contrast, is an Albany insider and has been in state government for two decades. His father is a former New York state secretary. His audience were plainly happy to have one of their own in charge. And it was clear that the legislature is eager to move on from what, even by Albany's standards, has been a rough week, not to mention a vitriolic year. Mr Spitzer's abrasive style alienated many people and did much to paralyse his own efforts at reform.

With a reputation as a good negotiator and compromise-finder, Mr Paterson may create the bipartisan consensus Mr Spitzer needed. But E.J. McMahon, of the Empire Centre for New York State Policy, predicts that goodwill will take him only so far. Mr Paterson will need every ounce of charm to pass a $124 billion budget and to close a $4.4 billion deficit by April 1st. Although he has said he will remain committed to the budget plan's outlines, he has not ruled out raising taxes. He must also convince the state to approve New York City's congestion-pricing plan by the end of the month or risk losing $350m in federal funding. It is not clear how much of the rest of Mr Spitzer's agenda he will keep.

Mr Paterson's legislative record gives only a hint of what his own plans may be. As an assemblyman, he introduced a number of bills (most of which went nowhere), including one that would have made it a crime for the police to shoot to kill a suspect. He considered extending voting rights to some illegal immigrants. He wanted to increase state income tax, and is a good friend to unions. Mr McMahon reckons Mr Paterson could well be the most left-of-centre governor New York has ever had. But he also admits it is difficult to predict what he will actually do now he is the state's chief executive.

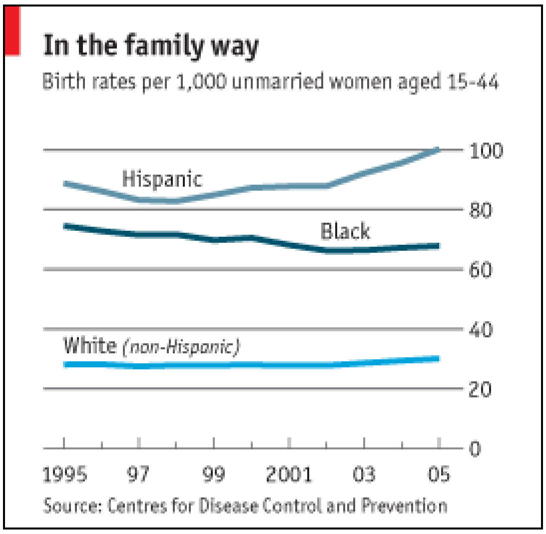
Doug Muzzio, a politics professor at Baruch College, thinks Mr Paterson may get a bit of help from state lawmakers, who are anxious to show they are not dysfunctional. But if they don't, will Mr Paterson be tough enough to force his former colleagues to behave? And what about Mr Spitzer's plans to clean up Albany? For all his charm, Mr Paterson may well be too much of an insider to be effective.

Hispanic families

Bad news from California

Mar 19th 2008 | FRESNO
From The Economist print edition

The vaunted Latino family is coming to resemble the black family



EVERY Sunday Elias Loera stands behind a pulpit made from motorcycle parts and preaches family values to the people of Fresno. He rails against sinful living and neglectful fathers, yet is careful not to offend. Mr Loera reckons more than half of the women in his almost entirely Hispanic congregation are single mothers. He tries to avoid speaking of “father God”, so dismal are many people's experiences with fathers in this struggling Californian city.

Whether Cuban, Mexican or Puerto Rican, most Latinos revere *la familia*. But the Hispanic family is changing. In the past ten years the birth rate among unmarried Latinas has risen from 89 to 100 per 1,000. It is now much higher than the rate among black or white women (see chart). Late last year came a significant but little-noticed announcement: probably for the first time, half of all Hispanic children in America were born out of wedlock.

The Latino family is not in such a dire state as the black family, where 71% of children are born to single mothers. Yet the gap appears to be closing. In 1995 the unmarried teenage birth rate for Latinas was 20% lower than the rate for blacks. It is now 12% higher. This is not just a worry for socially-conservative preachers. More than half of all young Hispanic children in families headed by a single mother are living below the federal poverty line, compared with 21% being raised by a married couple.

Many blame these changes on the decay of traditional mores. Ed Moreno, Fresno's public-health officer, points to the enormous differences between recent immigrants from rural areas—at the moment, the city is seeing an influx from the Mexican state of Oaxaca—and American-born Latinos. The new arrivals rule their children with an iron hand. Among them teenage pregnancies are rare and often followed by marriage, sometimes at the point of a metaphorical shotgun.

By the second or third generation such old-fashioned attitudes are generally forgotten. Among the poor, cohabitation is seen as normal and single parenthood merely regrettable. Research by Wendy Manning of Bowling Green State University and others shows that unmarried Mexican-American couples who have children while living together are slightly more likely to break up than are blacks or whites in similar circumstances.

America is not wholly to blame for the state of the Hispanic family. What may be particularly disastrous is the combination of American inner-city norms and traditional Latin attitudes. Those who campaign against teenage pregnancy complain of a “1950s mentality” among Hispanic parents, who continue to believe that talking to their children about sex puts ideas in their heads. Pedro Elías of Planned Parenthood says machismo persists among young Latinos in Fresno, making them less inclined to use condoms. Latinas frequently obtain imported birth-control pills from flea markets, together with dodgy advice about how to use them.

Although poor Hispanic families are coming to resemble poor black families, they do not feel like them. Marriage is no less prized as it becomes less common. Many Latinos still regard it as deeply shameful to allow one's parents to enter a nursing home. Yet this may be changing. A question about whether they expect to live with their children in old age provokes confident head-shaking among a group of Mexican mothers who are learning English in a Fresno school.

Above all, the large extended families and networks of godparents, which provide crucial support to young Latina mothers, seem to be weakening. A big reason is language. An immigrant grandmother, for example, may well struggle to communicate with her American-born children. She will probably speak little English, while they are likely to speak almost no Spanish. Extended families are also strained by migration: Latinos are increasingly spreading out from traditional enclaves in California, Texas and New York to places such as North Carolina and rural Ohio.

The alarm that these changes have produced has been picked up and amplified by the fast-growing Latino evangelical movement. Samuel Rodriguez, head of the National Hispanic Christian Leadership Conference, describes the state of the Latino family as a more urgent problem than reform of America's dysfunctional immigration system. For some, family breakdown presents an opportunity for evangelism. Mr Loera says his congregation has grown in part because he takes in women who are evicted from other churches when they become pregnant. He relentlessly promotes marriage.

A slim majority of Hispanic adults were born outside America, and retain a degree of traditional attitudes. In time the balance between native and foreign-born will surely tip, as it has already done in Fresno. As Latinos become more American, they may be able to achieve a more benign balance between old and new ways. Or they may fail. In which case, just as they overcome one obstacle to progress in America—the English language—they will hit another of their own making.

Lexington

The cult of Adams

Mar 19th 2008
From The Economist print edition

Illustration by Kevin Kallaugher

It's suddenly hard to escape America's second president

JOHN ADAMS has been the most neglected of America's Founding Fathers. There is no Adams memorial or monument on the Mall in Washington, DC. Adams's face does not grace the currency. Philadelphia is littered with reminders of Benjamin Franklin, not him. Boston has not bothered to erect a monument to Adams, despite the fact that he wrote Massachusetts's constitution, one of the oldest still in force in the world.

America is now making up for this neglect. Adams is the subject of a seven-part $100m HBO mini-series—and a very good mini-series at that—which started on March 16th. Adams's bald head stares out from the sides of buses and the pages of glossy magazines. Congress has belatedly voted to build a monument to the Adamses on the Mall. America's first vice-president and second president is more popular today than he has been at any point since he succeeded George Washington in 1797.

Why is America warming to a man who, on his own admission, was "obnoxious, suspected and unpopular"? His presidency lasted only a single term—"thorns without roses", his wife called it—and his party, the Federalists, went out of business. He was responsible for some of the nastiest legislation in American history, the Alien and Sedition Acts, which he used to persecute his rivals as well as to rid the country of French people. He was uncomfortable with the republic's faith in the common people. He thought Washington should be addressed as "his majesty or his highness", and argued for hereditary office-holding.

Part of the answer lies in the fact that every Founding Father eventually gets his turn, even short bald ones. The surest way to the top of the American bestseller list (apart from writing piffle about how all liberals are deviants or all conservatives pin-heads) is to pen a biography of one of the founders. The past few years have seen bestsellers on Washington, Franklin and Alexander Hamilton. Americans are drawn to these men not only for the obvious reason that they founded the country, but because they debated questions that still plague America—from the balance between the executive and the legislature to the separation of church and state—and they often did so with more intellectual clarity and philosophical depth than today's politicians.

And part of the answer lies in David McCullough. Mr McCullough is America's best-known popular historian, the author of numerous prize-winning histories and the voice of popular television series such as Ken Burns's “The Civil War”. Mr McCullough's 2001 biography, which has sold almost 3m copies, put Adams back at the heart of the revolution; the HBO series, for which he served as an adviser, goes further, sidelining Washington as an ornament, Franklin as an epigram-spouting bore and Thomas Jefferson as a high-minded hypocrite, and presenting Adams as the man who put the United into the United States.

But 3m copies is impressive even by Mr McCullough's standards. And $100m is a lot of money for a TV company to invest in a docudrama about a long-dead president. There must be deeper reasons why America is currently so fascinated by a man who has spent most of the past 200 years in the shadow of two Virginians, Washington and Jefferson.

An obvious reason is the question of dynasty. America is currently contemplating replacing one political dynasty, the Bushes, with another, the Clintons. This might seem odd for a country that was born in a revolt against hereditary privilege. But Adams's career suggests that it might not be so odd after all. Adams's eldest son, John Quincy, became America's sixth president despite losing the popular vote to a man from Tennessee. Fully 45% of the members of the first Congress in 1789 were related to each other. (Today 10% of members of Congress have relatives who also served in Congress.) That none of the other early presidents produced a dynasty may owe more to accidents of biology—none of them produced a son—than to a deep-seated aversion to family privilege.

Sometimes short bald men are right

Adams also has a quality that endears him to modern audiences: a cussed authenticity. Washington comes across as too good to be true. Jefferson owned 200 slaves at the time when he held “these truths to be self-evident”. Adams, the advocate of the hereditary principle, was the only one of the first three presidents to have pulled himself up by his bootstraps (his father was a farmer and a cobbler and his mother was probably illiterate) and the Adamses, father and son, were unique among the first dozen presidents in not owning slaves. He could also be irreverent about his fellow revolutionaries. He said that Washington's main qualification for leadership was that he was always the tallest man in the room, and he complained that Jefferson hogged all the glory for writing the Declaration of Independence.

Adams was also fortunate in his wife. Abigail was arguably America's most impressive first lady, a first-rate intellect who devoted her life to tending Adams's farm and raising a family of scholar-statesmen. Abigail was not the sort of woman to boast that she had solved this or that diplomatic problem because she had had a few people to tea. But she had strong views on racial and sexual equality, fulminating against “the sin of slavery” and advocating women's rights.

Adams's record may also strike a chord with a country that has grown weary of George Bush's mission to democratise the world. Adams believed that democracy needed to be restrained by checks and balances, by the good sense of the educated elite, and by the rule of law. (The HBO series rightly starts with an account of Adams's decision to brave the American mob and defend a group of British soldiers who were accused of massacring innocent Americans.) He also believed that a constitutional system could thrive only in the right soil. America is in the mood for Adams's dyspeptic common sense.

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WORLD
THE AMERICAS

Brazil and Argentina

The tortoise and the hare

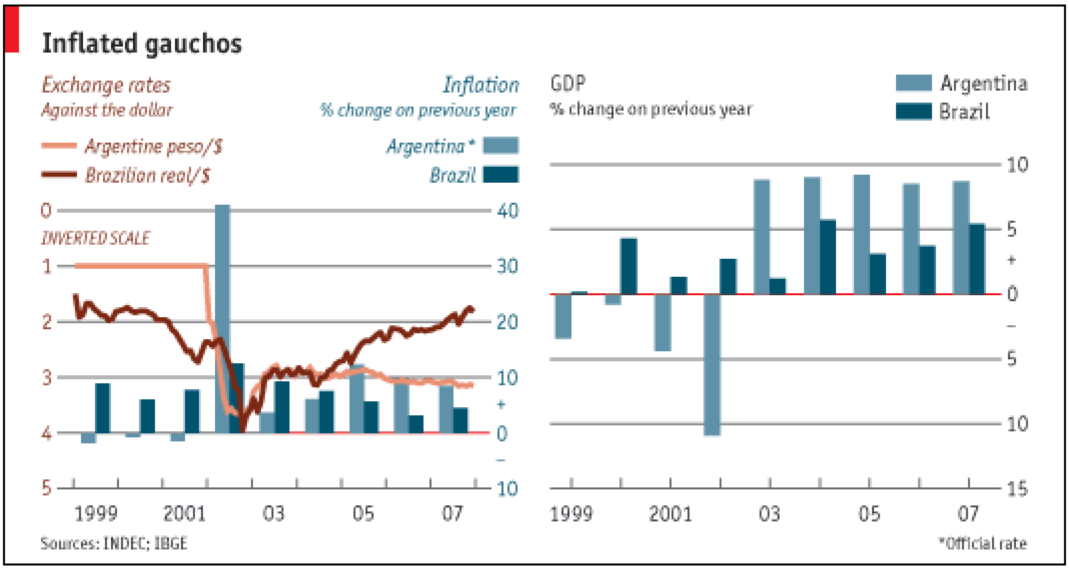
Mar 19th 2008 | BRASÍLIA AND BUENOS AIRES
From The Economist print edition

Illustration by Claudio Munoz

Why those wimpish Brazilians are catching up with Argentina's racier economy

Get article background

TAKE two neighbouring economies, both heavily dependent on commodity prices to make their trade figures look good. Give one an orthodox monetary policy, watch it embrace foreign investors and float its currency. Hand the other over to mavericks who have resorted to fixing prices, banning or taxing some of their own exports and baldly lying about the inflation rate. The result? The rascal—Argentina—continues to grow at a blistering 9% clip, while by contrast well-behaved Brazil plods along (see chart). Is it time to rewrite the economics textbooks? Argentines would like to think so. But there are signs that Brazil may yet come out ahead.



Both countries recently reported surprisingly strong GDP numbers. In the last quarter of 2007 Brazil grew at an annualised rate of 6.4% and Argentina at 8%. But the different reaction to these figures in the two countries was telling. Whereas Brazil's government showed concern, Argentina's touted the news as a vindication of its contrarian wisdom.

In Brazil Guido Mantega, the finance minister, announced a tax of 1.5% on foreigners' purchases of Brazilian treasury bonds to cool capital inflows and slow the steady appreciation of the currency, the real. In a faint echo of Argentina's approach, he said that he wanted to forestall a large current-account deficit. But Henrique Meirelles, the governor of the Central Bank, said that his top concern was still inflation (which cheaper imports help to control). President Luiz Inácio Lula da Silva concurred, describing inflation, long a Brazilian bugbear, as a “degrading disease”. Both Mr Mantega and President da Silva often say they would prefer steady growth at 5% a year for 15 years to a faster, bumpier ride towards riches.

In Argentina such caution sounds wimpish. Its policymakers seem determined to demonstrate that all Latin America needs to grow as fast as China is to cast off the straitjacket of “neoliberalism” and its main backers—those beastly foreign bondholders and the IMF. They gleefully point out that consensus forecasts for Argentina have predicted a slowdown for the past five years. “Those economists have been wrong so many times,” says one confidant of Cristina Fernández, the president, and her husband and predecessor, Néstor Kirchner, “maybe it's time to find some new ones.”

To understand how two nominally left-wing leaders came to embrace such different policies, look back at how their respective countries responded to economic troubles in 2001-02. Argentina, after several years of slump, abandoned a fixed exchange rate, devaluing the peso and defaulting on its public debt. Brazil, which had floated its currency in 1999, responded to turbulence in its currency and debt markets in 2002 by tightening fiscal and monetary policies.

Argentine officials have since been determined to keep the peso weak, mainly to protect local industry. Devaluation worked: the economy roared back to life. But by 2005 most of the country's idle plant was back in action, and new investment was insufficient to sustain rapid growth. Mr Kirchner loosened the government's purse strings, doling out increases in wages and pensions. Growth has continued, but inflation jumped to about 20% a year. Nobody knows the exact figure, since the government massages it. “Eventually, [the country] will lose track of where inflation is,” says Carola Sandy of Credit Suisse, an investment bank. “That's when it gets really risky, because people will start having second thoughts about leaving money in banks.”

By contrast, Brazil's Central Bank pursues a target for inflation, rather than the exchange rate. The real has appreciated on the back of record commodity prices, prompting grumbles from industrialists. But the Central Bank has kept its benchmark interest rate at 11.25% since last September. Even so, domestic demand is strong. With imports soaring, the economy is likely to post a small current-account deficit this year for the first time since 2002.

Argentina's presidential couple never miss an opportunity to take credit for breakneck economic growth under their administration. But according to Daniel Volberg of Morgan Stanley, another investment bank, soaring soyabean prices may have had more to do with it than the Kirchners' economic recipes. Had world GDP growth and commodity prices played out according to 2003 forecasts, Mr Volberg reckons that Argentina would have grown at just 3.7% a year. By contrast, only 1.6 percentage points would have been stripped from Brazil's growth.

So although both countries have benefited greatly from favourable external conditions, Brazil is better placed than it might appear. Because of low inflation, in real terms the growth of Brazilian incomes has started to keep pace with those of Argentines. But Brazil has far more room for manoeuvre if the outlook turns choppier. It is free to cut interest rates or increase spending. Argentina, by contrast, has set itself up for a hard landing. Any decrease in export revenues would damage its tax base, and its Central Bank could hardly print more money than it does already.

Argentina has indeed shown that a country can get away with sacrificing price stability in favour of growth for far longer than the naysayers claimed. But eventually, as in every other country in the world, the amount and productivity of its investment will determine its economic performance. With inflation rising ever higher—and becoming harder to calculate—that investment will prove hard to come by. Foreign direct investment to Argentina rose just 12% last year, compared with an 84% increase (to a record $35 billion) in Brazil, according to the United Nations Economic Commission for Latin America. Brazilians can be forgiven occasional bouts of envy at their neighbours' dash, but good things come to those who wait.

Guatemala

A test of will

Mar 19th 2008 | GUATEMALA CITY
From The Economist print edition

A new UN body tries to fix a broken justice system

Reuters

Not an accident

IT IS the mystery of the murders that vexes. They were arbitrary, but not random. Someone wanted to send a brutal message—but it remains unclear what the message was, who sent it or for whom it was meant. On February 5th five bus drivers were shot dead, each while driving passengers on different main roads into Guatemala City. Seven more were killed the following day, prompting their colleagues to go on strike for several days. The effect was to shut the city down for a week, “like a general strike”, says Carlos Castresana.

Mr Castresana is a respected Spanish prosecutor with a near-impossible task. He is the head of the International Commission Against Impunity in Guatemala (CICIG, for its initials in Spanish), a United Nations body charged with investigating organised crime and its links to the state. Although democracy was restored in Guatemala in 1985, and a 36-year civil war between the army and left-wing guerrillas ended a decade later, civilian institutions have struggled to take root. Many Guatemalans complain that the real powers in their country are shadowy rings of former army officers and drug-traffickers.

Álvaro Colom, Guatemala's new president, has asked CICIG to look into the bus drivers' murders as its first case. It is the kind of atrocity that the justice system has proved powerless to punish, let alone prevent. Guatemala is one of the world's most violent countries, with 43 murders per 100,000 people last year, according to a government estimate. In neighbouring El Salvador charges are filed in 45% of murders; in Guatemala that figure is just 2%.

Will the commission be effective? It has been handicapped from birth. The original idea, backed by human-rights groups and the previous government, was to create a UN court that would act as an independent investigator of organised crime. But Guatemala's Constitutional Court rejected this as a violation of sovereignty.

The resulting compromise means that Mr Castresana does not have the power of subpoena or of indictment. But he will have a broad remit covering almost any violent crime, since it is difficult to know at the outset whether the perpetrator might be linked to the state. Once an investigation is complete, it will be up to the Guatemalan courts to prosecute suspects.

CICIG's mandate runs for two years from last September, when the agreement setting it up was ratified by Guatemala's Congress. But it only started work in January, and it will not have its full complement of some 60 investigators and 30 lawyers until the middle of this year. Mr Castresana admits that his limited resources mean he can investigate only “test cases that change attitudes”.

Sergio Morales, the government human-rights ombudsman, worries that CICIG has “serious weaknesses”. He notes in particular the lack of a law allowing a systematic witness-protection programme. That is a problem. Mr Castresana, who admits that witnesses sometimes disappear even in important cases, is urging foreign governments to give refuge to witnesses on a case-by-case basis.

Guatemala's law-enforcement bodies are chronically short of resources. There are only 26,000 police, many without cars and radios, and 12,000 employees in the public prosecutor's department for a country of 12m people. But the biggest problem may have been a lack of will. UN officials see CICIG as a possible model for other countries emerging from civil wars. A lot is riding on its investigation into the drivers' killings—and on whether it can improve the performance of the local courts.

Consumer electronics in Cuba

Byte by byte

Mar 19th 2008 | HAVANA
From The Economist print edition

The inalienable right to a toaster—but not quite yet

Get article background

WHEN Raúl Castro took over the presidency of Cuba from his ailing brother, Fidel, last month his acceptance speech to the National Assembly included a teasing hint. “Within weeks”, he promised, some of the restrictions that circumscribe Cubans' daily lives would be lifted. That set off a public guessing game. Would an unpopular dual-currency system be modified and the local Cuban peso, in which wages are paid, be revalued? Long queues formed at exchange houses as Cubans rushed to swap “convertible” pesos for their lowlier counterpart. Others hoped for a lifting of curbs on foreign travel, or at least for permission for Cubans to stay in tourist hotels in their own country.

But Mr Castro's plans have so far been more modest. According to an official memo, the government is to lift a ban on the purchase of computers, DVD players and microwaves. Next year, air conditioners should be available. Cubans can also look forward to the right to buy an electric toaster by 2010. Days later news broke that private farmers will be allowed to buy their own supplies, rather than these being assigned by the state.

The government is able to widen access to consumer electronics because Venezuelan aid has allowed it to overhaul the electricity grid. Officials also know that the grid will not immediately be overwhelmed: monthly wages average $17. For those who don't receive remittances from relatives abroad, electronic gadgets will remain unaffordable. Even for those who do they will be expensive: they will only be available in state-owned shops that apply a mark-up of around 200%.

Nevertheless, lifting the ban on buying computers came as a surprise. Officials have long regarded the internet with suspicion. The government has set up a Cuban intranet, which is all that is available in schools and universities. Internet accounts are available only to foreigners, or to favoured Cubans for research purposes. Officials blame this on a lack of bandwidth. They have a point: the United States government has blocked plans for a fibre-optic link to an undersea cable in American waters (so Venezuela's Hugo Chávez is now building a similar link to his country).

But the official mood might be changing. “I think the leadership now recognises that when it comes to the internet the genie is out of the bottle, and they have to live with it,” says a foreign diplomat in Havana. Cubans have become remarkably inventive at getting online. Doctors and academics with internet access rent their passwords so that others can use them after office hours. Some entrepreneurs have smuggled in satellite receivers to connect to the internet; they then sell accounts to their neighbours.

The digital age has opened the odd crack in the state's information monopoly. At a meeting in January Ricardo Alarcón, the assembly president, struggled to explain to computer-science students why Cubans should be banned from travelling abroad. A video of the meeting was promptly posted on YouTube.

Another small sign that Raúl Castro is probably prepared to tolerate more debate than his brother did is the survival of *Generación Y*, a blog written in Havana by Yoani Sánchez, a young Cuban woman who posts her entries from tourist hotels or from one of Havana's few internet cafés. In a post this week she predicted that at the current rate of progress, by 2050 Cubans might be allowed satellite television.

Mexico

The resurrection

Mar 19th 2008 | MEXICO CITY
From The Economist print edition

The return of a former opponent adds to the president's troubles

Get article background

ONLY a few weeks ago Andrés Manuel López Obrador was sliding towards political oblivion. Narrowly but clearly beaten by Felipe Calderón in a presidential election in July 2006, Mr López Obrador, a left-wing populist who was once the mayor of Mexico City, organised months of protests against what he alleged was electoral fraud. His contempt for Mexico's democratic institutions scared off many of his erstwhile supporters and split his Party of the Democratic Revolution (PRD).

Now he is on his way back—and that is a problem for the president. First Mr López Obrador seized on a timid government proposal to open up parts of Mexico's declining oil industry to private investment. He has raised the bogie of “privatisation”, striking a nationalist chord with many Mexicans.

More significantly, he appears to have reasserted his grip on the PRD. Alejandro Encinas, a close ally who stood in as mayor when Mr López Obrador resigned to run for president, won a slim but seemingly decisive victory in a ballot for the party leadership held on March 16th. His opponent, Jesús Ortega, is a senator who led a moderate “new left” faction. He dismissed Mr Encinas as representing “a marginal and self-excluding left”. In a droll reversal of the presidential election, Mr Ortega cried fraud (as did his opponent).

The result showed the depth of the PRD's divisions. Assuming it hangs together, its legislators, who form the second-largest block in Congress, are likely to adopt a more combative stance towards Mr Calderón. But that might not help the party in a mid-term election due in July next year.

Mr López Obrador's resurrection comes at a bad time for the president. His energy reform looks unlikely to be approved in Congress, where he lacks a majority. In addition, Juan Camilo Mouriño, Mr Calderón's interior minister and closest aide, has been accused of impropriety. Between 2000 and 2004, when he chaired the energy committee of the lower house of Congress and then was an aide at the energy ministry (when Mr Calderón was minister), Mr Mouriño signed several contracts with Pemex, the state oil monopoly, on behalf of his family's business. He said his business had received many such contracts in the past, and denies any wrongdoing.

But Congress has opened an investigation, and the speaker of the lower house, a PRD member, has called on Mr Mouriño to resign. Jesús Silva-Herzog, a political commentator, says the allegations play on a public concern that Mr Calderón's conservative National Action Party is too cosy with business.

Until now Mr Calderón has confounded the expectation that his narrow mandate would make governing hard. He has struck a tacit alliance with the third party, the Institutional Revolutionary Party, while avoiding antagonising the PRD. This balancing act has suddenly got much harder.

Japan

Kamikaze politics

Mar 19th 2008 | TOKYO
From The Economist print edition

Illustration by Peter Schrank

How Fukuda and Ozawa might both self-destruct

THE troubles that seized Japan's politics last summer are approaching a crisis. After winning control of the upper house of the Diet (parliament) in July, the opposition Democratic Party of Japan (DPJ) has two issues it can use to frustrate the government led by Yasuo Fukuda and perhaps bring it down.

The first is the choice of a new governor for the Bank of Japan to replace Toshihiko Fukui, whose term expired on March 19th; in recent days Mr Fukuda's handling of the succession has descended into farce. The second issue is the budget for the tax year that begins on April 1st. This includes government proposals to renew a levy on petrol which, thanks to a powerful lobby within the ruling Liberal Democratic Party (LDP) known as the *doro zoku* or “road tribe”, is earmarked for building roads no one needs. The opposition's leader, Ichiro Ozawa, has vowed to oppose the “temporary” levy, now in place for over 30 years, as an emblem of the pork and patronage that lie at the heart of much that is wrong in Japan's politics.

The LDP-led coalition chose Mr Fukuda as prime minister for his competence and authority. Little of either has been evident in his handling of the succession at the central bank. DPJ members have long signalled their opposition to the government's first choice as new governor, Toshiro Muto, Mr Fukui's deputy. To some, it is Mr Muto's long career at the overbearing Ministry of Finance that counts against him; to others, he lacks international experience when it is most needed, at a time of turmoil in global markets (see article).

For weeks the government postponed the nomination, suggesting it was looking for a compromise candidate. It then announced Mr Muto. After the DPJ-led upper house predictably vetoed that nomination, the government proposed on March 16th that Mr Fukui should serve a second term. Even LDP members admit that this suggestion showed a breath-taking lack of due diligence, since Mr Fukui's political support crumbled two years ago, after he had admitted to placing undeclared investments with a financier later found guilty of insider dealing.

So, on March 18th, the government proposed a new candidate: Koji Tanami, once the top official at the finance ministry. The DPJ vetoed him too, on the ground that he is even more of an apparatchik than Mr Muto and has no expertise in monetary policy. At midweek a new deputy governor, Masaaki Shirakawa, looked likely, at least for a while, to fill the vacuum—an unnecessary one, since candidates acceptable to both sides have been there for the choosing all along, notably Haruhiko Kuroda, head of the Asian

Development Bank. By not putting him forward, Mr Fukuda showed himself unable and unwilling even to pick up the phone to the opposition. He also exposed a breakdown within his own administration. The prime minister's relations with his chief cabinet secretary and main gatekeeper, Nobutaka Machimura, are particularly bad.

A blow to credibility, then, even before Mr Fukuda's bigger fight, over the budget. The budget itself has already passed; it needs the approval only of the lower house, where Mr Fukuda commands a majority. Yet several supplementary measures, including the petrol levy as well as tax breaks on foreign funds invested in Japan, need upper-house approval, too. Mr Ozawa wants revenues from the levy to be put into the general tax pot, undercutting the road tribe. Some members of the LDP who resent the road-builders propose that the levy could be shifted into general revenue over three years. Mr Fukuda himself suggests he will compromise.

But it is unclear how much compromise Mr Ozawa will accept. Katsuya Okada, a former leader of the DPJ, says that with power apparently slipping away from Mr Fukuda, and back into the shadowy world of the bureaucracy, the opposition must stand firm and insist that the levy should be shifted into general revenue immediately.

If no deal is done, then the price of petrol will fall by ¥24 a litre (92 cents per American gallon) on April 1st. Mr Fukuda can accept it, and face a hole in the budget. Or he can use the coalition's supermajority to override the upper house and restore the levy. But that would take two months and risk angering motorists. Either way, his credibility may suffer further. Mr Ozawa claims the government will fall.

Yet he may fall first. Many modernisers in his party are unhappy with their mercurial, autocratic boss. They tolerate him chiefly for his tactical brilliance at election time. But if no election is in prospect—and Mr Fukuda or his successor is not bound to call one until September 2009—more DPJ members will want someone to challenge Mr Ozawa as party leader in September, even at the risk of splitting the party. Sensing the danger, Mr Ozawa may wish to bring the DPJ into a “grand coalition” with the LDP, and demand a senior post. But when he tried that last autumn he dismayed his party colleagues. His many enemies within the LDP, through whose ranks Mr Ozawa once rose, might also object.

So Japan remains stranded unhappily between the one-party state it once was, under a dominant LDP, and the truly competitive democracy it might one day become. Some politicians have mused about the possibility of a political upheaval after the next election, in which the main parties would collapse under their internal strains and regroup. Now, says Kaoru Yosano, economy minister under the reforming Junichiro Koizumi and briefly chief cabinet secretary before Mr Fukuda came to office, the conspiracies are multiplying, and more and more people are agitating for just such an upset even before an election.

One way it might happen is for modernising politicians in both the LDP and the DPJ—those who favour clear policies, structural reform and fiscal probity—to rebel against their leaders and join forces in a new pro-market majority. Such treachery is entertained in various new cross-party discussion groups, innocent though they look.

A central figure here is Hiroyuki Sonoda of the LDP, who in the 1990s helped found a short-lived party with now-prominent members of the DPJ. He is thought to favour Mr Yosano as the best would-be prime minister in any coup to bring down the LDP. A champion of Koizumi-style reforms, Mr Yosano himself remains enigmatic. So does Mr Koizumi, who once vowed to destroy the old LDP. He retired to the back benches in 2006 but has started giving public speeches again. His long shadow continues to haunt Japan's politics. One word from him could be enough to make—or break—any palace coup.

China

Unanswered questions

Mar 19th 2008 | BEIJING
From The Economist print edition

And introducing a future (but silent) boss

Reuters

Not yet time for Li

IT IS a ritual capping a ritual. Each spring, after China's parliament ends its annual session, the prime minister dutifully presents himself for two hours of grilling by the press, broadcast live on national television. It is the only time any senior Chinese leader need speak publicly without the benefit of a script. But many questions go unanswered.

Fresh from his uncontested re-appointment to a second five-year term, Wen Jiabao this week performed this chore for his sixth time. He admitted he was “deeply worried” about the world economy and said 2008 could be “the most difficult year” for China. He reiterated his government's unyielding stance on Tibet but, asked about Taiwan (which holds a presidential election on March 22nd), reeled off a few lines from a centuries-old poem about smiling brothers who put their grudges behind them. Faced with harder questions, he fell back on platitudes and rambling. Nonetheless, the National People's Congress (NPC) which Mr Wen wrapped up did take some steps of consequence this year.

For one thing, it ushered in a new slate of senior state leaders, notably Li Keqiang, a former party secretary from north-eastern Liaoning province. An ally of President Hu Jintao, Mr Li is widely seen as a rising star and the man most likely to take a top job in 2013, when Mr Wen and Mr Hu are due to step aside. In his new post as vice-premier, he will have to deal with the thorny macro-economic issues that so worry Mr Wen. Mr Li had an inauspicious debut. Asked to outline his political vision, he did not even have time to tap the microphone in front of him before a moderator decided that this was not a suitable occasion for him to speak.

The NPC's other main achievement was a long-mooted reordering of the central government's structure, folding separate bureaucracies into five “super-ministries”. Human Resources and Social Security, for example, are now one ministry, as are Housing and Construction. The former Environmental Protection Agency was upgraded to ministerial status, and a new National Energy Commission was established. The Ministry of Health, as expected, was handed oversight of food and drug safety.

China's sprawling bureaucracy needs streamlining, but there is no guarantee this will do the trick. Comparably ambitious reorderings have been undertaken half a dozen times over the past two decades only to bog down in the inertia and turf battles they were meant to overcome. Whether this attempt fares any better is yet another question that cannot yet be answered now.

Economist.com WORLD ASIA

Indian politics

Supersonia

Mar 19th 2008 | DELHI
From The Economist print edition

Congress's leader celebrates a fairly successful decade in politics

Get article background

The Times of India

Italy's most successful politician

EARLY on March 14th a clutch of powerful Indian politicians, including the prime minister, Manmohan Singh, lined up outside the front-door of the most powerful one—Sonia Gandhi. Their task was to congratulate Mrs Gandhi on the tenth anniversary of her accession to the throne of the ruling Congress party, formerly occupied by her assassinated husband, Rajiv, his assassinated mother, Indira, and his grandfather, Jawaharlal Nehru. In a formal address to their leader, the politicos assured her of their "deep gratitude".

And well they might. A reluctant politician, like her murdered husband, Mrs Gandhi was persuaded to take charge of the party after a seven-year spell of mourning for him. During that time—its longest without a Gandhi in command since 1947—Congress had been reduced to a dreadful state. The fortunes of its main rival, the Hindu-nationalist Bharatiya Janata Party (BJP), had soared. In an election in 1999, Congress's first under Mrs Gandhi, who was then perhaps best known for her Italian birth and bad Hindi, the party won its lowest ever number of seats, 114.

It is now in better shape. Having scored a surprise election victory in 2004, its government, a coalition including another dozen parties, has surpassed (admittedly low) expectations. It has so far held together, despite several mutinies. It has presided over high economic growth, despite having brought little of the economic reform that is often demanded of India. And it has at least tried—if not always wisely—to avoid the main mistake of its BJP predecessor, which is considered to have trumpeted high economic growth but done too little for the rural mass of Indians whose lives remained wretched.

For two of these achievements, Mrs Gandhi can take some credit. Her standing, both within and outside Congress, received a huge boost in 2004, when she passed up an opportunity to become prime minister in favour of Mr Singh. This and her growing competence in political scheming have helped Mrs Gandhi impose discipline within her schismatic party. With a reputation for relative rectitude, in India's rotten polity, she has also won grudging support from potentially troublesome coalition allies.

What is more, several grandstand schemes for the poor have her handprints all over them. These include a debt waiver for 30m small farmers announced in the budget last month; and a massive job-creation scheme for rural paupers which will go nationwide this year. Spendthrift though these schemes are, many in Congress consider them their best hope of surviving an election due by May 2009.

And yet if Congress does win the election, it will not be with an outright majority: in 2004 it won only 145 parliamentary seats out of a total of 543. Moreover, another Congress victory in the teeth of a political culture of anti-incumbency would owe more to a complicated election cycle and to the failings of the BJP governments running several important states than it would to Mrs Gandhi's own skills. And even with Congress's burgeoning reputation for managing a coalition, the party could perfectly easily come first in the next election but fail to make a government. This makes its revival look somewhat over-hyped—as indeed is the slavish reverence of the party faithful for a dynastic leader whose Hindi remains dicey.

Perhaps the best that can be said for Congress's cult of the Gandhi family is that it is no worse than the dynastic practices favoured by most other Indian political parties. The Gandhi name no doubt contains an additional seductive whiff of nostalgia, for the freedom and hopefulness of India's first independent decades. But this will not make up for the party's flaws, including a lack of leadership in many states, or reverse Congress's losses there. Indeed, the latest bearer of the name, Mrs Gandhi's 37-year-old son Rahul, who is being groomed as a future party leader (perhaps even in time for the next election), suggested as much last week.

On a visit to the eastern state of Orissa, Mr Gandhi lambasted all of India's political parties, Congress included, for lacking internal democracy. Instilling some of this, though unimaginable now, might indeed augur a renaissance in India's grand old party. Alas, Mr Gandhi, another reluctant politician (and one who has so far done little to impress), might not survive the cut.

Pakistan

After the mullahs

Mar 19th 2008 | PESHAWAR
From The Economist print edition

A secular party takes over in the North West Frontier Province

THE moustaches have ousted the beards. While Parliament met this week in Islamabad to debate who should be prime minister nationally, at the provincial level in the North West Frontier (NWFP), a deal has been done. Later this month, the Awami National Party (ANP), a secular Pushtun outfit, will take over the provincial government from the Islamist Muttahida Majlis-e-Amal (MMA), an alliance of six Islamic parties. It will do so in coalition with the Pakistan People's Party of the assassinated former prime minister, Benazir Bhutto, with which it signed a provincial power-sharing agreement on March 5th. The takeover is the result of Pakistan's recent election, at which the ANP increased its representation from a mere seven to 46 of the province's 99 constituencies. The Islamic alliance, half of which boycotted the poll, won just 14.

The result proved that Pushtuns “are neither extremists nor terrorists”, crowed the ANP's sturdy leader, Asfandyar Wali Khan. George Bush hailed it as “a part of the victory on the war on terror”—understandable, perhaps, given that the mullahs had been voted out. But a junior American official was probably nearer the mark when he noted that the vote had not vindicated American policy but “repudiated the MMA government”. The clerics had failed to curb terrorism, were tainted by their support for the country's discredited president, Pervez Musharraf, and were chaotic administrators. They had risen to power in NWFP, and shared it in Baluchistan, boosted by outrage at America's invasion of Afghanistan. They departed fatter and richer.

The new government is taking over one of the world's hardest-to-govern places. Last month a suicide-bomber killed 44 people at the funeral of a policeman in Swat. This week another suicide-bomber attacked a police station in the district. A third killed 43 people at a gathering of tribal elders at the town of Darra Adam Khel. Militants backed by al-Qaeda have expanded their insurgency from the lawless border areas near Afghanistan into the province's more settled parts. To make matters worse, the provincial government is taking over while the army's counter-insurgency operations are struggling, local-government institutions have atrophied after a year of upheaval and when the national government is being dogged by doubts over its durability even before it has been founded.

The ANP's leading members are descendants of Khan Abdul Ghaffar Khan, the so-called “frontier Gandhi” who opposed British rule. The Americans hope their ties with the Afghan president, Hamid Karzai, will lead to more cross-border co-operation. But their links to Afghanistan and to India's Congress party make some Pakistanis suspicious of them. The designation of Mr Wali Khan's 37-year-old nephew, Haider Hoti, as chief minister has revived grumbles that the party treats politics as private family business.

The party wants to change the province's colonial-era name to Pukhtunkhwa and says it will reform the administrative system both in the province itself and in adjoining tribal areas, which the provincial governor, Owais Ahmad Ghani, recently described as “weak, demoralised and despondent”. In Waziristan, local and foreign jihadists have demolished a fragile administration by murdering scores of pro-government tribal elders. The party will face stiff resistance to its plan to revoke a colonial-era parliamentary act that banned political parties from the tribal areas and left the field open to the mullahs.

The party, whose stronghold is the vale of Peshawar, also secured seats in Swat, to the north, where the army has mounted big operations against jihadists. But the mullahs' former chief minister, Akram Durrani, says that the ANP lacks sufficient clout in the tribal areas and restive southern districts of NWFP to secure a peace.

Though the Americans have backed it, the ANP has been ambivalent about the global “war on terror” and has criticised Pakistan's involvement. “The Taliban is a reality and has assumed the shape of a party and we have to talk with them,” says Mr Hoti. Such pledges may revive previous American worries about local peace deals with militants.

Aftab Sherpao, a Pushtun and former interior minister under Mr Musharraf, argues that any secular government would be an improvement “as the MMA had obstructed operations against militants”. He survived two recent suicide attacks that killed 75 people. Dozens of ANP supporters were also killed when suicide bombers attacked at election rallies. Mere survival will be an achievement for Mr Wali Khan's clan.

Democracy in Afghanistan

Spoilt for choice

Mar 19th 2008 | KABUL
From The Economist print edition

Afghanistan has politics and electioneering as well as fighting and bombs

"IF THEY want to hold all these elections then all Afghans will ever do is vote." So says the head of the Afghan parliament's elections committee, Salih Mohammad Registani. Having lived without democracy for 30 years, Afghans suddenly face a surfeit of it.

According to the 2004 constitution, the country will go to the polls in 11 of the next 17 years, the result of holding presidential, parliamentary and provincial-council elections on different cycles. If district-council elections were held on yet another separate cycle (as is proposed), the calendar would become more crowded still. Quite apart from voter fatigue, the financial burden will be enormous for the world's fifth-poorest country: it costs about $150m to hold each poll.

President Hamid Karzai, who completes his first term of office in May 2009, wants to synchronise the presidential and parliamentary cycles. This makes sense, not least because the elections will require a surge of international troops to guard against Taliban attacks on polling booths. But that would require parliamentarians to forgo one year of their term, an idea they do not like. The lower house voted this month to hold elections in consecutive years.

Many parliamentarians say that combining the polls would anyway require changing the constitution, which can only be done by a *loya jirga* (grand council)—which itself would have to be elected. And if a *loya jirga* were convened, it might want to tinker with the constitutional settlement in other ways—by trimming the power of the president, making Afghanistan "more Islamic" or reducing the 25% of seats reserved in parliament for women.

Time is short. Voter registration has to take place this summer if polls are to go ahead next year. So far, no plans are ready. The parliament has not yet decided which electoral system to use for the parliamentary vote, or even whether to allow political parties to take part (they were banned in the last election). Parliament may not change the electoral law in the final year of its term, so its members have only a few weeks left to take these decisions. In short, Afghanistan's arguments over the technicalities of voting are already complex. And that is before voters start thinking about whom to vote for.

Mr Karzai has not said he will run, though most people expect him to (not least, the Western governments which back him). His popular support, however, is lukewarm at best. His government has been tarnished by charges of incompetence and corruption, while his international backers have struggled to fulfil promises to rebuild the country. Large parts of the south, Mr Karzai's heartland, have descended into insurgent-inspired chaos. The president has become increasingly critical of the West, and particularly of Britain, the Afghans' historic foe.

But, as in 2004, Westerners think Mr Karzai will prove the worst Afghan leader except for all the others. He is from the dominant Durrani federation of the majority Pushtun tribe. He participated in the *jihad* against the Soviet occupiers but does not have blood on his hands from the civil war that followed. He did not leave his homeland for sanctuary abroad. (Those who did are called dogwashers: the Taliban leader, Mullah Omar, said they washed the dogs of rich Americans.)

No other prominent politician has that mix. Afghanistan may have capable technocrats on call, such as Ehsanullah Bayat, a telecoms mogul, Amin Arsala, a former vice-president, and even, improbably, America's (Afghan-born) ambassador to the United Nations, Zalmay Khalilzad. But they lived abroad. It also has former mujahideen commanders such as Burhanuddin Rabbani and Younis Qanooni, both Tajik leaders, and Gul Agha Sherzai, the energetic major of Jalalabad, whom Mr Karzai dubs the bulldozer. But they are tarnished by warlordism. An excess of would-be leaders, in short. And an excess of ways to vote for them.

Malaysia

Shuffling deckchairs

Mar 19th 2008 | BANGKOK
From The Economist print edition

The prime minister fights for survival

Get article background

TEN days after suffering heavy losses in a general election, Malaysia's prime minister, Abdullah Badawi, shuffled his cabinet on March 18th, hoping to stave off calls for his resignation from within his party, the United Malays National Organisation (UMNO). The removal of some scandal-tainted ministers and the elevation of a judicial reformer showed he is at least trying to get to grips with his problems. But Mr Badawi still seems to be shuffling deckchairs on a personal Titanic.

The National Front coalition, led by UMNO, won this election, as it has every one since independence from Britain in 1957. But it scraped barely half of the vote at national level and, most importantly, lost the two-thirds parliamentary majority it had held since 1974, which had allowed it to change the constitution at will.

Straight after the election, Mr Badawi's embittered predecessor, Mahathir Mohamad, called on him to resign. The retired leader's son, Mukhriz Mahathir, became the first UMNO official to echo his father's call. Another party figure, Razaleigh Hamzah, a former finance minister, called for an emergency party congress and later offered to stand against Mr Badawi if enough members supported him. Even if not, the knives may come out at the party's annual congress in August.

So Mr Badawi's survival rests on how his new ministerial line-up is received and how well it performs. His first change was to cut the cabinet list from a bloated 90 to a still excessive 68, merging several ministries. Some ministers were easy to cull, having crashed to defeat in the election. One such was Samy Vellu, the only representative of Malaysia's ethnic Indians (8% of the population) in the cabinet. He bore the brunt of Indian anger at discrimination in favour of the Malay majority.

The most notable sacking was that of Rafidah Aziz, believed to be the world's longest-serving trade minister, with over 20 years in the job. Ms Rafidah faced criticism over alleged corruption in her ministry's granting of car-import licences. The most noticeable absence was Khairy Jamaluddin, Mr Badawi's ambitious (and disliked) son-in-law, who might have expected a post after winning his seat (he was also once an intern at *The Economist*).

The most promising appointment was that of Zaid Ibrahim, a prominent lawyer, who will join the prime minister's office to oversee reforms of the justice system. Mr Zaid has criticised the government's sluggishness in investigating allegations of judge-bribing and his calls for a royal inquiry into the accusations were reluctantly accepted by Mr Badawi late last year. The inquiry, still going on, has heard damning testimony against Eusoff Chin, the chief justice from 1994 to 2000.

Another welcome move by Mr Badawi, if followed through, is that ministers will be required to disclose their assets. Such declarations could make interesting reading. One disclosure statement likely to be perused closely will be that of Muhammad Taib, one of the cabinet's not-so-new “new faces”. He resigned as chief minister of Selangor state in 1997, after being arrested at Brisbane airport in Australia for failing to declare a suitcase of money he had with him. Both the Australian and Malaysian courts acquitted him, but he was an odd choice for a prime minister seeking to project a cleaner image.

Of course, Mr Badawi did not have a free hand. He must satisfy factions within his coalition while finding seats for some token ethnic Chinese and Indians to disguise its increasingly Malay-dominated profile. Nevertheless, by dropping several big-hitters he may have created fresh enemies. The shuffle has not, overall, dispelled speculation that he may have to stand down, perhaps in favour of his deputy, Najib Razak. Mr Najib, however, has challenges of his own: his political adviser and two officers from a police unit that reports to him are on trial for the murder of a Mongolian fashion model. Though not accused himself, Mr Najib's prospects may be fatally damaged by the case.

Nepal

A Maoist on the hustings

Mar 19th 2008 | KATHMANDU
From The Economist print edition

A former revolutionary fighter hopes to take over through the ballot box

AFP

How democratic shall I be, wonders Prachanda

FOR years the only available photograph of Pushpa Kamal Dahal, better known as Prachanda ("awesome"), the founder and leader of Nepal's Maoists, showed him at a party gathering in a remote part of Nepal around 2001. The image stuck of a reclusive, unsmiling guerrilla leader, prepared to live underground for decades to wage war on feudalism.

Since he emerged above ground two years ago, the contrast has been marked. Twice-postponed elections to a constituent assembly are due on April 10th. Prachanda's campaign machine is in overdrive. He addresses rallies everywhere. His beaming face, minus the beard but richly moustachioed, is on posters all over the country. His hair is brushed back in a style that has become popular among party colleagues, who nickname it the *janabadi* ("pro-people") style.

The makeover worries some Maoists. Party bigwigs, some former fighters complain, are getting top medical care, live in posh houses and ride expensive cars captured in wartime. They lament that ordinary Maoists are homeless: they can no longer demand accommodation at gunpoint. The old ethos of equality has gone.

Prachanda dismisses these charges, but if he gets his way, he may indeed be heading for luxury. Smiling, he says he is confident his party will win the election and that he will in time become the first president of a Nepalese republic. The monarchy is due to be abolished and he says that as long as King Gyanendra abides by the constitution he will be pardoned and allowed to stay in the country as a common citizen. Maoists these days, says their leader, encourage the accumulation of capital. If his party forms the government, says Prachanda, he will use the law to push through land reform and the emancipation of lowly castes.

Other parties scorn Prachandra's claim to become president. They point out that the country's future system of government has yet to be decided. Also undecided, they say, is how far the Maoists are committed to democracy. Top party officials have jettisoned the grey uniforms they sported during peace talks in 2006—a sign, Prachanda says, that the party is pluralist, not totalitarian. Prachanda himself says the party will accept the "verdict of the masses". But he refuses to rule out a return to violence if "other sections of the people derail the peace process". There are frequent reports that party activists, often from the detested Young Communist League, violently disrupt meetings of other parties, shouting that these have no right to operate on "Maoist territory".

And the party's behaviour in running some ministries, such as the information ministry, has raised eyebrows. State television, once a mouthpiece for the king, runs regular propaganda programmes including pro-Maoist discussions and shows of “revolutionary songs”. No airtime is given to reported Maoist misdeeds. The election code of conduct requires state media not to favour particular parties.

Correction: Kerala's capital

Mar 19th 2008
From The Economist print edition

In our briefing on India's civil service ("Battling the babu raj", March 8th, 2008) we called Kochi the state capital of Kerala. This is wrong. The state capital is Thiruvananthapuram, also known as Trivandrum.

Zimbabwe's election

Coming to a crunch

Mar 19th 2008 | MASVINGO
From The Economist print edition

Fear a rigged election that returns President Robert Mugabe. Fear one that nearly does so even more

Get article background

AS YOU drive through the rolling green countryside of Gutu district, past the occasional outcrop of pink boulders leaning weirdly against each other, a gaggle of youths walking by the roadside give a cheeky two-handed wave, fingers and thumbs all splayed open. The youngsters' black-and-red T-shirts bear the smiling face of Morgan Tsvangirai, the rugged 56-year-old trade-unionist who has led the main opposition to President Robert Mugabe for nine years and who, for his pains, was savagely beaten by policemen a year ago. Several of the youngsters also hold up a red card, an insolent party symbol borrowed from football and meaning the president must be sent off.

It is impossible to say whether the youths are just brazen jokers enjoying a tilt against their elders and benefiting from the handout of a free shirt. But in a district that has been ardently loyal to Mr Mugabe ever since the guerrilla war against Ian Smith in the 1970s, it is astonishing that they are wearing these shirts here at all. A year ago they would have been beaten up, perhaps killed, for cocking such a snook.

“The coercive apparatus of ZANU-PF [the ruling party] is finally crumbling,” says Nelson Chamisa, a senior lieutenant of Mr Tsvangirai. Several of Mr Mugabe's main instruments of control, especially in the countryside—patronage, food and force—have started to dwindle. Three years ago, when the president won the last general election, albeit on flagrantly unequal terms, he could count on local party chiefs and worthies and on his own army and police to deliver basic services and to thump those who talked out of turn.

Now, even in a place like Gutu, the supply of such things as cooking oil, petrol, maize meal (the country's staple), sugar and salt is lacking. Schools and clinics are in sombre straits. Buses are scarce. The explanation that it is the fault of “the British imperialists” and their sanctions (actually aimed mainly at the assets and travel of 130-odd senior officials) has worn thin. And the rural people know that much of the land for which they fought their war of liberation from white supremacy has gone not to them but to Mr Mugabe's already prosperous colleagues.

Moreover, the army, police and much-feared Central Intelligence Organisation (CIO) may no longer be united behind the 84-year-old president. His party has fractured, thanks to the intervention six weeks ago, as a challenger from within, of Simba Makoni, a former finance minister whom many of Zimbabwe's black and shrinking white professional middle class see as the decent and competent face of ZANU-PF.

So a bitter triangular contest has broken out. Almost every day the sole national daily, the *Zimbabwe Herald*, which slavishly defers to Mr Mugabe, carries headlined protestations of loyalty from such people as Solomon Mujuru, a former head of the army who is also one of Zimbabwe's richest men and happens to be married to one of its two vice-presidents. Such articles only alert Zimbabweans to the whispers and mutterings of dissent within ZANU-PF that have become ever louder since Mr Makoni threw his cap in the ring. Mr Mujuru and assorted other party bigwigs are reckoned to be biding their time, waiting to see which way the wind will blow in the next few weeks.

In a country where opposition has been reviled and harassed, it is hard to foretell the outcome of the “harmonised elections”—at four different levels of office, from the presidency and parliament down to local councils—on March 29th. But it is pretty clear that the president's popularity, such as it is, has been waning, even among his old guard. Even if he somehow hangs on, and lots of seasoned watchers think he will, the mantra in Harare is that “something big has changed”, thanks to Mr Makoni's challenge. Many of the ruling party's vultures clearly sense it is time to eye fresh pickings.

The latest opinion poll by the Mass Public Opinion Institute, run by a professor at the University of Zimbabwe, gives Mr Tsvangirai 28% of the vote, Mr Mugabe 20% and Mr Makoni 9%. Another 24% refuse to reveal a preference, suggesting still wider support for the opposition, and 8% are undecided. Such figures should be treated cautiously, but it seems more than possible that Mr Mugabe will fail to win the 50%-plus needed to clinch victory in the first round, even if he rigs as ruthlessly as he has done before. A run-off would have to be held within three weeks.

Mr Makoni, who declared his candidacy only on February 5th, may have joined the fray too late. His rallies have been less well attended than Mr Tsvangirai's, though both men have faced the expected array of bureaucratic obstacles and intimidation put in their way by the police, who are still expected to do the president's bidding, though they seem less zealous—so far—than before.

The able and pleasant Mr Makoni, who earned a chemistry doctorate in Britain, is well financed by businessmen and professionals in Zimbabwe, South Africa and even Britain. But he has suffered from having to start from scratch, whereas Mr Tsvangirai, in nearly a decade of struggle, has woven a sinewy web of intrepid supporters, which now seems to stretch into the rural areas, Mr Mugabe's well-controlled heartlands. Moreover, while Mr Mugabe has portrayed Mr Makoni as a traitor—and, by the by, a prostitute and a frog—the newcomer's rivals in the opposition sneer at him as a johnny-come-lately who served Mr Mugabe as a loyal ZANU-PF apparatchik off and on for 28 years, most recently as finance minister bewteen 2000 and 2002. Until his sacking last month, he remained deputy head of finance in the party's ruling Politburo.

Indeed, Mr Makoni, 58 next week, has been careful not to attack ZANU-PF wholesale, hoping to turn the more acceptable face of it to his cause. In particular, he is said to have sympathetic contacts in the army, police and CIO who may tell him how to stymie some of Mr Mugabe's old rigging tricks, because they were the ones who executed them before. It is possible that Mr Makoni, who has no party, will yet build up a head of electoral steam, but so far he has emerged as a spoiler against Mr Mugabe, opening up cracks of disloyalty in an increasing twitchy ruling party, yet without gaining mass support himself.

Mr Makoni's refusal so far either to attack his old party outright or to put much flesh on his broadly sensible but vague policy ideas has made him look amiable but wishy-washy. His allies are a mix of old left-wing ideologues, displaced rivals of Mr Mugabe, disenchanted ZANU-PF people who want a younger man at the helm, and businessmen, many of whom would not dismantle the present system of crony capitalism but want to make it more efficient, notably by ending the global isolation wrought by Mr Mugabe.

The recent defection of Arthur Mutambara, leader of the lighter wing of Mr Tsvangirai's fractured Movement for Democratic Change (MDC), has yet to bring much extra to Mr Makoni's show. Though Mr Mutambara is also able, his own support seems to have fizzled. His close colleague, Welshman Ncube, a member of the minority Ndebele group (who, with the related Kalanga, make up about a fifth of Zimbabweans), may pull in some votes from the utterly disgruntled west.

A little help from the ship-jumpers

Mr Makoni was chuffed, too, when he was joined by Dumiso Dabengwa, who ran the intelligence service for the guerrilla movement drawn mainly from the Ndebele during the anti-colonial war but who, despite four years' imprisonment by Mr Mugabe, later served for eight years as his minister for home affairs.

Mr Mugabe anyway looks set to be trounced in the towns, where the MDC always wins easily, though the contest between Mr Makoni and Mr Tsvangirai could split the opposition vote to the benefit of the old man. Indeed, many Zimbabweans, always prone to conspiracy theories, think Mr Makoni was brought into the game by Mr Mugabe to do just that.

At best, Mr Makoni may perform respectably in Matabeleland, in the west, where Mr Mugabe is still hated for bloodily suppressing dissent there in the early 1980s; among his own Manyika in the east; and in the smarter suburbs of Harare. But his support looks thin elsewhere. The Karanga, who inhabit the Gutu area among others, may be the swing electoral group among the dominant Shona; more of the Zezuru stick to their own Mr Mugabe.

EPA

Mugabe targets the traitor...

In any event, there is not the slightest chance of the election being fair. The media are hugely stacked against the opposition, which is rarely given even a cursorily polite airing by the all-state-run radio and television services. The election commission is chaired by a Mugabe man, a former general. The registrar-general, another loyalist, presides over an electoral roll that is notoriously unreliable and incomplete, and contains thousands of dead people whose votes are expected to go to the president. Unless voting is extended beyond one day, many town-dwellers may be unable to cast their ballots, because there are too few urban polling stations. The diaspora, some 2m-3m mostly disenchanted Zimbabweans, is barred from voting.

Another obstacle is the recent gerrymandering of constituencies, which gives rural areas, where Mr Mugabe is strongest, a large disproportion of seats in the 210-member parliament. To make matters worse, the opposition will find it hard to recruit agents to man all the 8,212 polling-stations, where, in past elections, the ruling party has been able to stuff unwatched ballot boxes with impunity when opposition officials have been absent or chased away. By tradition, fiddling the figures can also be carried out at the centre, and this time Mr Mugabe has banned any observers who might cry foul.

Then there is the politicisation of food distribution, which goes on apace in a country where a third of the 11m-12m people who have not fled abroad might starve without handouts, according to the UN's World Food Programme. As Mr Mugabe smells the possibility of defeat, he has raised the pay of civil servants and soldiers in the past few weeks, and is endlessly pictured sending consignments of new tractors and buses into the rural areas.

“It all happens before election day,” says Noel Kututwa, head of the Zimbabwe Election Support Network, a lobby accused by Mr Mugabe's friends of being a foreign stooge. “The votes have been counted already,” is often heard. Indeed, the armed forces have already cast their votes, with most soldiers believing their ballots have been seen by their superiors.

And yet, despite this stack of advantages, Mr Mugabe is plainly on the defensive. He must fear that Zimbabwe is in a state of such economic and political ruin that he needs more of a head-start than the 20% or so of votes provided by the standard forms of rigging. For Zimbabweans, however, there are two worries. One is that Mr Mugabe steals the election. The other is that he just fails to, especially if that means the president is forced into a run-off. In that case, he may resort to outright violence. “The violence has so far been contained, more or less,” says a former ZANU-PF minister who has joined Mr Makoni, “but if the election goes to two rounds it'll go right up.”

AFP

...while Makoni eyes the prize

Moreover, the heads of the army, the prison service and the police have all stated flatly that they will not let Mr Tsvangirai win. That is one reason why many people, especially among the professional middle class, have switched their opposition allegiance to Mr Makoni. So Mr Makoni has called for a government of national unity, bringing together both wings of the MDC and the supposedly acceptable bits of ZANU-PF, along with his own team. Mr Mugabe would be allowed to go into a dignified retirement, and not be sent to The Hague for crimes against humanity.

Mr Tsvangirai, more of a bruiser and showman, sounds less accommodating. He would form a “national government”, drawing people but not necessarily parties into a coalition. He has refused to discuss deals before the election. Yet he would probably have to do so, if Mr Mugabe and his army and police let him get beyond the first round.

This is all uncertain territory. Almost no one disputes Mr Tsvangirai's courage and resilience, but many doubt whether he is astute enough to lead the country and heal its wounds. “How can you expect to unify the country when you can't unify your party?” was a telling question at one of his meetings. For his MDC has been riven with factional feuding. He is an erratic tactician with authoritarian tendencies. In his negotiations with Mr Mugabe's representatives under the aegis of the Southern African Development Community, he has been serially outwitted. In his early days he made the big mistake of letting himself look as if he were being bankrolled and even manipulated by Zimbabwe's aggrieved white farmers.

Even so, Mr Tsvangirai might win most first-round votes in a free election. But the election will not be free; a Mugabe victory should not be ruled out. Conceivably, he might then agree to step down sooner rather than later, perhaps handing over to his heir-apparent, Emmerson Mnangagwa, who, among other things, ran the security services for nine years. Alternatively, he might bring the Makoni faction back into his government. Such a course may be advocated by South Africa. But it would be unlikely to extricate the country from its current mess.

For Zimbabwe is a wreck. Inflation is running at more than 100,000% a year. Virtually no one changes money at the official rate of Z$30,000 to $1. On the black market, you pay around Z$250,000 (at least, you did last week), making virtually everyone, especially the middle class, technically crooks. At independence in 1980, a Zimbabwe dollar was slightly more valuable than its American namesake.

AP

Tsvangirai shouts the odds

Some economists think that, if prices double every month, a government can still collect revenue. But if prices double every week, you hit a point where people start to flee the currency altogether. Zimbabwe is heading in the abandon-ship direction, perhaps only a few months away.

The country's white population, once the economy's motor, has shrunk from around 200,000 at independence in 1980 to fewer than 50,000 today. Some estimates go as low as 20,000. Of the 6,800 commercial farms in the hands of some 4,500 white farmers at independence, about 300 are still owned and actively farmed by them, with a few hundred more still in white hands but left unproductive while their ownership is under threat.

Particularly wretched is the plight of black workers on the former white-run farms. Including seasonal workers and their dependants, they account for at least 1m people, perhaps 2m. According to a government-linked institute, only 10-12% became landowners themselves when land was redistributed. Academic studies say the real figure is less than 2%. Many of the rest have been thrown into destitution.

For mile after mile, expropriated farmland seems empty of cattle or infested with weeds. Zimbabwe's production of tobacco, once the second-biggest in the world, has slumped from 237m kilograms in 2000 to 70m last year. Official gold output, probably the country's biggest foreign-currency earner, has dived from 27m tonnes in 1999 to seven last year.

An “indigenisation and economic empowerment” act was signed by Mr Mugabe earlier this month, with potentially grave consequences for white entrepreneurs. It entitles a minister to transfer the majority share of any company—a garage, shop, factory and, more significantly, a mine or a bank—owned by non-indigenous Zimbabweans to “any person who before 1980 was disadvantaged by unfair discrimination on the grounds of his or her race, and any descendant of such person.” That means no whites. This bluntly racist bill may cause even more whites to flee, as their assets are liable to be grabbed as rewards for ZANU-PF loyalists.

The health service, once resilient, is falling apart. Especially in the rural areas, people are dying fast. HIV or AIDS has hit nearly a fifth of the population. Life expectancy has dived from the highest in sub-Saharan Africa to 36 years, one of the lowest. Surgical operations in the biggest hospital have had to be stopped because basic equipment is defunct and drugs have run out. Three-quarters of the doctors have emigrated, along with more than half of nurses, physiotherapists and social workers. Patients seeking operations and treatment must buy medicine themselves.

Virtually anything essential is scarce—unless you have foreign currency, but not even that always does the trick. Bread is often hard to find. The electricity in Harare is frequently off: the main transformers are bust. Water in some of the poorer townships has not flowed for two years. Petrol can be bought only with coupons; petrol stations are often empty. The only things that seem to multiply, apart from the noughts on the bank-notes, are pot-holes in what used to be Africa's smoothest roads north of the Limpopo river.

It is a puzzle how people manage to survive at all; many do so through barter, begging, chicanery or, most especially, remittances from the diaspora. Some 80% of Zimbabweans have no formal job. Many have reverted to the subsistence economy.

Send for a saviour

On the surface, people in Harare still go about their daily lives in an air of normality. The streets bustle. Zimbabweans remain remarkably friendly. Many are fatalistic but some manage to stay hopeful that their country will recover. Yet they know that what was once one of Africa's most thriving economies is virtually ruined.

A mere reshuffling of the ZANU-PF pack, even with Mr Mugabe graciously retiring, seems unlikely to put the country on the road to recovery. Its economic, political and moral muckage has gone too far for that. Zimbabweans find it hard to see a way out. Messrs Tsvangirai and Makoni have managed to show that the spirit of courage and decency is still alive. But whether that is enough to turn round a country heading for dereliction any time soon—or whether they will be allowed to try doing so—is still doubtful.

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Iran's election

Back to first principles

Mar 19th 2008 | TEHRAN
From The Economist print edition

Any candidate—so long as he's conservative

Get article background

Reuters

He may need more than just his own vote

THE day before Iran's parliamentary election on March 14th, a grin kept creeping onto Alireza Zakani's face. Explaining why he thought it fair that the Council of Guardians, an appointed body of senior clerics, had barred 1,700 of his party's opponents from contesting the poll for parliament, the smooth-faced conservative said it was just a matter of upholding the law, "as in any country that imposes its defining values". Many of the disqualified candidates faced legal problems, he primly noted; other reformists had apparently sought to have themselves banned as a publicity stunt.

The reason for his smugness soon became clear. As the counting of the 23m ballots proceeded, it emerged that conservatives, or "principlists" as they prefer to be called, in deference to their claimed allegiance to the Islamic republic's founding principles, had trounced the reformists by three to one. In the biggest constituency, Tehran, where the voters could choose up to 30 names on the ballot, the conservatives took 19 seats in the first round. The reformists got none, though they consider the capital to be their main stronghold. Mr Zakani, who represents a faction loyal to President Mahmoud Ahmadinejad, ranked 24th in the voting, meaning he is likely to do well in the run-off next month for the 11 Tehran seats still undecided.

Turnout was modest. Government officials claimed that as many as 65% of Iran's 44m eligible voters took part, trumpeting this as a victory over foreign plots to undermine the Islamic revolution. Yet the Ministry of the Interior's own figures indicated a national turnout of 52%, and no more than 30% in Tehran, close to the tally in the most recent election, in 2004, which many Iranians boycotted after a similar mass disqualification of reformists.

Candidates in the capital, with a population of 12m, needed to capture at least a quarter of the 2m votes cast to win in the first round. Whereas the conservatives could rely on a loyal core of state employees, pensioners and members of the security forces and the *Basij*, a large paramilitary volunteer group, the reformists struggled to rally supporters. The disqualification of all the better-known reformist figures meant they could field candidates for barely half the seats; many sympathisers seem to have seen no point in voting.

The reformists were also handicapped by the short time allowed for campaigning, a ban on posters and the urgings of the powerful and respected Ayatollah Ali Khamenei to vote for conservatives. As supreme leader, the ayatollah ranks above the president; he also controls the state broadcasting monopoly. In view of all this, say the reformists, the 35 or so seats they took in the first round was not bad.

Ill winds ahead for the president

The reformists may have been pruned back in parliament. Yet the outcome of the election does not necessarily mean plain sailing for the president, whose relations with the outgoing conservative-controlled *majlis* had grown increasingly testy. Since coming to power in 2005, the populist president has alienated much of the conservative establishment. His spendthrift and ill-planned economic decisions are held by many to have fuelled inflation. The price of some basic foods has doubled within the past year and rents are soaring.

Although most conservatives back Mr Ahmadinejad's refusal to compromise on Iran's nuclear programme, many blame his brash talk for inflaming world opinion and frightening off foreign investment. The president's folksy and superstitious brand of ostentatious piety and his favouritism to men of military rather than clerical backgrounds raise hackles among senior clerics.

“Basically, his rivals fear Ahmadinejad is discrediting the conservatives,” says a senior economic consultant in Tehran. This, he says, explains why conservative candidates ran on two separate lists. Significantly, in the Shia holy city of Qom, one candidate backed by the president polled less than 10% of the vote. By contrast, Ali Larijani, a former negotiator on the nuclear issue who was replaced by Mr Ahmadinejad, apparently for being too soft (despite his reputation as a leading conservative), scored a resounding 70%. Mr Larijani, along with the like-minded mayor of Tehran, Mohamed Baqer Qalibaf, is seen as a likely conservative challenger to Mr Ahmadinejad in next year's presidential election.

By one Iranian political analyst's reckoning, the incoming parliament of 290 members may prove to be finely balanced between perhaps 40 strictly loyal to Mr Ahmadinejad, 40 critical conservatives and 40 reformists. The remainder, he predicts, will prove fickle, backing any party likely to help with their local or provincial agendas. Should the tide appear to turn against the president, they might abandon him wholesale. This indicates a further shift of power towards Ayatollah Khamenei, whose favour all will be keener than ever to seek.

Mr Ahmadinejad's failure to consolidate a firm power base may not mean any dramatic policy shifts. As if to underline its hold, his government's first act after the election was to ban the publication of nine large-circulation lifestyle magazines, signalling a determination to pursue the crackdown on “corrupting” influences, the most obvious manifestation of which is police yanking women off the streets for wearing what is known as “bad *hijab*”—usually an “immodest” covering of the head. The president is also likely to stick unwaveringly to Iran's controversial nuclear project: a government spokesman has brushed off suggestions by a leading pragmatist, ex-president Akbar Hashemi Rafsanjani, that the time may be ripe for broad talks on the issue.

Yet Mr Ahmadinejad may well face increasing pressure to rein in his language—and his fiscal indiscipline. Iranians are finding it ever harder to make ends meet. Young professional couples in the capital say that even with husband and wife in steady jobs, they cannot afford to bring up children. Just enough Iranians voted in this election to show backing for their country's peculiar system, with its uncomfortable balance of power between the popular will and the will of God, represented by the supreme leader. By the time of next year's presidential election, they may have grown discontented enough to take the trouble to go to the polls and vote, jolting Ayatollah Khamenei, and sending Mr Ahmadinejad packing. Mr Zakani's Cheshire cat grin may yet fade away.

Djibouti

St Tropez in the Horn?

Mar 19th 2008 | DJIBOUTI
From The Economist print edition

A tiny country makes the best of a bad neighbourhood

IN THE centre of the blazing whiteness, four Afar herdsmen chip away at the salt with pickaxes. The milk-green waters beyond the salt pans look almost glacial, but the burning hot wind, the camels and dizzying mirages dispel the illusion. This is Lake Assal. At 155 metres (509 feet) below sea-level, it is Africa's lowest point—and one of its hottest. The Afars (sometimes known as the Danakil) gather the salt into sacks. They used to carry the salt on camels west into the Ethiopian highlands but times have changed. These Afars sell it for $7 a sack in Djibouti town, a couple of hours' drive away.

The road there winds across black lava fields and moonscapes, past a hilltop garrison of the French Foreign Legion, down dry river beds to the azure Gulf of Tadjoura. The capital's outskirts look unpromising but as you get closer to Djibouti Ville—the city itself—an unexpected order asserts itself. Even locals admit that, until recently, the tiny country, with a mere 800,000 people, was asleep. Now, against the odds, it is stirring.

Until recently, it relied almost entirely on French largesse. When independence came, in 1977, the founding president, Hassan Gouled, fretted about what would happen if the colonialists left. But Djibouti (formerly called the French Territory of the Afars and the Issas) is still France's largest foreign base, hosting a force 2,600-strong. It deters the statelet's much bigger, predatory neighbours from even thinking of invading. (Earlier this year, France and the United Arab Emirates signed a deal to let France set up a military base in Abu Dhabi, the largest of the seven emirates.)

After independence, Djibouti's two ethnic groups, the Issas (who are ethnic Somalis) and the Afars drifted into Djibouti city. Most swapped a nomadic life of herding goats and cattle for long heat-haze afternoons chewing *qat*, a narcotic leaf flown in from Ethiopia. But things began to change when Eritrean independence cut Ethiopia off from the sea. Since then, almost all Ethiopia's trade has been shipped through Djibouti, some of it on a rickety railway linking it to Addis Ababa. The bullish—some say bullying—thinking of Djibouti's current president, Ismail Guelleh, a protégé and nephew of Mr Gouled first elected in 1999, has also helped pep things up. His slogan on billboards throughout the town is "*Nous croyons*" (We believe).

In what? Well, in Dubai. He wants Djibouti to follow the example of the booming gulf emirate or perhaps even of Malaysia, a Muslim model where many children of Djibouti's elite head for university. Dubai Ports now runs Djibouti's upgraded port. The economy may grow by nearly 6% this year, though unemployment is high and the IMF is unhappy with the government's shoddy fiscal management. Businessmen say the port's improvements make it hard to imagine that Eritrea's Massawa, Somaliland's Berbera or Somalia's Bossaso will catch up soon. Some talk of turning the city's scorching seafront into “St Tropez in the Horn”.

There is also a spectacular plan said to have the backing of Tarek bin Laden, a half-brother of Osama bin Laden, to build the world's longest bridge, across the Bab al-Mandib (Gate of Sorrows), the strait between Djibouti and Yemen. Even for ambitious Djibouti, this may be a bridge too far, judging by local scepticism and the developers' evasiveness.

But the country may profit from its new strategic importance. Mr Guelleh let America set up a large military base, from which it conducts anti-terrorist operations across east Africa. Ruthless policing and foreign troops have so far stopped Islamist militants from getting a foothold there, although there are complaints that Mr Guelleh is increasingly undemocratic.

Mr Guelleh's main aim is not to annoy any government in the region. Relations with Ethiopia are tense but practical. Mr Guelleh opposed Ethiopia's invasion of Somalia in late 2006 but avoids the topic when meeting Ethiopian officials. Djibouti's people resent the advertisements along their roads in Amharic, Ethiopia's main language. But grumbling is quickly silenced by Ethiopian threats to cut off *qat* imports. Djibouti is similarly cautious with Somalia. Mr Guelleh is disappointed by the feebleness of Somalia's transitional government but does not endorse neighbouring Somaliland's bid for independence. In sum, Djibouti is surviving cannily in a tough neighbourhood.

The Comoro Islands

Send in the Afro-marines

Mar 19th 2008 | ADDIS ABABA
From The Economist print edition

The African Union gets tough, even if it's not quite Iwo Jima

THE archipelago of Comoros, 300km (186 miles) off the coast of Mozambique, consists of four islands. In 1975 Grande Comore, Mohéli and Anjouan became an independent country, the Union of Comoros. The fourth, Mayotte, stayed French and has prospered as a strategic base and fancy holiday destination. In contrast, the Union of Comoros has fared pathetically, with a score of coups or attempted coups since independence. The hogging of power by Grande Comore, the largest island, led Mohéli and Anjouan to declare independence in 1997. The country was saved only by bringing in a new constitution, giving each island its own president and administration—all for 840,000 impoverished citizens.

More trouble erupted last year when Anjouan's president, Mohamed Bacar, refused to step down after his five-year term; he held an illegal election and claimed a landslide victory. The Comoros' federal president, Ahmed Sambi, disputes the result and says that Mr Bacar is a thug. If and when he is captured, Mr Sambi wants him tried for treason.

The African Union (AU), nervous about secessionist feeling anywhere in Africa, got involved in the affair when Mr Bacar threatened to turn Anjouan into a micro-state. Negotiators shuttled back and forth from Grand Comore to Anjouan, only to be deceived by Mr Bacar, who, say diplomats, promised compromise while digging in.

Earlier this month the AU lost patience. At midweek, an AU military force was assembling for an amphibious assault on Anjouan. Military commanders were confident that a joint force of Tanzanian, Libyan, Senegalese and Sudanese troops would smash Mr Bacar, “killing him if necessary”. The AU hopes that the military initiative will show that the continent is now serious about policing itself. But some wonder why the AU can mobilise resources to save a tiny island in the Indian Ocean, yet refuses to bolster its troops deployed in its embattled mission in Somalia.

France

Sarkozy rebuked

Mar 19th 2008 | PARIS
From The Economist print edition

AFP


The French president is treating his local-election setback as a call for more and faster reform. Not all voters see it that way

IT MAY not have been the crushing defeat that some predicted, but it was certainly a firm rap on the knuckles. On March 16th Nicolas Sarkozy's centre-right UMP lost control of a swathe of towns and villages, mostly to the opposition Socialists. It lost nine of the 21 big cities it held, including Metz, Strasbourg and Toulouse, leaving it in charge of just 12. The left now runs three of France's biggest cities—Paris, Lyon and Lille—and 25 of the top 37. Although the elections were local, they were a big setback for Mr Sarkozy.

The UMP found some crumbs of comfort, notably the retention of Marseille, a swing city. Many of Mr Sarkozy's ministers, whom he has allowed to carry on the tradition of holding both mayoral and ministerial jobs, were re-elected. Alain Juppé, a former prime minister who resigned from the government last year after failing to win a parliamentary seat, won the mayoralty of Bordeaux. Rachida Dati, the (Muslim) justice minister, was elected in the posh seventh arrondissement of Paris. The UMP managed a few surprises, such as a win in Calais, where the Communists had been in power for 37 years.

Yet the overall picture was one of defeat. In total, the left (and Greens) won 49.3% of the vote, compared with 47.6% for the UMP and its allies. In prosperous Paris, Bertrand Delanoë, the Socialist mayor, was re-elected with a 58% vote, a personal triumph in a city that for decades was ruled by the Gaullist right. Even relatively quiet rural towns swung left. Xavier Darcos, the education minister, lost his job as mayor of Périgueux, in the Dordogne.

Although ministers brushed aside suggestions of a national message in the result, one poll suggested that 29% of voters wanted to send one. Many working-class voters who backed Mr Sarkozy for the presidency last year abstained or plumped for the left this time. The president's popularity has collapsed, from a high of 65% last July to only 37% this month, according to TNS-Sofres, a pollster.

If Mr Sarkozy is to rebuild his credibility, he needs to deal with two main causes of voters' disaffection. The first is his presidential style. Voters were dismayed by the distraction of his whirlwind romance with Carla Bruni, a former supermodel, whom he married in February after divorcing his previous wife, Cécilia, last autumn. Famously tolerant of colourful private lives, the French were bothered not so much by the marital turbulence as by the exhibitionist way in which the president seemed more concerned with his life than with theirs. Although the press nicknamed him “President Bling Bling”, this message was slow to register at the Elysée.

Now it appears that Mr Sarkozy has got the point, and intends to moderate his image. He is to concentrate on trips to distressed corners of rural France; and on such solemn occasions as a state visit to Britain on March 26th and 27th. As Christophe Barbier, editor of *L'Express*, wrote, “he needs to put a little bit more de Gaulle and a bit less Tom Cruise into his cocktail of presidential modernity.” Presidential advisers have been told to spend less time in the limelight, as a response to criticism of *hyperprésidentialisme.* David Martinon, the presidential spokesman, has lost his job, and his weekly White House-style press briefings have been abandoned.

The second cause of disillusion is a sense that Mr Sarkozy's reforms, which he promised would boost growth, jobs and pay, have not yielded results. Despite a tax-cutting package last year, which made time worked over the legal 35-hour week tax-free, voters have not felt the benefit in their household budgets. This is partly thanks to lower world economic growth and rising food and energy prices. The economy has slowed and inflation is running at some 3.2%. On top of this, many business types who supported Mr Sarkozy are disappointed over the pace of the reforms, which have ground to a virtual halt.

The president decided this week against a big ministerial reshuffle, tinkering instead with only a few junior portfolios. “I would like to put an end to this French disease, which consists of changing ministers every six months,” he told *Le Figaro*, noting that France had eight finance ministers during the ten years when Gordon Brown held the job in Britain. Moreover, François Fillon, his prime minister, is well liked. Against all precedent under the Fifth Republic, the prime minister's poll numbers have climbed as the president's have tumbled. Mr Sarkozy may be paying the price of *hyperprésidentialisme*, but Mr Fillon seems to be benefiting.

Mr Fillon insisted this week that the government would step up its reforms in response to the election. The message, he told voters, was that “you have invited us to put even more force into our policy of change.” There are plans for two new laws in the coming months: one to make it easier to shed workers and loosen the labour market, another to stiffen competition and cut red tape for entrepreneurs. In addition, the government is due to review its structure of social charges, as well as its public-pension rules.

Mr Fillon may be right that many voters are impatient for more and deeper reforms. Certainly, this is the case for the professionals who voted for the centre-right last year and now feel disappointed. In the long run, such changes should boost economic growth as well.

But it is less clear that the French in general want change. If anything, they are looking for more protection and higher pay, not for easier firing rules or more competition. Already interest-groups from taxi-drivers to retailers are fighting deregulation. The test in the months ahead will be whether Mr Sarkozy can resist making crowd-pleasing gestures in hopes of propping up his short-term popularity and instead recover the reformist reflexes that marked his early months in office.

Anglo-French relations

An entente in London

Mar 19th 2008 | PARIS
From The Economist print edition

Nicolas Sarkozy's state visit to Britain will be more glamour than substance

THE most recent French president to pay a state visit to Britain, Jacques Chirac, had an inimitable way of referring to the British. “You can't trust people who have such terrible food,” he once said. At one European summit he denounced Tony Blair's “selfish” attitude to farm spending and called his refusal to give up the British budget rebate “pathetic”. How times have changed. The state visit on March 26th and 27th by Nicolas Sarkozy and his new wife, Carla Bruni, comes at a time of vastly improved mutual understanding.

Mr Sarkozy, who made a campaign stop in London last year, has often publicly admired Britain. He is close to Mr Blair, who shares his exuberant style—although relations with Gordon Brown, Mr Blair's successor, are businesslike rather than warm. The British are pleased that he wants to strengthen France's role in NATO and is considering sending more troops to Afghanistan. The French, mindful of British Euroscepticism, are taking care not to push Europe's nascent defence project too hard before Britain ratifies the Lisbon treaty this summer. At their meeting, the two leaders will doubtless sound in tune on matters from development and immigration to defence and climate change.

Economic ties between the two countries are also ubiquitous. The French supply electricity to over 5m British customers, as well as football players—and managers—to such clubs as Arsenal (the bilateral summit is even being held in Arsenal's Emirates football stadium). France is Britain's third-biggest trading partner. Britain is the biggest foreign investor (by stock) in France.

As for citizens, they are more linked than ever. At least 300,000 French people live in Britain. As many as 500,000 Britons own homes in France. France's prime minister, François Fillon, has a British wife. The French have opened an English-speaking tax office in the Dordogne. Several hundred British candidates ran in the local elections, estimates Sue Collard, a British academic studying the matter, who was herself elected. Unlike previous aspirants, most of them retired, many of the new councillors are women, often with children at local schools. Some even speak French.

Yet plenty of differences remain. Mr Brown and Mr Sarkozy do not see eye to eye on many economic matters, including free trade and industrial policy, not to mention farm subsidies. Mr Sarkozy's unilateral diplomacy irritates Downing Street. Mr Brown's reluctance to set foot on continental soil baffles and frustrates the French. Best behaviour, a decent gastronomic effort by the chefs at Windsor Castle and excited British newspaper coverage of Ms Bruni will doubtless ensure a smooth summit. But the entente will not be *cordiale* for ever.

Germany and Israel

Friends in high places

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From The Economist print edition

The pomp and symbolism of Angela Merkel's visit to Israel

THE Federal Republic of Germany waited until Israel was 17 years old before establishing diplomatic relations. But the two countries have since more than made up for the delay. This week the German chancellor, Angela Merkel, took half her cabinet to Jerusalem for an early celebration of Israel's 60th birthday (in May). Israel's prime minister, Ehud Olmert, greeted her at the airport as if she were an American president. On March 18th Ms Merkel addressed Israel's parliament, an honour previously reserved for heads of state. It is almost official: Germany is Israel's second-best friend.

Obviously, Germany counts for less than the United States, but its friendship is valuable even so. Within the European Union, Germany lobbies against one-sided criticism of Israeli behaviour towards the Palestinians. It championed the 2000 association agreement, which liberalised trade between the EU and Israel. When the EU debates the Middle East, Germany is said by some to keep Israel quietly in the loop. Israel's trust in Germany has even lessened its longstanding aversion to giving the EU a formal role in the Middle East peace process.

Few German politicians question the relationship, but some think Ms Merkel confuses friendship with fawning. She condemned rocket attacks on Israel from Gaza, but not Israel's recent incursion, which killed more than 110 Palestinians, and barely alluded to Mr Olmert's decision to keep building settlements in East Jerusalem. Ms Merkel should realise that “the special relationship with Israel demands open words,” says Rolf Mützenich, a Social Democrat in the Bundestag. She has spoken more plainly to Russia and China, critics say.

Ms Merkel's diffidence arises from history: her country's and her own. The Nazis' attempt to exterminate the Jews helped bring about Israel's creation; its survival is a sacrosanct principle of German foreign policy. The tardiness in establishing diplomatic links was partly meant to stop Arab states recognising East Germany (under the “Hallstein doctrine”, West Germany severed relations with any country that recognised its sibling). Friendship with Israel served Germany's goal of better links with America as well as its conscience. Even before establishing relations it secretly sold weapons to Israel.

Having grown up in East Germany, Ms Merkel is a latecomer to German-Jewish rapprochement. East Germany portrayed its citizens as co-victims of Nazism and, unlike West Germany, did not own up to German responsibility for the Holocaust. Ms Merkel, who has visited Israel three times in her 26 months as chancellor, is trying to build a relationship that relies more on future collaboration than on fading memories of genocide.

The joint cabinet meeting is the start of annual get-togethers that Germany holds with just five other countries, all of them European. With €4.3 billion ($6.6 billion) in bilateral trade last year, Germany is Israel's second-biggest trading partner. The main tension is over Iran: Germany is the largest EU exporter to Iran, whose president appears to want both a nuclear weapon and the destruction of Israel. Trade with Iran is shrinking, points out Ms Merkel, and the EU may enact more sanctions on top of those approved by the United Nations. Any threat to Israel is a threat to Germany, she declared. To avoid spoiling the mood, Mr Olmert did not press for an EU economic boycott of Iran.

When Germany deals with conflicts between Israel and its neighbours, it does so mainly through the EU, notes Patrick Müller of Stiftung Wissenschaft und Politik, a Berlin think-tank. George Bush's road map for peace drew on ideas first proposed by Joschka Fischer, then the German foreign minister. His successor, Frank-Walter Steinmeier, has tried vainly to lure Syria into the peace process by offering better relations with the EU. In June Germany will host a conference on Palestinian justice and policing. However rocky the road to Middle East peace, Germany and Israel are travelling on a smoother path.

Kosovo's riots

Border clashing

Mar 19th 2008
From The Economist print edition

This week's violence in northern Kosovo could be a taste of the future

Get article background

AFP

Burn, baby, burn

WHEN Kosovo declared its independence from Serbia on February 17th, the doomsters predicted political turbulence and spasms of violence. A month later their predictions may be coming true. On March 18th United Nations police stormed a courthouse that had been seized by Kosovo Serbs in the north of the divided city of Mitrovica. Scores were injured in the ensuing violence, a Ukrainian policeman was killed and UN vehicles were set alight. The UN personnel were withdrawn but NATO troops remained.

The violence was about more than just a courthouse, of course. Veton Surroi, often seen as Kosovo's de facto foreign minister (the new state does not have an official one yet), says it was really about who is in control of Kosovo as the different contenders for power are “fighting for turf”.

Kosovo has some 2m people, 90% of whom are ethnically Albanian. About 120,000 Serbs remain, half of them in the north. The Albanians have long wanted full independence; Serbia insists that Kosovo must remain Serbian forever. In this stubborn stance, it is backed by Russia. Almost 30 countries have now recognised Kosovo, including America and most European Union countries.

When it declared independence Kosovo pledged to stick to a plan first drawn up by Martti Ahtisaari, a former Finnish president. Under this, Serb-populated areas of Kosovo were to have extensive autonomy. Meanwhile the UN mission in Kosovo, which has had jurisdiction ever since the end of the Kosovo war in 1999, would after 120 days hand over its authority to Kosovo's government and to two new missions sent by the EU.

Carl Bildt, Sweden's foreign minister and an old Balkan hand, sums up the problem: “We don't have a settlement, and the role of the UN remains to be defined.” Over the past month diplomats and politicians have been left trying to work out what they are supposed to do, or how much power they can grab. The Serbian authorities are trying to impose full control of Serb-majority areas, which is why they encouraged Mitrovica's Serbs to occupy the courthouse. Serbs have been told to quit Kosovo's police force and other institutions. Few dare disobey; anyone who thinks of it is threatened by fellow Serbs.

The EU says that it has begun its 120-day countdown. But the UN mission in Kosovo has been told nothing by its masters in New York and so has no plans to hand over authority. According to a senior EU source in Brussels, the plan now is for the UN's power in Kosovo to be progressively “diluted” and then finished off, “not by design, but rather by default”. In the meantime the elected government in what some now call Kosovo proper (ie, the areas controlled by ethnic Albanians) is taking a low-key approach, perhaps to avoid fanning the fires of violence.

When calm returns after the Mitrovica clashes, Kosovo will be left with a frozen conflict in which, for now, power will lie with the Serbian authorities in Serb areas and it may be unclear who is in charge elsewhere. This, frets Mr Surroi, will “suck the political energy of Kosovo's society” and distort normal political life for years to come, in both Kosovo and Serbia. He calls it “a dangerous period, and one that requires an urgent response”. On May 11th Serbia will hold general and local elections, and fully intends to include Serb areas in Kosovo. This could be the next flashpoint—if one does not erupt earlier.

Turkey's secular constitution

See you in court

Mar 19th 2008 | ANKARA
From The Economist print edition

A state prosecutor wants to ban the ruling party

Get article background

AP

Hands off our mildly Islamist party

AUTOCRATIC regimes in the Muslim world often ban religious parties, which then go underground and turn violent. Turkey's Islamists have taken a different path. Despite being repeatedly outlawed and ejected from power, pious politicians have shunned violence, embraced democracy and moved into the mainstream. No Islamic party has been as moderate and pro-Western as the Justice and Development (AK) party, which catapulted into government in 2002 promising to lead Turkey into the European Union.

Yet the country's secular elite is still fighting to oust the AK government, on thinly supported charges that it wants to wreck Ataturk's secular republic. A senior prosecutor has made the charges official, by asking the constitutional court to shut AK down because it has become “a centre for anti-secular activities”. In a 162-page indictment, Abdurrahman Yalcinkaya argued that AK is using democracy as a vehicle for imposing *sharia* law. He asked the court to slap a five-year ban on more than 70 AK officials, including the prime minister, Recep Tayyip Erdogan, and the president, Abdullah Gul.

The court, dominated by pro-secular judges, said it would decide by April whether to proceed with the case. Already jittery financial markets have taken fright. On March 17th the Istanbul Stock Exchange plunged by 7.5% and the Turkish lira fell by 3.5% against the dollar. Should the court decide to take up the case, the battle could last for a year, pushing Turkey into a prolonged period of instability, hampering reforms and jeopardising membership talks with the EU.

Mindful of all this, TUSIAD, the main business lobby, has denounced the case. “Shutting down parties is not compatible with democracy,” said its president, Arzuhan Yalcindag. America and the EU have also rushed to AK's defence. A combative Mr Erdogan has opined that AK's legal woes will only raise its popularity. He is probably right. The most recent challenge to AK rule came a year ago when he nominated Mr Gul for the presidency. The prospect of a president whose wife wore the Islamic headscarf and who would not veto AK-inspired laws galvanised the generals into threatening a coup. Many believe the army's meddling helped AK to a bigger share of the vote (47%) in last July's election. So why has the prosecutor chosen to act against AK now?

Some see it as a last-ditch attempt by Turkey's old guard to cling to power. A new and pious class of Anatolian entrepreneurs, who have thrived under AK, is challenging the elite. One such group, Calik, which employs Mr Erdogan's son-in-law, has acquired a media conglomerate, whose assets include a television channel, ATV, and the third-biggest daily, *Sabah*. “The reign of the Bosporus princes is over,” says a Western banker.

Ertugrul Gunay, the culture minister, has another explanation. He believes the case is connected to the recent arrests of generals, academics and journalists linked to a string of murders, including that of an ethnic-Armenian editor, Hrant Dink. Proponents of this theory note that Turkey's first Islamist-led government was ejected in 1997 after it began investigating links between the army and organised crime. Another theory is that the case was prompted by AK's efforts to ease the strict secular ban on the Islamic headscarf in universities. This move is cited in Mr Yalcinkaya's indictment. Other “evidence” is said to range from the AK-run Istanbul council's censoring of bikini ads to an AK official's observation that “asking a pious girl to remove her headscarf is akin to telling an uncovered one to remove her underpants”.

It is hardly the stuff of an Islamic revolution. Yet even AK's closest allies agree that Mr Erdogan should have done more to reach out to secular opponents. On the headscarf, he might have worked harder to protect the rights of women who choose not to cover their heads. He might also have scrapped Article 301 of the penal code, which has been used to prosecute scores of Turkish writers and academics for “insulting Turkishness”. With much of Mr Yalcinkaya's case built on things that the prime minister and his lieutenants have said, Mr Erdogan should see the value of free speech. His secular opponents, meanwhile, would do better if they left their ivory towers and spent more time with the ordinary people of Turkey.

Free speech and Islam

Flat-earth fears

Mar 19th 2008 | COPENHAGEN
From The Economist print edition

Danish cartoons, Dutch films and trouble with radical Islamists

Get article background

THE Danes and the Dutch share more than flat landscapes, blond natives and laid-back lifestyles. Their latest similarity is a fear of Islamist terrorism. It is leading to stepped-up security and diplomatic forays to reassure the Muslim world that they are nice people, really.

The common cause is free speech. Last month 17 Danish newspapers reprinted one of the Muhammad cartoons that in 2006 led to riots, burnt embassies and deaths across the Muslim world. The decision to republish came after Danish police arrested three men on suspicion of plotting to murder Kurt Westergaard, a cartoonist who drew a caricature of the prophet with a bomb as his turban (Mr Westergaard is now trying to sell the original).

The Dutch case concerns a plan by Geert Wilders, a strident anti-Muslim member of parliament, to broadcast a film denouncing the Koran, which he calls a “fascist” book. After months of trying vainly to persuade Dutch state-owned television to show it, Mr Wilders now intends to put out the film, “Fitna” (“Challenge”, in Arabic), in some other form during the next two weeks.

The leaders of both countries have tried to discourage these ventures. They are doing their utmost to soothe bruised sensibilities abroad. The Dutch prime minister, Jan Peter Balkenende, has had several talks with his Danish counterpart, Anders Fogh Rasmussen, about how to cope with the incipient crisis.

One sign that events are escalating came this week, when Mr Wilders secretly visited Copenhagen in an attempt to persuade Danish television to broadcast his movie. As in the Netherlands, the argument against doing so is to avoid provoking retaliation. Already Danish goods are being widely boycotted in Muslim countries.

The Danes seem to have had their fill of the controversy. An opinion poll in *Jyllands-Posten*, the newspaper that first published Mr Westergaard's cartoon, showed that almost 60% of Danes thought republication was ill-advised—whereas a majority supported publication the first time round. On the other hand, the Danes (and Dutch) are staunch believers in free speech. A Danish minister has talked of offering a Dutch-Somali politician, Ayaan Hirsi Ali, a safe bolt-hole. Two Danish television stations also aired clips of “Submission”, the film made by Theo van Gogh, who was murdered by an Islamic fanatic in 2004, for which Ms Hirsi Ali wrote the script.

There is also a natural unwillingness to bow to bullies. In the Netherlands, Mr Wilders is admired for his free-speech stance even by those who hate his politics. When two Danish soldiers were killed in Afghanistan, Mr Fogh Rasmussen rejected calls to bring the troops home. “Violent groups are trying to halt progress. They must not succeed,” he said. Many Europeans apply the same logic to free speech and Islamists.

Charlemagne

The hot air of hypocrisy

Mar 19th 2008
From The Economist print edition

The European Union summit reveals plenty of hypocrisy over climate-change targets

Illustration by Peter Schrank

DEMAND agreement on a divorce settlement before you marry, and the world may believe many things of you: that you are prudent, or cynical, or just a bit mean. What it will not believe is that you are a swooning romantic, moved only by the high ideals of love. You can boast you are an idealist, in other words, or you can make a pre-nuptial agreement: you cannot plausibly do both.

Just such a test faced European Union leaders at their recent summit, when they reviewed their year-old plan to lead the world in the fight against climate change. A year ago they were brimming with selfless idealism. They agreed to make deep cuts in carbon emissions (by a fifth from 1990 levels by 2020), even if other rich countries did not follow. The signal was clear: Europe will start saving the planet now, even if the selfish Americans (not to mention the Chinese and Indians) are not ready. Bigger cuts were promised if other countries joined in, prompting much self-congratulatory talk about the EU's “leading role”.

That was then. A year on, with the world economy looking wobblier, the March summit was a less uplifting affair. Leaders from countries with powerful heavy-industry lobbies called for explicit measures to “protect” European firms in case talks on a global climate-change deal failed (and left the Europeans pushing ahead with tough curbs on their own). In a move that would make an American divorce lawyer proud, Germany, France, Austria, Italy and the Czech Republic all asked the EU to plan for failure, insisting that defensive measures must be agreed before climate-change talks in Copenhagen at the end of 2009.

Demanding “certainty” today for businesses that have to make long-term investment decisions, the heads of governments also asked for a list of energy-intensive industries “particularly exposed to international competition”. Industries making steel, aluminium, paper, chemicals and bricks were all cited, as were others such as cement that are barely touched by imports (being cheap and heavy, cement is usually produced round the corner from where it is used).

EU leaders then asked for a range of protective policies to be spelled out. Germany backed a carve-out for the most energy-guzzling factories, giving them continued access to free carbon credits from the EU's emissions trading scheme (ETS) after 2012, by which time other polluters will mostly be buying emissions allowances at auction. The worst idea came from France's president, Nicolas Sarkozy, who renewed calls for a carbon tax on imports from countries that “don't play the game” on climate change. The European Commission should find a way to “penalise” companies from such countries, he added—

blithely ignoring the existence of firms that come from more than one country, source components from a dozen more and manufacture on every continent. Otherwise, he said, Europe would “get all the downsides [of fighting climate change], and none of the benefits”. Other than the benefit of saving the planet, one might retort: the project in which Europe claims a “leading” role.

Others were more subtle than Mr Sarkozy, but even more hypocritical, dressing up calls for handouts as concern for the world. Endless bigwigs said heavy industry would move to countries with “lower standards” unless helped to stay (by letting factories observe, er, lower standards). This argument even has its own jargon: “carbon leakage”, an ugly term gaining currency in Euro-circles, to convey the threat that carbon-spewing firms might move to places with weaker environmental laws.

Advocates of special favours for EU industry insist that factory owners will still have an incentive to install clean technology, because “free” ETS allowances will not really be free. They may be accompanied by benchmarks—eg, setting maximum carbon emissions for every tonne of steel produced—with free allowances given only to firms that meet the standard (and then only within a sector-wide cap). Another suggestion is to make importers enter the ETS and buy European emissions allowances to cover their products (though squaring this idea with fixed Europe-wide caps on allowances sounds a nightmare).

Yet listen to European industrialists, and they are saying something simpler: they may leave if carbon curbs make it more competitive to produce elsewhere. One can play with the details, but if carbon curbs bite at all, such a threat must remain. If they do not bite, it is hard to see how European production will become magically greener. (There is also the small detail, raised by countries such as Sweden, that investment may actually be more effective outside the EU: building a clean new plant in China to replace a Mao-era horror might reduce global emissions more than tweaking technology at a European factory, say).

Green fudge and pre-nups

As usual the summit ended in a fudge, after the dangers of pre-empting a global deal were pointed out forcefully by leaders from Sweden, Denmark, the Netherlands, Britain and the European Commission. The commission will “analyse” and “address” carbon leakage in a directive on the next generation of the ETS, coming out in early 2009. But details remain vague.

Germany's chancellor, Angela Merkel, insisted that the summit was “not calling into question” last year's headline targets. One might wonder. As one senior official notes, if Europe lets favoured industries fight Chinese or Indian rivals with a “race to the bottom” on emissions, that means other bits of the economy must slash emissions even more, if Europe means what it says on overall caps. There was much talk in Brussels of ensuring a “level playing-field” for EU industries. But here is the rub: if you do the right thing, you will not be on a level playing-field with those doing the wrong thing. Like marriage, fighting climate change involves a leap of faith. Does Europe accept that? Like a blushing bride suddenly demanding a pre-nup, it is sending out rather mixed signals right now.

Correction: London and Paris

Mar 19th 2008
From The Economist print edition

In our briefing on London and Paris ("The rivals", March 15th) we incorrectly compared London's Oyster card limit for Zone 1-2 with a single cash fare for similar zones in Paris. The single cash fare in London is €5.16 (£4); Paris charges €1.50.

Inflation resurgent

Unwelcome lift-off

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Illustration by David Simonds

The news on prices is bad, and there is worse to come

INFLATION, the bane of Britain's post-war economy, has been uncharacteristically docile over the past ten years. It lurched upwards in early 2007 but then obligingly subsided again. That relief has been short-lived. In recent months the prices of essential items such as food, heating and petrol have soared. And the prospects for hard-hit households look even grimmer as Britain imports inflation on a scale not seen for decades: commodity prices are rising and the pound is sliding.

These cost pressures are the biggest challenge yet to Britain's 15-year-old regime of inflation-targeting, which has underpinned the greatest price stability since the second world war. After Britain was turfed out of the European exchange-rate mechanism (ERM) in September 1992, the Conservative government gave the Bank of England the job of ensuring low inflation, which was measured by the retail-price index excluding mortgage-interest payments (RPIX). When Labour came to power in 1997, that target was set at 2.5%. In December 2003 it was changed to 2.0%, and inflation began to be measured by the consumer-price index (CPI) designed to be used by members of the European Union.

A year ago CPI inflation reached 3.1%, the first overrun big enough (more than a percentage point) under Labour's inflation-targeting rules to require an explanatory letter from the central bank's governor. Mervyn King said that he expected inflation to fall in coming months. That proved right—but it has now moved sharply up again (see chart). Figures published this week showed that inflation rose from 2.2% in the year to January to 2.5% in February. The jump was caused by higher gas and electricity charges, which have gone up by 11.5% since the start of the year.

Even after this rise, annual inflation is still considerably lower than in America, where the headline rate is 4.0%. But Britain's CPI measure, which unlike RPIX excludes housing costs for owner-occupiers as well as local-property tax, bears little resemblance to most people's experience of inflation. According to a recent poll published by the central bank, people think prices have risen more over the past year than at any time since the survey started in 1999: the median perception is that they have increased by 3.9%. As it happens, that is close to the RPIX measure of inflation, which moved up from 3.4% in the year to January to 3.7% in February. If RPIX and the former target of 2.5% were still being used, Mr King would once again have had to explain an embarrassing overrun.

Ominously, the latest wave of price increases is only just starting to break over the heads of consumers.

For one thing, the steep increase in alcohol duties in the budget will add a tenth of a percentage point to the annual inflation rate in April. More important, retailers are facing hefty cost pressures in their own purchases. Prices charged by manufacturers for domestic sales are rising by 5.7%, the highest since mid-1991—and small wonder, given that the prices manufacturers themselves are paying for fuel and materials rose by 19.4% in the year to February, the highest rate since the spring of 1980.

Over the past decade cheap imports have helped shops to keep their prices down, especially for clothing and electronic goods. Indeed, the cost of imported goods, excluding oil, fell by 18% between spring 1996 and the end of 2004. The decline reflected the emergence of low-cost producers such as China as well as the strength of the pound. In the course of the last three years import prices have been rising again, but at a moderate rate; the increase in 2007 as a whole was only 1.1%. But between July and January they rose by 4.4%; including oil, they went up by 6.4%.

The turnaround in import prices reflects in large part the sharp depreciation of sterling since last summer. Although the pound is still worth around $2, that says more about the weak dollar than it does about the strength of sterling, which slid to an all-time low of €1.27 against the nine-year-old single currency on March 17th. On a trade-weighted basis, the pound has fallen by 11% since the start of August, just before the credit crisis got under way. This is easily the biggest decline since sterling tumbled out of the ERM.

The weakening pound has removed one of the shields against the recent surge in global commodity prices. In sterling terms, the price of crude oil has risen by 23% since early December. And *The Economist* commodity-price index, which covers industrial raw materials and foods but excludes oil and precious metals, has risen by 27% over the same period (see article).

Retailers will absorb some of the higher costs moving along the distribution chain by trimming their profit margins. But the scale of the pressure suggests that consumers face still higher inflation over the next few months. Mr King himself said in February that it was "more likely than not" that he would have to write a second letter explaining another overrun.

The deteriorating outlook for prices has put the Bank of England in a bind as it also grapples with the credit crisis. The worse the financial difficulties become, the bigger will be their impact in slowing the economy. That calls for much looser monetary policy. But the danger in cutting interest rates when inflation is rising is that people may start to expect higher inflation and to act on it when setting prices and negotiating wages. Worryingly, the bank's own survey shows that the median expectation of inflation over the next year has risen to a new high of 3.3%.

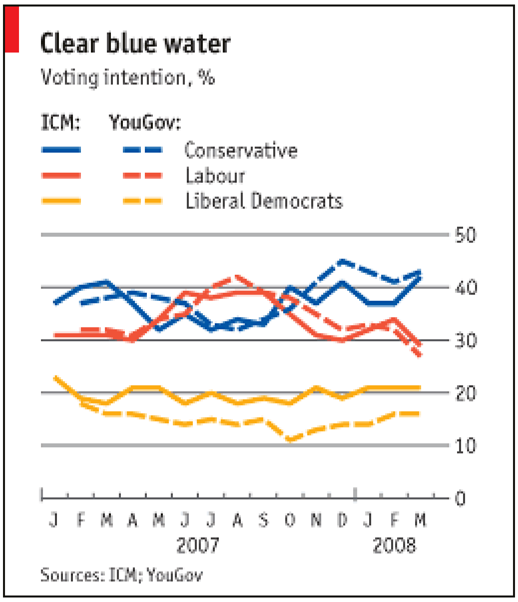
So far the central bank has moved cautiously. It has made only two quarter-point cuts in the base rate, in December and February, bringing it down to 5.25%. Worsening credit conditions mean that another reduction is likely in April. That will be some relief to borrowers, but it will still leave Britain's harassed households struggling to cope with higher inflation.

Polls and politics

Up, up and away

Mar 19th 2008 | GATESHEAD
From The Economist print edition

He who doesn't dare may win



WHY aren't you doing much better? That was the question journalists, and some of his own supporters, were putting to David Cameron, the Conservative leader, as he arrived at his party's spring conference in Gateshead, on Tyneside. After an autumn of government embarrassments and a winter of economic gloom, the Tories seemed stubbornly stuck with only a modest poll lead over lumpen Labour. Ministers affected to laugh off the numbers as an inevitable mid-term dip.

By the time Mr Cameron headed back to London on March 16th, he had an answer: we are doing better. A poll by YouGov, published in the *Sunday Times*, put support for the Tories at 43%, and for Labour at 27% (see chart), the party's lowest rating for 25 years. Another survey, by ICM and published in the *Guardian* on March 18th, had the gap at 13 points. The subsidiary good news for Mr Cameron is the growing proportion of people who think that he and George Osborne, his puckish shadow chancellor, would look after the economy better than Gordon Brown and Alistair Darling, their opposite numbers.

British polls have been unusually volatile in the past year, convulsed first by Mr Brown's arrival and lofty bounce, then by the fiasco of the snap election he did not call. This clutch of surveys may well overstate the decline of Labour's support; it would be surprising and (for Mr Brown) catastrophic if Labour's rating were to stay below 30%. The budget on March 12th, to which the polls are in part a reaction, was dour rather than painful, but it seems to have tipped some voters into disenchantment with the government. The polls also suggest (though it is too early to say for sure) that bad economic news is unlikely to drive voters back to Mr Brown's reassuring embrace, as Labour hopes.

If they can keep their numbers up, the Tories can begin to hope for a sizeable majority after the next general election (though if they do, the election will probably be put off until 2010). That will strengthen Mr Cameron's hand in his confrontations with those in his party who want him to frighten a few horses by, for example, making firm promises to cut taxes.

There were grumbles in Gateshead about the leader's latest family-friendly policies; there are still lots of Tories who are excited only by tough talk on criminals, immigrants and so on. But for now, triumphalism looks a more pressing risk for Mr Cameron than internal revolt.

Nuclear energy

Hot property

Mar 19th 2008
From The Economist print edition

British Energy is up for sale as the nuclear revival gathers pace

Get article background

ANY company would be pleased to see its share price jump 20% in a day. Managing this feat while stockmarket indices plummet and sober economists talk earnestly of meltdown is even more impressive. Most noteworthy is that the firm causing the excitement is British Energy, whose eight nuclear power stations (and one coal-fired plant) produce around a sixth of Britain's electricity. On Monday it announced that it was pondering collaboration with other companies—through joint ventures, or perhaps even a takeover—after a weekend of rumours that potential buyers had approached the government about its 35.2% interest in the firm.

British Energy has a colourful history. Formed in 1995 to run the second generation of Britain's nuclear plants, it has been plagued by financial trouble. A last-minute government rescue eventually valued at £5.3 billion ($10.7 billion at today's rates) stopped it going belly-up in 2002. Its plants are elderly (Sizewell B, the newest, began running 13 years ago; the rest are over 20 years old) and four reactors have been offline since last year, when inspections revealed cracks in their cooling systems.

But the interest is less in the company's existing plants than in the role it could play in building new ones. A combination of energy-security worries (fuelled by declining domestic oil and gas production), the need to replace many superannuated power plants (fossil-fired as well as nuclear) and concern over climate change has convinced the government that more nuclear energy is needed. Despite their repeated insistence that they will leave the details for the market to decide, ministers have become increasingly bullish: vague statements a few years ago about replacing existing capacity have given way to a call earlier this month by John Hutton, the business secretary, for nuclear electricity to make up a bigger proportion of supply than it does now (some 18%).

A merger or joint venture with another company could be attractive for both players. British Energy is keen on building new plants itself but it is a medium-sized fish in a very expensive pond. Its debt is junk-rated, thanks to past financial woes and unreliable reactors. A suitor could provide the money to back a building programme. In return, British Energy has a unique advantage: its land. The easiest place to build new reactors is next to existing ones: locals (who often work at the plant) tend to be enthusiastic, and there is easy access to grid connections and less risk of protracted planning battles.

Rumours about the identity of potential suitors swirl. Likely front-runners include EDF, a French firm that is Europe's biggest generator of nuclear energy, as well as E.ON and RWE, two German firms. All three are already operating in Britain, and EDF in particular has lobbied vigorously for a nuclear renaissance. The first two are large enough to consider financing new plants directly from their balance sheets without having to convince sceptical markets (for which new nuclear plants are unfamiliar territory). Centrica, a vertically integrated British firm that owns gas fields, power stations and an energy retail business, has also been named as a possible bidder, as has Scottish and Southern (another British firm).

On one reading, foreign interest in Britain is odd. In contrast to America, say, where new nuclear plants are heavily subsidised, the British government has long insisted that the private sector will have to pay for any new plants. That is risky: nuclear plants are expensive to build and vulnerable to fluctuations in power prices (it was cheap electricity that brought British Energy to its knees in the first place). Markets have little experience of paying for them. Only in Finland, where a new plant—currently hundreds of millions of euros over budget—is being built by a consortium of big energy users, is something similar being tried.

But nuclear enthusiasts see this laissez-faire approach as a proving ground, a chance to show that nuclear power can compete with fossil-fuel generation, especially if carbon is properly priced. For others the market's openness is the attraction, although some in Britain do worry about handing over to foreigners such a strategic asset. “In many countries, foreign firms could have a hard time winning contracts,” says one observer. “That's unlikely to be the case in Britain.”

McCartney divorce

Breaking up is hard to do

Mar 19th 2008
From The Economist print edition

Lessons from the latest high-profile divorce

WHEN they broke up two years ago, predictions of how much Heather Mills, aka Lady McCartney, could expect to get from her ex-Beatle husband ranged from £50m ($100m, at today's rates) to £400m. In the end, a High Court judge awarded her just £24.3m—a fifth of what she herself had demanded—as well as some uncomfortable home truths.

For the less-well-off spouse (usually the wife), England is reputed to have the most generous divorce laws in the world. Not only are the couple's assets supposed to be divided roughly equally, but also—rare in a rich country—everything gets thrown into the pot, including wealth acquired before the marriage. And prenuptial agreements are not recognised under English law.

So why has Ms Mills fared so "badly"? Mr Justice Bennett made that abundantly clear in his judgment on March 17th. First, because hers was a short marriage, lasting just four years, so the strict principle of equality did not apply. Second, she did not, as she claimed, lay down her career as a television presenter, public speaker and charity fund-raiser when she married; Sir Paul supported her in her professional endeavours. So she was not entitled to compensation for loss of earnings or opportunity, as other high-profile divorcees have been. Nor did Ms Mills make the "significant" contribution to her husband's own career that she claimed, acting as his "business partner" and "psychologist".

Then came the question of just how high on the hog Ms Mills should expect to live after her divorce. Recent rulings have suggested that the ex-wife should continue to enjoy the lifestyle to which she had become accustomed, but given her short marriage, such an expectation in Ms Mills's case was "unreasonable", Mr Bennett said. He reckoned that she needed £600,000 a year, or a capitalised lump sum of £14m. Together with her existing assets of £7.8m, plus a further £2.5m to buy a house in London, this should allow her "to adapt to a standard of living that she could expect as a self-sufficient woman".

If Ms Mills found this settlement—in fact England's biggest payout in a contested divorce after the £48m won by Beverley Charman last year—"unfairly low", she had only herself to blame, Mr Bennett suggested. Her "exorbitant" claim was unsupported by reason or logic. After some favourable opening remarks about Ms Mills, Mr Bennett had barely a good word to say about her in his 58-page ruling.

Unlike her husband's balanced and honest evidence, much of her own had been not just "exaggerated,...inconsistent and inaccurate", but also "less than candid", he said. In view of Sir Paul's generosity towards her, he found her own greed and "underhand" conduct particularly "distasteful". And although it was true that she had been ridiculed in the press, she was to some extent her own worst enemy.

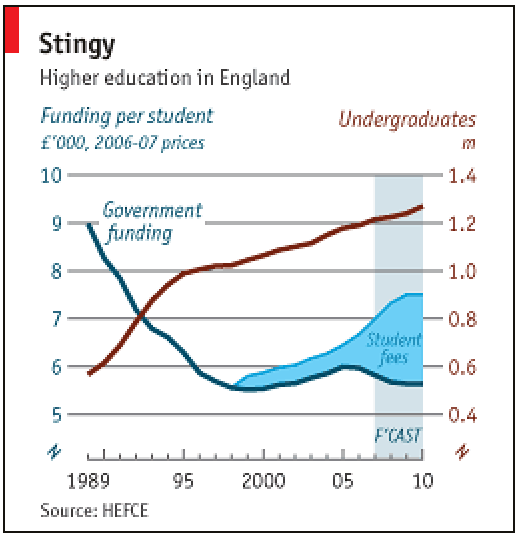
Ms Mills understandably fought to stop the judgment being made public, not only launching an unsuccessful appeal against the judge's decision to do so but also angrily dousing with water the immaculate bouffant hair-do of her husband's (female) lawyer. Despite the diverting drama, the ruling is unlikely to deflect increasingly urgent calls for a review of England's confusing law on the division of marital assets.

Universities

Maturing market

Mar 20th 2008
From The Economist print edition

Fewer youngsters will mean universities scrabbling for students



THE ivory tower is no longer a haven from the harsh world outside its walls, if indeed it ever was. Since tenure was abolished in 1987, mergers and departmental closures have seen some lecturers lose their jobs. Trendy new courses have replaced fusty old ones. The rankings that are used to dole out cash have put academics under pressure to churn out papers and whittled away their freedom to pick their own research topics. Finances have been stretched as institutions chase academic stars to boost their rankings.

The biggest source of stress, though, has been the expansion of higher education on the cheap. Government funding has picked up since 1997, and student fees, introduced in 1998 and raised in 2006, have filled coffers further. But funding is still less generous than when student numbers took off in the late 1980s (see chart).

Bursars in England and Northern Ireland are hoping for a hefty rise in student fees after the government reviews the current £3,145 cap next year. But demographic trends are pulling the opposite way. A report published on March 20th by Universities UK, an industry body, estimates that by 2020 there will be 16% fewer 18-year-olds than now. That would mean universities fighting over 70,000 fewer customers, if current recruitment patterns continued.

This could be good news for today's six-year-olds. It would be easier to get into the most selective institutions (Oxford and Cambridge between them now reject around 10,000 straight-A students each year). And some universities at the “pile 'em high and teach 'em cheap” end of the market might decide to compete on cost even if they are allowed to charge more; in today's cushier market, only a handful charge less than the maximum permitted.

These ominous warnings may be premature: demographic predictions are notoriously tricky. Universities might be saved by a surge in immigration like that from eastern Europe since 2004. But if the students of 2020 are not to be fewer, they will need to be more diverse. Universities will have to keep scrambling for foreign students, and that will be tough: relative to its size Britain already absorbs more of them than anywhere else, and higher education is expanding rapidly in the places its universities traditionally recruit from. They will also need to offer more part-time courses and programmes giving professional qualifications in order to appeal to businesses and career-switchers.

The numbers could be made up if British boys did as well at school as girls, or poor British youngsters as well as rich ones. Neither would be easy to bring about. Boys underperform in most places, not just in Britain. And deprivation wreaks its havoc early; dim rich children overtake brighter poor ones by the age of seven.

Most teenagers with three A-levels already go on to do degrees. The government hopes that its new school-leaving qualification, the diploma, will create a wider pool for universities to fish in. There is a precedent: GCSES, which replaced O-levels in 1988, led to more pupils staying in school past 16 and eventually going on to university. But the diploma will run alongside A-levels. And although there has been talk of dropping the latter once the diploma is available everywhere, this will not happen unless universities are keen.

In the late 1980s, similar demographic trends also led to warnings about declining student numbers. In the event the introduction of GCSEs, together with the government's decision to make nursing a graduate profession, meant that numbers rose steeply. Today's universities are hoping for a similar feat of prestidigitation from the diploma, and from the recent announcement that new teachers will be expected to get a master's degree.

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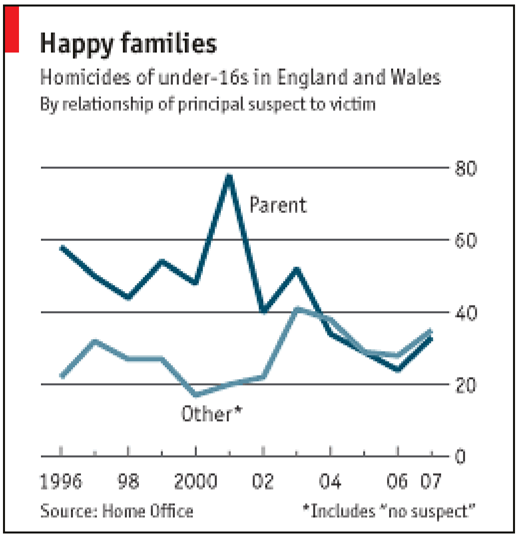
WORLD
BRITAIN

Child killings

The good news

Mar 19th 2008
From The Economist print edition

Safer times for Britain's babies, but watch out for the teenage years



ARMCHAIR detectives all agree on one thing: if a child goes missing or dies in mysterious circumstances, the most likely culprits are the parents. That principle led some to question the role of Karen Matthews and her partner in the disappearance of her nine-year-old daughter, Shannon, who was eventually discovered, alive, on March 14th. This week the *Express* newspapers ran front-page apologies for similar speculation about another couple, Kate and Gerry McCann, whose daughter vanished in May. Finger-pointers admit that such suspicion is cruel, but claim that crime statistics are on their side.

Are they? In fact, parents are less frequently to blame than they used to be. Whereas children under 16 are being slain in increasing numbers by friends and strangers, they are less often killed by their mothers or fathers (see chart). For parents in Britain, 2004 marked the first year in which other people were more likely to kill their children than they were themselves.

In some cases, the confluence of these upward and downward trends might be linked. Family breakdown means that when a child is killed by the man of the house, that man is less likely than in the past to be their father. More complex family arrangements mean that friends and extended family are more closely involved in every aspect of a child's upbringing—including, perhaps, in their abuse.

For the most part, though, homicides by parents and by others seem to be unrelated. The risk to older children is growing: their vulnerability to gang violence has increased the number of teenagers killed by strangers and friends. (Chaotic street violence might also explain why the number of cases with no suspect has been rising.)

The risk to the very young, meanwhile, is diminishing. Much homicide is infanticide: of the 720 under-16s killed in the past decade, four out of ten were less than a year old. The Department of Health reckons that post-natal depression is the biggest cause of such killings and has focused on tackling it. Something is working: a third fewer under-ones were killed in the past six years than in the six before that.

Better economic times may also be a reason why parents have been lashing out less often. Domestic violence against women is linked to poverty and, sure enough, solid economic growth over the past decade and a bit has been accompanied by a fall in domestic abuse. If being employed and having savings makes partners less likely to hit each other, and more likely to split up if they do, it might also make parents less likely to become depressed, and to take out other frustrations on their children.

Whatever the reason, babies are bucking a strong national trend. Overall, the chances of being a victim of homicide in Britain are about a sixth higher than they were ten years ago. The rates have gone up for nearly all age groups, particularly those aged between 16 and 30. For them, the homicide rate has risen from 18 per million people to 24 over the past decade, while for children less than a year old it fell from 50 per million to 26. Adulthood may be more violent than in the past, but children are more likely to reach it. That is surely progress of sorts.

Foreign bosses for defence firms

CEO wanted, English not required

Mar 19th 2008
From The Economist print edition

The last bastion of corporate nationalism may finally be crumbling

FROM the Afrikaans accent of the doormen at its smart hotels to the east European lilt of waiters in its restaurants London's workforce is unmistakably global. Yet one unlikely pocket of discrimination remains. The jobs of running Rolls-Royce and BAE Systems—Britain's biggest aerospace and defence firms—are reserved for British citizens, an anomaly that both firms are lobbying hard to end.

The two argue that they should be allowed to scour the world for talent, as other firms do. Only 64 of the bosses of the 100 biggest firms on the FTSE share index are British, reckons Odgers, Ray & Berndtson, a headhunting firm. Rolls-Royce is not anxious to see the back of its boss, Sir John Rose. But BAE wants to replace Mike Turner by August, and it has some able Americans, along with a couple of Britons and a continental European, in mind.

The firms' hands are tied by the terms of their privatisation two decades ago. The government hung on to a single special share in each of them that conveys particular powers. Both companies may hire only British chief executives or executive chairmen (and most of their directors must be British too) unless the government agrees otherwise. And government approval is needed before a foreign shareholder may own more than 15% of the company.

Such “golden” shares were once common in privatised industries such as water and electricity utilities. Yet most have been allowed to expire or have been removed. The government quickly scrapped its golden share in Jaguar, a carmaker with a glamorous name but a prodigious spending habit, when it fell into the loving embrace of Ford in 1989. In 2003 the European Court of Justice forced Britain to shred its golden share in BAA after deciding that it inhibited the free movement of capital. The airports operator was later sold to Ferrovial, a Spanish construction firm.

That the government has kept its golden shares in BAE and Rolls-Royce despite abandoning them in so many other businesses is hardly surprising. Both are intimately involved in Britain's defence. Rolls-Royce makes the nuclear reactors that power its submarines. BAE has played a role in making just about all the triggers that military fingers rest on, from jet fighters and tanks to dusty rifles.

Nor is it unusual. Most countries limit the ownership of big defence firms and insist that only their own citizens can be trusted with their deepest military secrets. The American subsidiaries of British defence companies, for instance, are managed by American boards whose directors have been approved by the Pentagon.

Proponents of golden shares argue that they are needed in crucial areas so that Britain will be beholden to no one. Yet believing that this is possible reflects an outdated view of defence and the industry needed to support it. Most weapons now have parts from all over the world. They are so expensive and complicated that few countries can make more than a bit of what they need. Even America, which spends as much on defence as the rest of the world combined, is buying tanker aircraft designed and partly made in Europe.

Because Britain has already gone further than most in opening its defence market to foreign competition, it would be hard pressed ever to fight a war without the support of its allies. An American firm produces the radios carried by British soldiers in Afghanistan and a French one provides the unmanned drones that keep an eye on them from the air. The country's national champions, meanwhile, do more business outside Britain than in it. BAE's biggest customer is not the British Ministry of Defence but the Pentagon.

Letting the firms choose their own chiefs would be good not just for them and their shareholders but for taxpayers too, many argue. Defence firms are notorious for extracting handouts from governments in the name of national interest. The more they look like any other firm operating in a competitive market, the easier it will be to turn a deaf ear to special pleading.

Bagehot

The forgotten war

Mar 19th 2008
From The Economist print edition

Illustration by Steve O'Brien

Five years on, the impact of the Iraq war on Britain has been remarkably slight

A MILLION people marched in London. A million dinner parties were wrecked by violent rows. It was the most divisive issue Britain had known in decades, infinitely more controversial than it was at the time in America. Five years ago 46,000 British servicemen helped to overthrow Saddam Hussein; 4,100 soldiers are still in Iraq. Considering how schismatic the war felt then, and how badly it has gone since, it has made eerily little difference to Britain.

That is partly because it was never as divisive in Parliament as it was in the country. The Conservatives supported Tony Blair's commitment of troops, which muted the unpopular conflict's influence on the general election of 2005. The Liberal Democrats opposed the war, but have failed to maintain the momentum that stance won them. Iraq precipitated a rancorous split within the liberal intelligentsia; but its long-term impact on the shape of national politics has been nugatory.

It did have an impact on Mr Blair himself. He won that 2005 election, it is true, but with a reduced majority, and struggled thereafter with a recalcitrant Labour Party and hostile media. Like an old soldier dying of ancient wounds, he was pressed out of Downing Street in 2007 partly because of Iraq. On the other hand, he stayed there for more than four years after the invasion, and more than a decade overall. It is unlikely that he would ever have carried on much longer, even if Basra and Fallujah had not become household names: his unyielding zeal over Iraq can be seen as the product of a long incumbency as much as the reason it ended. It was thought to have blighted his reputation, but Mr Blair is now talked of as a possible president of the European Union's council. Two of those most intimately implicated in his Iraq policy, Jack Straw and Geoff Hoon, are still in the cabinet.

There may be a more general and insidious consequence of the war and the way Mr Blair justified it. The unwarranted confidence and dropped caveats, the cajoling of supposedly independent spooks: whether or not it qualifies as lying, the way the government, like America's, manipulated the evidence of Iraq's weapons of mass destruction, portraying a potential threat as an urgent one, was a scandal. “What price our credibility with the next tyrant?” Mr Blair asked Parliament on the eve of war. Indeed. The effect on public attitudes to government, and thus on government's ability to act, may be felt only when another prime minister asks the country to trust his case for war.

Yet the evidence of slipperiness and sloppiness that continues to drip out—more may emerge if Gordon

Brown eventually makes good on his pledge to hold a full inquiry into the war—commands little attention. In part that is because the subject is tired and recondite. But the sad reality is that the mis-selling of the war confirmed rather than created a widespread belief that ministers lie and spin rules. The public's view of politicians was worryingly jaundiced even before Iraq.

Five years on, Britain's international situation looks oddly undisturbed too. In 2003 the world seemed to be experiencing an epochal realignment, which for Britain meant compromising its place in Europe and embracing outright Atlanticism. If Iraq had been a triumph, perhaps that realignment might have lasted. But it wasn't—and it didn't. Mr Blair's failure to sway America's post-invasion behaviour (in Palestine as well as Iraq) swiftly disproved the idea that loyalty to George Bush would be rewarded with influence. His successor has edged away from Mr Bush—understandably, given the widespread sense of indignant emasculation among British voters. Some in America have been scornful about Britain's shrinking presence in southern Iraq—doubly painful criticism, since maintaining American goodwill is one of the main motives for keeping British troops there at all.

Perhaps Mr Blair built up credit for Britain in Washington that will outlast him and Mr Bush. But as other leaders again court the hyperpower, the so-called “special relationship” looks much as it did before Iraq: strong, but less special and monogamous than some pretend. Meanwhile, Britain is again as (semi-) engaged in Europe as it was before the pre-Iraq split, hokey-cokeying with the European Union and wrangling with its other members as it has always done. The passions aroused by Iraq have passed, along with many of the European leaders who voiced them. There has been a reputational cost for Britain, especially in the Middle East. But its geopolitical orientation looks roughly as it did before Iraq convulsed global diplomacy.

The Teflon nation

Iraq has changed Britain in two important ways. It is true, as some pro-war ultras argue, that because of its demography and location Britain was vulnerable to Islamist terrorism before Iraq—and that other motives and complexes contribute to the apocalyptic longing of murderers such as the suicide-bombers of July 7th 2005. But Iraq has unquestionably made the terrorist threat worse. It has thus also contributed to the sense of permanent emergency that has crept into politics and policing.

The other big and troubling result concerns the armed forces, which have successively felt under-equipped for the invasion, under-appreciated, embarrassed by the exposure of abuses and overstretched by their ongoing dual deployment in Iraq and Afghanistan. That unhappiness may also have implications for future crises. But those grievances only trouble a minority, and the terrorists have recently been quiet or thwarted; so those two legacies are, for the moment, relatively inconspicuous.

Iraq turned out to be as catastrophic as it was controversial. It has cost untold thousands of lives, including those of 175 Britons. Nothing else Mr Blair did, or Mr Brown is likely to, will be as momentous. And yet—in testimony perhaps to Britain's robustness, perhaps to its democratic shortcomings, maybe just to short attention spans—it already feels like a forgotten war.

Mathematics

Let's talk about figures

Mar 19th 2008
From The Economist print edition

Panos

The eternal language of numbers is reborn as a form of communication that people all over the world can use—and, increasingly, must use

BRILLIANCE with numbers is a curious thing. Paul Erdos, a Hungarian who died in 1996, used to travel the world and stop briefly at the offices and homes of fellow mathematicians. “My brain is open,” he would announce as, with uncanny intuition, he suggested a problem that, without realising it, his host was already half-way to solving. Together they would find the solution.

In a discipline-wide joke, grateful mathematicians still use “Erdos numbers” to indicate how close they were to contact with the great man: “Erdos 1” describes his co-authors, “Erdos 2” indicates their co-authors, and so on. And in all seriousness, the fruits of Erdos's 83-year life include more than 1,500 jointly authored publications, and a network that extends via his collaborators not only into most areas of mathematics but into many other fields—physics, biology, linguistics and more.

With his determination to overcome all the difficulties posed by immigration authorities or language (gestures and formulas were enough, if he and his hosts shared little vocabulary), the Hungarian epitomised many things about his subject. More than most other sorts of knowledge, mathematics has always transcended the limits of time and space. The genius of ancient Greek geometry not only stands the test of time (Pythagoras's theorem is as valid now as when it was first proved); its discoveries can suddenly find new applications in the 21st century.

And in an age of e-communications, continent-hopping scholars (not usually as eccentric as Erdos), and journals whose authors and readers come from every corner of the earth, mathematics is coming into its own as a sort of global dialogue in which anybody can take part—and whose fruits are not just beneficial, but indispensable, in just about every area of science.

In years past, people with a gift for numbers often overcame vast odds to find an outlet for their genius. Srinivasa Ramanujan was a humble clerk in British India when, in 1912, he began sending theorems to Cambridge professors. Just one recipient saw the work's value and invited Ramanujan to England.

The internet gives today's Ramanujans a better chance. But in any case, by comparison with the arts, doing well at maths was always much less dependent on cultural or economic factors. A talented number-spinner doesn't need to be nurtured by visits to art galleries or the opera, or access to a parental library. Nor are the rules of algebra governed by social conventions: a gawky 14-year-old who clams up in interviews can still do well.

And pure mathematics, at least, needs no fancy facilities like particle accelerators or wind tunnels. Sometimes a pen and paper is enough. Many a researcher has returned from an international conference with a napkin or beer-mat covered in jottings from a spontaneous and convivial late-night collaboration.

Admittedly, there is less of a distinction these days between pure maths and the applied sort; that is one of the consequences of a world where all sorts of knowledge seem to spread and fuse in unpredictable ways. For example, the kind of theoretical maths that would terrify a layman has become an indispensable key to understanding the way that living things behave. Anything that grows and disseminates—from single-celled organisms to malignant tumours, from rainforests to the pigments that form stripes or spots in the animal kingdom—can be modelled with the latest computational tools. At a time when the volume of data about every form of life is vast and crying out to be processed, “some kinds of pure maths are remarkably useful for biology,” says Philip Maini, a mathematician who divides his time between Oxford, China, Australia and American campuses.

Topology in transit

The sheer mobility of talented mathematicians makes them hard to pin down, in any sense. Earlier this year (in a move comparable to the flight of a bond-trading team from one bank to another), a dozen experts on topology, a branch of geometry, revealed that they had constituted the editorial board of a new journal founded by the London Mathematical Society (LMS), a scholarly body. Previously—before resigning en masse—they had formed the board of a journal on a similar topic produced by Elsevier, a Dutch-based publishing concern. The LMS already owns or co-publishes 11 other weighty journals: less than a fifth of the writers for those august tomes are British.

The world of mathematics is not exactly a market, in the sense of a forum where people always sell to the highest bidder: indeed, one (fully intended) consequence of the topologists' change of affiliation is that work in their field will be available at lower prices to humble scholars. But international maths is a form of marketplace, where all sorts of people trade their intellectual wares to enormous mutual benefit.

In an age where you need to be numerate to do almost anything else (from building bridges to conquering disease), governments anxiously compare their performance in mathematics with that of competitor nations. This month a new cry of alarm came from America, where a National Mathematics Advisory Panel, established by George Bush in 2006, reported that “without substantial and sustained changes” the country was doomed to “relinquish its leadership” in the world of numbers as the century wears on.

America has long masked its difficulty in educating enough mathematicians by importing lots of ready-made talent, especially from East Asia and the former Soviet Union. But the problems are real enough. As the panel noted, the share of American students doing degrees in maths or related areas fell from 32% in 1994-95 to 27% in 2003-04. And the share of maths-related doctorates at American universities that went to American citizens or residents fell over the past four decades from 80% of the total to less than 60%. The panel concluded that America's problems become apparent when students start to study algebra—for most, their first encounter with genuinely abstract thinking.

For really high-flying mathematicians, the very idea of a national maths culture sounds dated. It comes naturally to them to find collaborators in one continent, publish in another and teach all over the world. But governments cannot help worrying; and the trick of importing fully-trained brains will become less viable as “exporting” countries develop their own systems of higher learning.

Among the communist or ex-communist countries whose brightest sons and daughters have often found their way to America, Canada or Australia, there are some interesting differences. As Ari Laptev, the (Soviet-born) president of the European Mathematical Society, points out, Tsarist Russia had a fine maths culture, and even in the darkest Soviet days, pure maths was an island of excellence and integrity. In the post-communist slump, Soviet mathematicians emigrated in droves, leaving a lack of mentors for today's brainy kids. But in the new mood of nationalism and oil wealth, the mathematicians who stayed in Moscow are walking taller. Their challenge is how to keep youngsters in academia when they could be making money.

In China, the cultural revolution hurt maths more than Russia's Bolsheviks ever did; but these days, Chinese teenagers do superbly in global maths contests, and most of the Chinese doctoral students who people the maths faculties of the world will probably bring their talents home. Opportunities are expanding in China and narrowing elsewhere. China's output of original mathematical work is still mediocre, but it is improving rapidly. New Chinese journals are being started; inventive minds will soon be filling them.

In any case, it may be time to rethink the very idea of national teaching systems that with varying success prepare youngsters to join a global conversation when they grow up. Already, some of the solutions to school-teaching challenges are as global as could be. Take HeyMath!—an interactive maths-education package co-designed by Britain's Cambridge University and some bankers in the south Indian city of Chennai: it has served 250,000 children in 33 countries; 2,000 teachers are using it now. Having gained an American foothold in Massachusetts, HeyMath! programmes honed in India (with help from partners in Singapore) are now being tried out by three schools in Connecticut. If only Ramanujan were alive to see it.

The World Bank

Dirty linen

Mar 19th 2008
From The Economist print edition

Can a big lender fight sleaze?

DENOUNCING sleaze and kickbacks has long been fashionable among the bosses of the World Bank. Back in 1996, James Wolfensohn piously vowed to root out the “cancer of corruption” and even made some modest internal efforts at reform. His successor, Paul Wolfowitz, also made the issue a priority, linking it to his goal of making aid effective. Both men genuinely tried to tackle the scourge. And yet this week saw yet another bank boss, Robert Zoellick, forced into the spotlight by yet another scandal.

For several years there have been whispers about wrongdoing in the agency's lending to Indian health-care projects. The allegations led to a “detailed implementation review” by the bank's internal auditor. That report, made public in January, concluded that over $500m-worth of contracts may have been tainted by “significant indicators of fraud and corruption” such as “collusive behaviours, bid rigging, bribery and manipulated bid prices”. Though the bank was initially slow to respond to the allegations, it said this week that it had started nine investigations into the matter. The Indian government has also started several related probes.

Not everyone is convinced. In 2006 Amir Attaran of the University of Ottawa co-authored a paper in the *Lancet*, a British medical journal, pointing to apparently falsified results and other deficiencies in health projects paid for by the bank. He is convinced that its managers are too cosy with their clients in India to conduct a proper investigation: “This is a corrupt party investigating itself.”

World Bank spokesmen hotly deny this, insisting that anti-corruption efforts are gathering pace. They point to multiple examples of firms punished by such measures as temporary bans on doing business with the bank. Yet even if the World Bank emerges untainted from this affair, that may not be enough to solve a deeper problem that may produce more scandals in future. As an institution which is under strong pressure to lend as much as possible, says Francis Fukuyama of America's Johns Hopkins University, the World Bank is “poorly structured to lead a fight against corruption”. Another problem: the bank's mandate forbids it from dabbling in local politics—and that can mean failing to make sober enough assessments about what is really going in the countries where it is pushing out money.

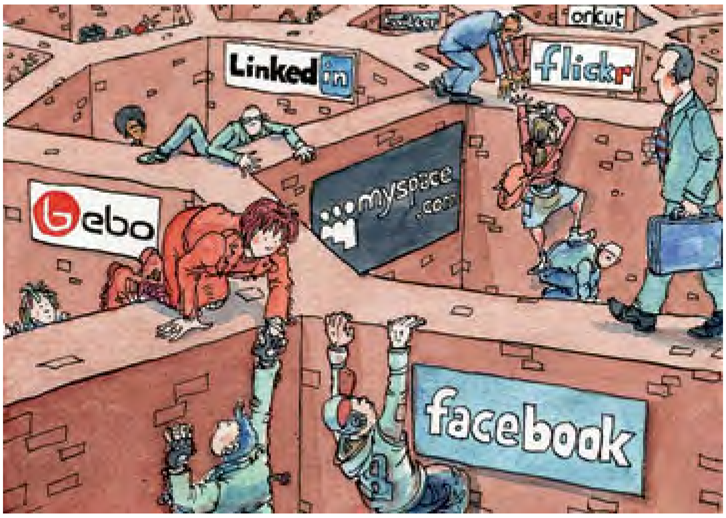
Economist.com BUSINESS

Online social networks

Everywhere and nowhere

Mar 19th 2008 | SAN FRANCISCO
From The Economist print edition

Illustration by David Simonds



Social networking will become a ubiquitous feature of online life. That does not mean it is a business

A LARGE but long-in-the-tooth technology company hoping to become a bigger force in online advertising buys a small start-up in a sector that everybody agrees is the next big thing. A decade ago, this was Microsoft buying Hotmail—the firm that established web-based e-mail as a must-have service for internet users, and promised to drive up page views, and thus advertising inventory, on the software giant's websites. This month it was AOL, a struggling web portal that is part of Time Warner, an old-media giant, buying Bebo, a small but up-and-coming online social network, for $850m.

Both deals, in their respective decades, illustrate a great paradox of the internet in that the premise underlying them is precisely half right and half wrong. The correct half is that a next big thing—web-mail then, social networking now—can indeed quickly become something that consumers expect from their favourite web portal. The non sequitur is to assume that the new service will be a revenue-generating business in its own right.

Web-mail has certainly not become a business. Admittedly, Google, Microsoft, Yahoo!, AOL and other providers of web-mail accounts do place advertisements on their web-mail offerings, but this is small beer. They offer e-mail—and volumes of free archival storage unimaginable a decade ago—because the service, including its associated address book, calendar, and other features, is cheap to deliver and keeps consumers engaged with their brands and websites, making users more likely to visit affiliated pages where advertising is more effective.

Social networking appears to be similar in this regard. The big internet and media companies have bid up the implicit valuations of MySpace, Facebook and others. But that does not mean there is a working revenue model. Sergey Brin, Google's co-founder, recently admitted that Google's "social networking inventory as a whole" was proving problematic and that the "monetisation work we were doing there didn't pan out as well as we had hoped." Google has a contractual agreement with News Corp to place advertisements on its network, MySpace, and also owns its own network, Orkut. Clearly, Google is not making money from either.

Facebook, now allied to Microsoft, has fared worse. Its grand attempt to redefine the advertising industry by pioneering a new approach to social marketing, called Beacon, failed completely. Facebook's idea was to inform a user's friends whenever he bought something at certain online retailers, by running a small announcement inside the friends' "news feeds". In theory, this was to become a new recommendation economy, an algorithmic form of word of mouth. In practice, users rebelled and privacy watchdogs cried foul. Mark Zuckerberg, Facebook's founder, admitted in December that “we simply did a bad job with this release” and apologised.

So it is entirely conceivable that social networking, like web-mail, will never make oodles of money. That, however, in no way detracts from its enormous utility. Social networking has made explicit the connections between people, so that a thriving ecosystem of small programs can exploit this “social graph” to enable friends to interact via games, greetings, video clips and so on.

Coming up for air

But should users really have to visit a specific website to do this sort of thing? “We will look back to 2008 and think it archaic and quaint that we had to go to a destination like Facebook or LinkedIn to be social,” says Charlene Li at Forrester Research, a consultancy. Future social networks, she thinks, “will be like air. They will be anywhere and everywhere we need and want them to be.” No more logging on to Facebook just to see the “news feed” of updates from your friends; instead it will come straight to your e-mail inbox, RSS reader or instant messenger. No need to upload photos to Facebook to show them to friends, since those with privacy permissions in your electronic address book can automatically get them.

The problem with today's social networks is that they are often closed to the outside web. The big networks have decided to be “open” toward independent programmers, to encourage them to write fun new software for them. But they are reluctant to become equally open towards their users, because the networks' lofty valuations depend on maximising their page views—so they maintain a tight grip on their users' information, to ensure that they keep coming back. As a result, avid internet users often maintain separate accounts on several social networks, instant-messaging services, photo-sharing and blogging sites, and usually cannot even send simple messages from one to the other. They must invite the same friends to each service separately. It is a drag.

Historically, online media tend to start this way. The early services, such as CompuServe, Prodigy or AOL, began as “walled gardens” before they opened up to become websites. The early e-mail services could send messages only within their own walls (rather as Facebook's messaging does today). Instant-messaging, too, started closed, but is gradually opening up. In social networking, this evolution is just beginning. Parts of the industry are collaborating in a “data portability workgroup” to let people move their friend lists and other information around the web. Others are pushing OpenID, a plan to create a single, federated sign-on system that people can use across many sites.

The opening of social networks may now accelerate thanks to that older next big thing, web-mail. As a technology, mail has come to seem rather old-fashioned. But Google, Yahoo!, Microsoft and other firms are now discovering that they may already have the ideal infrastructure for social networking in the form of the address books, in-boxes and calendars of their users. “E-mail in the wider sense is the most important social network,” says David Ascher, who manages Thunderbird, a cutting-edge open-source e-mail application, for the Mozilla Foundation, which also oversees the popular Firefox web browser.

That is because the extended in-box contains invaluable and dynamically updated information about human connections. On Facebook, a social graph notoriously deteriorates after the initial thrill of finding old friends from school wears off. By contrast, an e-mail account has access to the entire address book and can infer information from the frequency and intensity of contact as it occurs. Joe gets e-mails from Jack and Jane, but opens only Jane's; Joe has Jane in his calendar tomorrow, and is instant-messaging with her right now; Joe tagged Jack “work only” in his address book. Perhaps Joe's party photos should be visible to Jane, but not Jack.

This kind of social intelligence can be applied across many services on the open web. Better yet, if there is no pressure to make a business out of it, it can remain intimate and discreet. Facebook has an economic incentive to publish ever more data about its users, says Mr Ascher, whereas Thunderbird, which is an open-source project, can let users minimise what they share. Social networking may end up being everywhere, and yet nowhere.

German corporate governance

Raising their voices

Mar 19th 2008
From The Economist print edition

Activist shareholders claim a rare victory

MICHAEL FRENZEL is remarkably resilient. The boss of TUI, Europe's biggest travel company, has been in his job since 1994. He has survived the slump in travel and tourism after the terrorist attacks in America on September 11th 2001; speculation about a takeover by a secret buyer through stake-building by Morgan Stanley, an investment bank; and fierce attacks on his strategy from shareholders. But in the past few weeks it seemed that the tenure of the longest-serving boss of a German blue-chip company was coming to an end at last. John Fredriksen, a Norwegian shipping tycoon who is one of TUI's biggest shareholders, and Guy Wyser-Pratte, an American investor, demanded the separation of Hapag-Lloyd, its container-shipping division, from the rest of the firm—and claimed to have the necessary support among other shareholders.

Mr Frenzel faced the choice between a showdown with shareholders at the general meeting on May 7th, or giving up his “two pillar” tourism-and-shipping strategy, which he has fiercely defended on the basis that shipping provides a hedge for the volatile travel business. He chose the latter course: on March 17th TUI said it was preparing to separate its shipping division. By giving in to shareholder pressure Mr Frenzel, whose mandate was recently renewed for another four years, has probably saved his skin. His concession was a rare victory for shareholders in a German company. But shareholders are starting to become more vocal and are making their demands in public, as Mr Fredriksen did.

“The example of the activism of London-based investors influences Germans,” says Holger Schmieding, an economist at Bank of America. They regard the Children's Investment Fund (TCI) as a role model, after it forced the management of Deutsche Börse, Frankfurt's stock exchange, to abandon an attempt to take over the London Stock Exchange in 2005, triggering the resignation of Werner Seifert, the chief executive, and Rolf Breuer, the boss of the supervisory board.

German shareholders have more rights than investors in other European countries. In the Netherlands, for example, shareholders have “almost zero rights”, according to Marco Becht of the European Corporate Governance Institute. But German shareholders are far less powerful than those in Britain, where investors need only a 10% stake in a public company in order to force an extraordinary general meeting of shareholders to vote on important strategic decisions or remove directors from the company.

Foreign investors tend to lead the charge. Three years ago Mr Wyser-Pratte and other shareholders managed to oust Hans Fahr, the boss of IWKA, a German engineering and automotive supplier. Last year another foreign investor—Rustam Aksenenko, a Russian financier—led the successful campaign to topple Frank Rheinboldt, the boss of Escada, a fashion firm.

Meanwhile corporate Germany is fighting back. Big companies are pressing the government in Berlin and BaFin, the financial watchdog, to strengthen their defences by sharpening the definition of “acting in concert” in Germany's takeover law. The clause stipulates that if shareholders accounting for more than 30% of the voting rights are found to act in concert to push their agenda, they are required to launch a full takeover of the company or face a fine.

Mr Frenzel could have hoped for a decision by BaFin to investigate whether TUI's shareholders had fallen foul of this rule. Yet he preferred to placate his investors with the announcement of a sale of Hapag-Lloyd, which will not be easy. “We remain sceptical about any form of spin-off for Hapag-Lloyd, in the light of TUI's corporate history," says Carmen Hummel, an analyst at HypoVereinsbank. A few years ago TUI called off a flotation of Hapag-Lloyd because of weak markets. This could happen again, which means that this month's shareholder rebellion may not be the last under Mr Frenzel's stewardship.

Economist.com BUSINESS

Israel's technology cluster

Land of milk and start-ups

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From The Economist print edition

Silicon Wadi v Silicon Valley

IF HIGHWAY 101 south of San Francisco, Silicon Valley's main artery, were mysteriously to connect to one of the roads around Tel Aviv, many drivers would not even notice. The office blocks with large, tinted windows, housing technology start-ups, are hard to tell apart. Indeed, many people would argue that the world's second most important technology cluster, called Silicon Wadi ("canyon" or "gorge" in Hebrew), is essentially a clone of the first.

When it comes to entrepreneurial infrastructure, the similarities between the Valley and the Wadi are certainly striking. In both places corporate hierarchies are despised, risk-taking is rewarded and failure tolerated. Israel also boasts several elite universities, such as Technion in Haifa, and research centres run by big technology firms such as Cisco and Intel. Entrepreneurs have their pick of providers if they need legal or other services. And, as in California, there are plenty of well-funded venture-capital (VC) firms providing cash.

Yet there are many differences, too, starting with venture capital. In 2007 VC firms invested $1.76 billion in Israel. Although this was the highest figure since the dotcom bubble burst in 2001, and was up 8.5% on 2006, it is still less than a fifth of the $10 billion or so invested in Silicon Valley. (The figure for Europe was $7.2 billion, down 5% from 2006.) Local funds do more than half of the deals, but almost all the money comes from abroad, mostly from America. And most of it is invested not in software or trendy web-based services, but in start-ups developing specialised chips or advanced telecoms equipment.

If Israeli entrepreneurs are more into hard-core technologies and innovation, it is in part because they have such a small market. Selling their wares abroad is more difficult in market segments in which firms must be close to the user, such as "Web 2.0" sites, which are as much a social and cultural phenomenon as a technological one. A more important reason is that many entrepreneurs cut their teeth in the Israeli army, which has always needed to compensate for the county's lack of manpower and resources with cutting-edge technology, mainly in communications.

As a result, Israeli high-tech is particularly strong in wireless technology, especially when it comes to combining digital and analogue signals on a single chip. Take Wisair, a start-up that designs such chips for a technology called ultra-wideband, which is expected to begin replacing cables between electronic devices, such as computers and monitors, later this year. David Yaish, the firm's founder and chief executive, used to manage wireless R&D at the Israeli ministry of defence.

The mindset of the typical Israeli entrepreneur has also helped shape the business. He (and it is usually a he, for there are even fewer female entrepreneurs than in Silicon Valley) is more of a nuts-and-bolts innovator than a clever marketer. Having grown up in a truly multicultural society, he is well equipped to deal with diversity, for instance in standards bodies. Being used to less generous funding, he knows how to improvise. Many Israelis also see their work as an act of patriotism, which explains how they can be both ultra-competitive, yet help each other out. And they are more interested in inventing things than in protecting them with patents. "It's like painting a good picture for others to see it," says Zion Hadad, boss of Runcom, a pioneer of WiMax, an upstart wireless-broadband technology.

All of this means that hard-charging Israeli entrepreneurs can find it difficult stepping down as chief executive when a start-up reaches the stage at which marketing and management become more important. They often work around the clock as well as the globe. Mr Hadad's day, for instance, is split into three shifts. In the morning he takes care of business in Israel. From the afternoon until after midnight he is on the phone to America, where many of his customers are. After that it is the turn of Asia, where the firm's chips are made. In between, he tries to get some sleep.

The focus on innovation and technology, and a relative lack of interest in management and marketing, explain why Israeli entrepreneurs tend to sell out early, mostly to big foreign firms, rather than build up their companies. Israel has few sizeable technology firms. There is a huge pressure to exit, argues Zeev Holtzman of Giza Venture Capital, a leading Israeli VC firm, but entrepreneurs are starting to acquire the necessary staying power—*Sitzfleisch*, in Yiddish—to make it big. A handful, such as Amdocs and Check Point, which sell telecommunications and security software respectively, have done so.

Still, as things stand, Israel is mainly an exporter of start-ups, and thus an R&D centre for large technology firms. It is not such a bad role, but being confined to a small country and far removed from their markets, Israeli entrepreneurs do not always get the best price for their labours of love. And one day soon, Chinese engineers, in particular, will be as good at building start-ups and developing intellectual property, warns Zohar Zisapel, a serial entrepreneur and chairman of RAD, a group of telecoms-equipment firms. After all, he says, “the Chinese mother is like the Jewish mother—quite demanding.”

Alitalia

Rapid descent

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Air France-KLM makes an offer that Italy's troubled airline cannot refuse

BEGGARS cannot be choosers: the threat of insolvency can push even the most politically motivated managers to make tough decisions. When the board of Alitalia, Italy's state-controlled national airline, met on March 15th, it had no choice but to accept a takeover offer worth €139m ($217m) made the day before by Air France-KLM, a large Franco-Dutch airline group which began exclusive negotiations with Alitalia in December. The conditions that Air France-KLM has set are harsher than expected, but Alitalia's tattered finances mean any bid is better than none.

If the deal goes ahead, it will be the final stage of a privatisation that began at the end of 2006 when Italy's economics and finance ministry, which has a 49.9% stake in the airline, invited expressions of interest for its shares. Alitalia's plight has worsened significantly since then. Having lost about €2.6 billion between 1999 and 2005, it lost €605m in 2006 and a further €364m last year. It is losing around €1m a day and had €282m in cash and short-term credits at the end of January, and net debt of €1.3 billion. Air France-KLM says it will also buy Alitalia's convertible bonds for €608m and has promised to underwrite a capital increase of €1 billion immediately after the closing of its offer.

Unsurprisingly, the offer comes with strings attached. One is the price that Air France-KLM is willing to pay for Alitalia's shares: it has offered one of its own shares for every 160 Alitalia shares (less than half of what had been rumoured), valuing each one at around €0.10, against a market price of €0.54 per share on March 14th. A second is that Air France-KLM will pay only the market value of convertible bonds that Alitalia issued, rather than their nominal value.

A further condition of the deal concerns the controversial airport at Malpensa near Milan, a white elephant backed by local politicians where operations cost Alitalia €200m a year. When it announced its summer schedule last month, Alitalia slashed its intercontinental flights to and from Malpensa and said that Rome's Fiumicino airport would be its main hub. Air France-KLM's offer gives only Fiumicino a significant role as an intercontinental airport.

Under the salvage plan, Alitalia's fleet will be cut and jobs will go. Given the fractiousness of Alitalia's staff, Air France-KLM has wisely made its offer conditional on trade unions formally signing up, and was talking to them as *The Economist* went to press. It also wants to be indemnified against any legal action taken as a result of its plan to reduce operations at Malpensa. The Italian government accepted the offer from Air France-KLM on March 17th, although it is open to a higher offer and the question of Malpensa remains. Italy's trade unions now face a simple choice: accept the offer and keep Alitalia flying, or reject it and ground the airline.

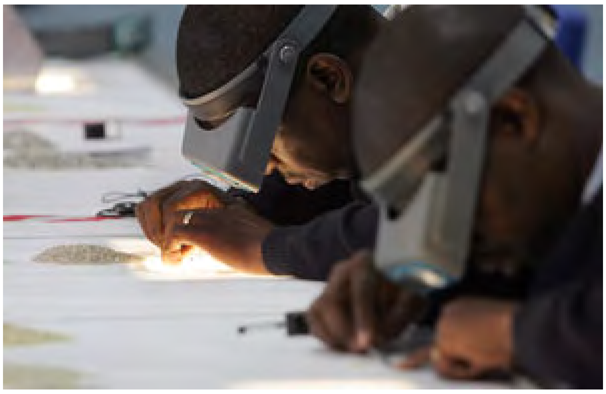
Economist.com BUSINESS

Diamonds in Africa

Keeping the sparkle at home

Mar 19th 2008 | GABORONE
From The Economist print edition

AFP



African diamond producers want to extract more value from their stones

AT THE new Eurostar diamond cutting factory in Gaborone, the capital of Botswana, hundreds of workers in neat rows are labouring over tiny stones. Eurostar, an Indian-owned diamond cutting and trading company headquartered in Belgium, set up in Botswana in 2004 and has been training locals to polish and cut diamonds. The factory, which employs 456 people and shapes about 1,000 stones a day, hopes to expand to over 1,000 employees. Another 15 big international diamond firms also have operations in Botswana, the world's largest diamond producer.

Until recently Botswana, a country of 1.8m people that produces 27% of the world's diamonds by value, exported only rough stones. The government, which is struggling to diversify its economy and create jobs, wants to get more out of its main commodity. Cutting adds about 40% to the value of rough stones. But the idea, explains Akolang Tombale, the permanent secretary of the ministry of minerals and energy, is to create an international diamond centre that not only cuts and polishes, but also trades diamonds and provides security, technology and financial services. The government hopes this will spill over into other sectors and help diversify the economy. For now, the diamond industry should create over 3,000 jobs by the end of next year.

A significant step in that direction was the opening in Botswana on March 18th of a Diamond Trading Company (DTC), a joint venture between De Beers, a big diamond producer, and the government. De Beers, which produces about 40% of the world's diamonds, extracts almost all of Botswana's stones through Debswana, its partnership with the government. In 2006, when its mining licence and sales agreement in Botswana came up for renewal, De Beers agreed to open a DTC in Gaborone. The swanky new centre sorts and values local rough stones and, by 2009, expects to sell $550m-worth of diamonds to the 16 carefully selected international firms that were required to set up shop in the country to be allowed to buy. From next year De Beers will also aggregate all the diamonds it markets—45% of world production—in Botswana rather than London.

Turning Botswana into an international diamond centre will not be easy, though. About 58% of the world's diamonds are cut in India, where labour is cheap and the government provides attractive incentives. Other Asian centres, such as China and Thailand, are rising fast. The long-established cutting centres in Israel, and to a lesser extent Belgium and America, remain competitive for the largest, most valuable diamonds. Antwerp is still where many of the world's polished diamonds are bought and sold. Botswana's production costs are three times those in India. It does not make economic sense to cut very small diamonds there.

Mr Tombale admits that unionised Botswana cannot compete on labour costs with India. But when demand outstrips supply, access to rough stones is a key attraction, as is the government's attitude, says Mervin Lifshitz, who chairs the Botswana Diamond Manufacturers' Association. The country tops the regional charts for good management and low corruption.

South Africa and Namibia, the fifth- and sixth-largest diamond producers, are also keen to make more of their diamonds. But unlike Botswana, which is happy to have its stones mixed with those from other countries, both its neighbours have decided to earmark a portion of their own production for local manufacturing. Namibia has set up a DTC with De Beers to sort and value the country's production and sell a fraction of it to the 11 manufacturers it has licensed. And on February 29th South Africa launched the State Diamond Trader, which will buy up to 10% of diamonds extracted locally to resell to small cutters, who complain that they cannot buy enough diamonds.

Critics point out that most South African diamonds cannot be profitably cut at home. Yet rather than selecting those that can be, the State Diamond Trader will buy a representative selection of production. It says it will pay market prices, but producers are concerned that they may have to sell on the cheap. Local manufacturers also point out that the duty, tax and currency regime is not as favourable as in India or Israel. Fixing those problems might be a better way to boost the local industry than forcing diamonds to stay at home.

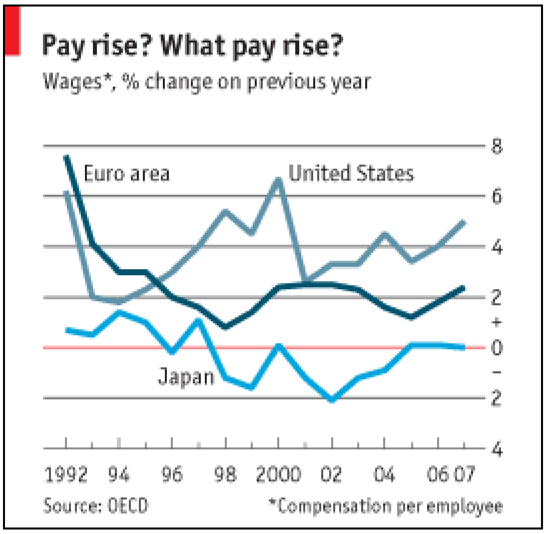
Economist.com BUSINESS

Business in Japan

Silent spring

Mar 19th 2008
From The Economist print edition

Japanese companies pay their workers little, but it may cost them a lot



THE annual wage negotiation between Japan's unions and its biggest companies is called *shunto*; the characters literally mean "spring struggle". The closely watched outcome at a handful of firms—Toyota, Nissan and Mitsubishi, among others—serves as a benchmark for wages for the rest of corporate Japan. In the post-war boom years, *shunto* was regarded as a core element of Japanese stakeholder capitalism, on a par with lifetime employment, the seniority-wage system and cross-shareholding. But in recent years it has descended into empty theatrics.

During the "lost decade" of the 1990s, the unions shied away from asking for much. As the labour force changed—one-third of workers are now part-time or temporary, rather than "regular" staff—the unions' importance was diluted. In the past five years many of Japan's big firms made record profits, but they have not been sharing their good fortune with their workers. Take-home wages have remained stagnant and, in some years, have even declined over the past decade (see chart).

At the same time, the aggregate wage cost that firms bear has fallen sharply as expensive baby-boomers retire and cheap, non-regular employees take up the slack. The problem has become so severe that the prime minister, Yasuo Fukuda, uncharacteristically urged companies to pay their workers more. Even Japan's conservative business lobby, the Keidanren, has pushed firms to crack open their coffers.

This year's *shunto* ended this month with a hollow victory for employees. Most firms offered an increase in basic monthly pay of ¥1,000 (around $10). So futile have the talks become that the unions have shifted tack. They now focus on improving working conditions and are trying to narrow the income gap between regular and non-regular workers, notes Charles Weathers, an economist at Osaka City University, in a comprehensive paper* on *shunto*. The wage difference can be as much as 40%. The big buzzwords in Japan are *kakusa kakudai* (growing inequality) and *waakingu pua* (literally, "working poor"). Japan, once among the most egalitarian societies among industrialised countries, has become one of the least.

Strikingly, as the cost of imports such as oil and raw materials has soared, the price of finished goods has remained stable and profit rates have not declined much. What explains this odd situation? Kyoji Fukao, an economist at Hitotsubashi University in Tokyo, says that by paying workers less, companies have in essence boosted their productivity growth (by around 1.5%, according to preliminary data). But this saving may lead to problems in the future, he warns, because part-timers do not receive the same training as regular employees.

The *Nikkei*, Japan's business daily newspaper, reminds its readers that wages in Japan are ten times higher than in China. That might prevent workers from getting too uppity. *Shunto* was used to neuter militant left-wing unions in the 1950s. But then Japan grew its way out of its social problems, notes Mr Weathers. With a shrinking population and sluggish economic growth, that is no longer an option.

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* "Shunto and the Shackles of Competitiveness" by Charles Weathers. *Labor History*, 49, no. 2; May 2008.

Internet jewellers

A boy's best friend

Mar 19th 2008 | NEW YORK
From The Economist print edition

Gentlemen prefer buying diamonds online

“MEN are intimidated when they go into a jewellery store to buy their first diamond,” says Diane Irvine, the chief executive of Blue Nile. Creating a website that looks good and makes it easy for men to learn about diamonds before buying has turned Blue Nile into the leading online seller of jewellery, confounding predictions that luxury and e-commerce would never mix. With revenues of $319m in 2007, 70% of which is from sales of engagement rings, it is now the biggest online specialist jeweller, and has a 4% share of the engagement-ring market in America. It is also gaining sales in Britain and Canada, where it has operated for a few years, and last month it opened in 12 new countries including Singapore and Japan.

Some 85% of purchases from Blue Nile are made by men. On average they pay $6,200 per engagement ring and take three weeks to make up their minds. Yet the majority of visitors to the Blue Nile site are women, who browse and e-mail pictures of the stone and ring they want to friends for comment, and ultimately to the target fiancé-to-be.

Blue Nile was one of several diamond or jewellery sites launched during the late 1990s, but its need to preserve capital after the dotcom crash led to a crucial innovation in its business model. The traditional approach is for a retailer to buy a diamond which then sits in its inventory awaiting a buyer, often for months or even years. Blue Nile adopted a virtual model, in which it provides a shop window for suppliers yet does not put any of its own capital at risk. It carries little inventory and simply takes a cut when a transaction occurs.

This model has enables Blue Nile to sell at “30-40% below the price of a traditional jewellery store, and 50% below the high-end shops,” says Ms Irvine. Traditional high-street jewellers are now being squeezed by Blue Nile on the one hand and America's biggest retailer, Wal-Mart, on the other. Ms Irvine thinks Blue Nile “can emerge stronger” from the economic slowdown and will gain market share, not least because high-street jewellers are stuck with much higher fixed costs. In February Zale, a struggling high-street jeweller, said it would cut 20% of its head-office staff and close 105 stores. Diamonds are forever, but if Blue Nile continues to wash over the market, some traditional sellers may not be.

Face value

Service is everything

Mar 19th 2008
From The Economist print edition

AFP

Hartmut Ostrowski has a simple answer to the woes of traditional media: expand into a different field entirely

IN 1992 Hartmut Ostrowski, head of a little-known services division at Bertelsmann, did a deal with Lufthansa to take charge of some of the airline's back-office functions. He signed the contract without asking his bosses' permission. Some months later Bertelsmann's chief executive, Mark Woessner, asked about the deal. Mr Ostrowski explained, only to be scolded and reminded that Bertelsmann was in media, not services—and certainly did not serve airlines. “Then I told him how much money Arvato made,” says Mr Ostrowski, “and he said ‘Carry on, but don't say much to anyone about it.'”

Mr Ostrowski took over as chairman and chief executive of Bertelsmann on January 1st, and the firm is now shouting as loudly as it can about Arvato. Its services unit may cut a drab figure next to its glamorous television, music and publishing units, but it is growing quickly. It employs half of Bertelsmann's workers and is its second-biggest division after television. The signs are that Mr Ostrowski will continue to shift the firm's centre of gravity towards services. This week Bertelsmann said it was examining strategic options for Direct Group—which operates book, music and DVD clubs and bookstores—and may sell it. Many people also expect the firm to sell out of Sony BMG, its recorded-music joint venture with the Japanese giant.

Reinhard Mohn, who resurrected the firm after the second world war, started the book-club business in 1950, and until recently no one thought it possible that Bertelsmann would part with it. The Mohn family, which owns a large stake in Bertelsmann, exercises considerable sway over strategy. In 2002 the firm's board ousted the chief executive at the time, Thomas Middelhoff. His dealmaking was straining the company's finances and the family disagreed with his plan for a stockmarket listing. Mr Middelhoff's successor, Gunter Thielen, was close to the family and pursued a more conservative strategy. In 2006 the firm bought out an outside shareholding of 25% in the company for *euro*4.5 billion ($5.8 billion), giving the family greater control.

Now everyone is waiting to see how the new chief executive will behave. Is he independent, or is he there to do what the family wants? Is he a younger version of Mr Thielen or more like Mr Middelhoff, with global ambitions for Bertelsmann? Best of all, say company executives, would be a combination of the two. For all his faults, they point out, Mr Middelhoff won control of RTL, the television group which alongside Arvato has driven Bertelsmann's growth in recent years. Mr Ostrowski's bold decision to put Direct Group under strategic review suggests that he will be a strong chief executive at the family-owned firm.

Mr Ostrowski grew up in Bielefeld, near Bertelsmann's headquarters in Gütersloh. “He's a real Westphalian,” says a former Bertelsmann executive who knows him well, “sober-minded, down-to-earth, reliable and not into sophisticated intrigues.” Mr Ostrowski became interested in business aged 11, after delving into the ledgers of his father's plumbing firm. After a degree at the local university he joined Bertelsmann's distribution division. In 1988 he decided to broaden his horizons and went to work for an American bank, setting up its operations in Frankfurt and Munich, but he returned to Bertelsmann two years later.

In 1990, when Mr Ostrowski took over Bertelsmann's distribution division, it was merely shipping books and CDs for the firm and for other German companies. He won new contracts to ship mobile phones for telecoms firms, moved into customer-relationship management for airlines and other industries, and expanded the division's operations into Poland, Spain, Italy, France, America and Asia; it now employs about 2,000 people in China. Arvato, as the division was named in 1999, even handles the billing when people click on Google ads. Most traditional media companies are scared of Google because it is drawing advertising revenue away from them, but Bertelsmann is quietly making money from the internet giant.

“For years not everyone was proud of this business,” says Mr Ostrowski, “but now everyone is.” Arvato has scope to grow further as more firms outsource back-office activities. It also expects to find new customers among European governments. Since 2005 it has taken on tax administration for a local authority in the north of England, and will soon start a pilot project handling passports and health insurance for a branch of local government in Bavaria. Mr Ostrowski also wants to move into education.

Who needs glamour?

Mr Ostrowski, whose stated goal is to revive growth at Bertelsmann, has never been in direct charge of any of its media businesses. Last year only Arvato and RTL grew; revenues from recorded music, book publishing and book clubs fell, and overall the company achieved organic revenue growth of just 0.4%. That is likely to mean more disposals. “In most cases, you're not going to turn a lamb into a lion,” Mr Ostrowski told Bertelsmann's executives in December.

Perhaps because he has Arvato up his sleeve as a source of future growth, Mr Ostrowski appears to be far less interested in the internet than other media bosses. Losses made by Mr Middelhoff's internet ventures may also contribute to his caution. “I will not put a bet on one or two big internet investments; we must build an online presence organically,” he says. In 2006 the firm set up a digital-media fund of *euro*50m to take stakes in young internet businesses, and last year it contributed *euro*500m to a *euro*1 billion fund alongside outside investors, which may also invest in new media. Critics say this may be too little, too late. Despite the emphasis on services, RTL is not for sale, so Bertelsmann will still be a media firm. Mr Ostrowski has done an excellent job of finding new sources of growth outside the core business, but now he is going to have to deal with the question that plagues all media bosses: how to make money on the internet.

Economist.com FINANCE & ECONOMICS

The financial system

What went wrong

Mar 19th 2008
From The Economist print edition

AP

In our special briefing, we look at how near Wall Street came to systemic collapse this week—and how the financial system will change as a result. We start with how financiers—and their critics—have laboured under a delusion

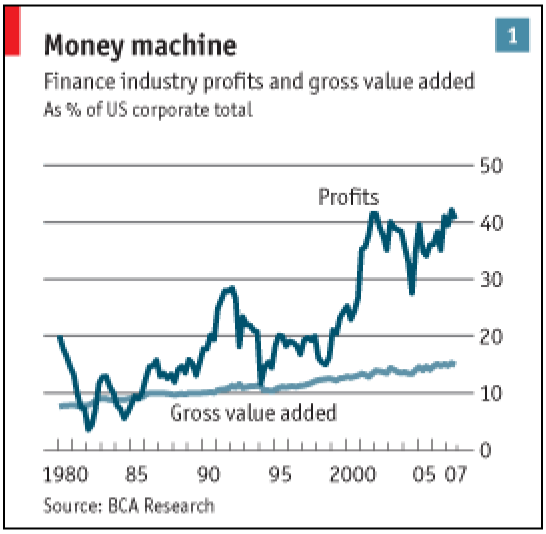
"A COMPANY for carrying out an undertaking of great advantage, but nobody to know what it is." This lure for the South Sea Company, published in 1720, has a whiff of the 21st century about it. Modern finance has promised miracles, seduced the brilliant and the greedy—and wrought destruction. Alan Greenspan, formerly chairman of the Federal Reserve, said in 2005 that "increasingly complex financial instruments have contributed to the development of a far more flexible, efficient, and hence resilient financial system than the one that existed just a quarter-century ago." Tell that to Bear Stearns, Wall Street's fifth-largest investment bank, the most spectacular corporate casualty so far of the credit crisis.

For the critics of modern finance, Bear's swift end on March 16th was the inevitable consequence of the laissez-faire philosophy that allowed financial services to innovate and spread almost unchecked. This has created a complex, interdependent system prone to conflicts of interest. Fraud has been rampant in the sale of subprime mortgages. Spurred by pay that was geared to short-term gains, bankers and fund managers stand accused of pocketing bonuses with no thought for the longer-term consequences of what they were doing. Their gambling has been fed by the knowledge that, if disaster struck, someone else—borrowers, investors, taxpayers—would end up bearing at least some of the losses.

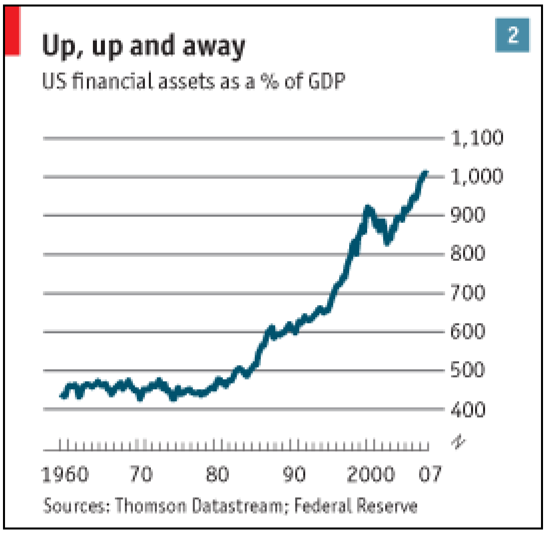
Since the era of frock coats and buckled shoes, finance has been knocked back by booms and busts every ten years or so. But the past decade has been plagued by them. It has been pocked by the Asian crisis, the debacle at Long-Term Capital Management, a super-brainy hedge fund, the dotcom crash and now what you might call the first crisis of securitisation. If the critics are right and something in finance is broken, then there will be pressure to reregulate, to return to what Alistair Darling, Britain's chancellor of the exchequer, calls "good old-fashioned banking". But are the critics right? What really went wrong with finance? And how can it be fixed?

Happy days

The seeds of today's disaster were sown in the 1980s, when financial services began a pattern of growth that may only now have come to an end. In a recent study Martin Barnes of BCA Research, a Canadian economic-research firm, traces the rise of the American financial-services industry's share of total corporate profits, from 10% in the early 1980s to 40% at its peak last year (see chart 1). Its share of stockmarket value grew from 6% to 19%. These proportions look all the more striking—even unsustainable—when you note that financial services account for only 15% of corporate America's gross value added and a mere 5% of private-sector jobs.



At first this growth was built on the solid foundations of rising asset prices. The 18 years to 2000 witnessed an unparalleled bull market for shares and bonds. As the world's central banks tamed inflation, interest rates fell and asset prices rose (see chart 2). Corporate restructuring, wage competition and a revolution in information technology boosted profits. A typical portfolio of shares, bonds and cash gave real annual yields of over 14%, calculates Mr Barnes, almost four times the norm of earlier decades. Financial-service firms made hay. The number of equity mutual funds in America rose more than fourfold.



But something changed in 2001, when the dotcom bubble burst. America's GDP growth since then has been weaker than in any cycle since the 1950s, barring the double-dip recovery in 1980-81. Stephen King and Ian Morris of HSBC point out that growth in consumer spending, total investment and exports in this cycle has been correspondingly feeble.

Yet, like Wile E. Coyote running over the edge of a cliff, financial services kept on going. A service industry that, in effect, exists to help people write, trade and manage financial claims on future cashflows raced ahead of the real economy, even as the ground beneath it fell away.

The industry has defied gravity by using debt, securitisation and proprietary trading to boost fee income and profits. Investors hungry for yield have willingly gone along. Since 2000, according to BCA, the value of assets held in hedge funds, with their high fees and higher leverage, has quintupled. In addition, the industry has combined computing power and leverage to create a burst of innovation. The value of outstanding credit-default swaps, for instance, has climbed to a staggering $45 trillion. In 1980 financial-sector debt was only a tenth of the size of non-financial debt. Now it is half as big.

This process has turned investment banks into debt machines that trade heavily on their own accounts. Goldman Sachs is using about $40 billion of equity as the foundation for $1.1 trillion of assets. At Merrill Lynch, the most leveraged, $1 trillion of assets is teetering on around $30 billion of equity. In rising markets, gearing like that creates stellar returns on equity. When markets are in peril, a small fall in asset values can wipe shareholders out.

The banks' course was made possible by cheap money, facilitated in turn by low consumer-price inflation. In more regulated times, credit controls or the gold standard restricted the creation of credit. But recently central banks have in effect conspired with the banks' urge to earn fees and use leverage. The resulting glut of liquidity and financial firms' thirst for yield led eventually to the ill-starred boom in American subprime mortgages.

The dance of debt

The tendency for financial services to run right over the cliff is accentuated by financial assets' habit of growing during booms. By lodging their extra assets as collateral, the intermediaries can put them to work and borrow more. Tobias Adrian, of the Federal Reserve Bank of New York, and Hyun Song Shin, of Princeton University, have shown that since the 1970s, debts have grown faster than assets during booms. This pro-cyclical leverage can feed on itself. If financial groups use the borrowed money to buy more of the sorts of securities they lodged as collateral, then the prices of those securities will go up. That, in turn, enables them to raise more debt and buy more securities.

Indeed, their shareholders would punish them if they sat out the next round—as Chuck Prince let slip only weeks before the crisis struck, when he said that Citigroup, the bank he then headed, was “still dancing”. Mr Prince has been ridiculed for his lack of foresight. In fact, he was guilty of blurting out finance's embarrassing secret: that he was trapped in a dance he could not quit. As, in fact, was everyone else.

Sooner or later, though, the music stops. And when it does, the very mechanisms that create abundant credit will also destroy it. Most things attract buyers when the price falls. But not necessarily securities. Because financial intermediaries need to limit their leverage in a falling market, they sell assets (again, the system is pro-cyclical). That lowers the prices of securities, which puts further strain on balance sheets leading to further sales. And so the screw turns until those without leverage will buy.

You do not need bankers to be poorly monitored or over-incentivised for such cycles to work: finance knew booms and manias long before deposit insurance, bank rescues or bonuses. And, human nature being what it is, Jérôme Kerviel, who lost Société Générale a fortune, and the staff of various loss-making, state-owned, German Landesbanks did not need huge pay to lose huge sums. The desire to show that you are a match for the star trader next door, or the bank in the next town, will do.

Yet pay—or at least bad management—probably made this crisis worse. Trades determine bonuses at the end of the year, even though their real value may not become clear until later. Earlier this month a group of financial supervisors reported how managers at the banks worst hit by the crisis had failed to oversee traders or take a broad view of risk across their firms. Perhaps, with proper incentives, managers would have done better.

Alan Johnson, a consultant who designs pay packages for Wall Street, predicts that in future senior executives will face the prospect of some of their bonuses being contingent on the bank's performance over several years. Yet to the extent that many senior bankers are paid in shares they cannot immediately sell, they already are. And to the extent that Bear Stearns's employees owned one-third of the firm, they already looked to the longer term.

If altering pay cannot stop manias, can regulation? The criticism that this crisis is the product of the deregulation of finance misses an important point. The worst excesses in the securitisation mess are encrusted precisely where regulation sought to protect banks and investors from the dangers of untrammelled credit growth. That is because regulations offer not just protection, but also clever ways to make money by getting around them.

Existing rules on capital adequacy require banks to put some capital aside for each asset. If the market leads to losses, the chances are they will have enough capital to cope. Yet this rule sets up a perverse incentive to create structures free of the capital burden—such as credits that last 364 days, and hence do not count as “permanent”. The hundreds of billions of dollars in the shadow banking system—the notorious SIVs and conduits that have caused the banks so much pain—have been warehoused there to get round the rules. Spain's banking regulator prudently said that such vehicles could be created, but only if the banks put capital aside. So far the country has escaped the damage seen elsewhere. When reformed capital-adequacy rules are introduced, this is an area that will need to be monitored rigorously.

It is the same with rating agencies, the whipping boys of the crisis. Most bonds used to be issued by companies, and to judge something AAA was straightforward. Perhaps back then it made sense for some investors, such as pension funds, to be obliged to buy top-rated bonds. But this rule created a boundary between AAA and other bonds that was ripe for gaming. Clever people, abetted by the rating agencies, set out to pass off poor credit as AAA, because they stood to make a lot of money. And they did. For a while.

The financial industry is likely to stagnate or shrink in the next few years. That is partly because the last phase of its growth was founded on unsustainable leverage, and partly because the value of the underlying equities and bonds is unlikely to grow as it did in the 1980s and 1990s. If finance is foolishly reregulated, it will fare even worse.

And what of all the clever and misused wizardry of modern finance? Mr Greenspan was half right. Financial engineering can indeed spread risk and help the system work better. Like junk bonds, reviled at the end of 1980s, securitisation will rebound, tamed and better understood—and smaller. That is financial progress. It is a pity that it comes at such a cost.

Economist.com FINANCE & ECONOMICS

Investment banks

The $2 bail-out

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From The Economist print edition

The wreck and rescue of America's fifth-biggest Wall Street bank

AS PRANKS go, it oozed vitriol. On March 17th, while employees at Bear Stearns were coming to terms with the implosion of their once-venerable investment bank, one of them stuck a $2 note to the revolving doors of the firm's midtown-Manhattan headquarters. That was the amount, per share, that Bear had fetched in a fire sale to JPMorgan Chase a day earlier, when the Federal Reserve was rushing to secure a deal before the markets opened on Monday (see chart 1). A year ago the shares had topped $170.

Now that the credit crisis has hit at the heart of Wall Street, policymakers are meeting the threat of catastrophe with some extraordinary manoeuvres. On March 18th the Fed slashed interest rates by 75 basis points, adding to big cuts over recent months. It is also ripping up its rulebook on financing troubled institutions. As the takeover of Bear was being finalised, it extended lending through its discount window, usually reserved for commercial banks, to all bond dealers; for the first time, investment banks have a lender of last resort (though too late for Bear, alas). All this underlines how what began as a seemingly containable problem in one part of the mortgage market now threatens the integrity of America's financial system. One day, the Fed will make Wall Street pay for its support—possibly through far stronger oversight.

The frenzy highlights another big change. Thanks to rampant innovation, particularly in futures, options and swaps, regulators must worry not only about those banks that are too big to fail, but also about middle-sized outfits with tentacles that wind through the derivative markets. Measured by assets, Bear is not that big. But with positions in credit-default and interest-rate swaps worth a notional $10 trillion, the idea of its sudden collapse was chilling—and nobody wanted to put that foreboding to the test. Aptly, although the Fed's rescue is no bail-out of Bear, it does set out to save the system.

Bear, the smallest of the big five Wall Street investment banks, was the most exposed to the toxic mortgage market. It had been in trouble since two of its hedge funds collapsed last summer. Regulators had been frustrated that the bank was working less hard than its peers to shore up its funding. Nevertheless, the speed of its demise was shocking. Clients withdrew $17 billion in two days last week, after rumours swirled that other banks were refusing to step into clients' shoes as counterparties in derivatives trades. The Fed moved in with emergency funding, using JPMorgan Chase, Bear's clearing bank, as a conduit. But it was clear that no one would want to do business with a bank reliant on 28-day loans from the central bank. With Bear facing bankruptcy if it could not find a quick buyer, JPMorgan opened its arms.

At $236m, the deal looks like a steal for Jamie Dimon, JPMorgan's canny boss—and reward for keeping his bank relatively stable as others have stumbled. Bear's swanky headquarters alone is worth six times that. To smooth the deal, the Fed is taking the unprecedented (and, some say, disturbing) step of financing up to $30 billion of Bear's weakest assets. This could cost the central bank several billion dollars if those assets fall in value.

Tellingly, JPMorgan's shares rose sharply the day after the takeover, even as other financials tumbled. The $14 billion added to its stockmarket value was Bear's true worth, said cynics. Brad Hintz, an analyst at Alliance Bernstein, puts the break-up value of Bear's good bits at $7.7 billion. Around $3 billion comes from its prime-broking business, which finances hedge funds' trading, and which Mr Dimon has wanted to get into for some time.

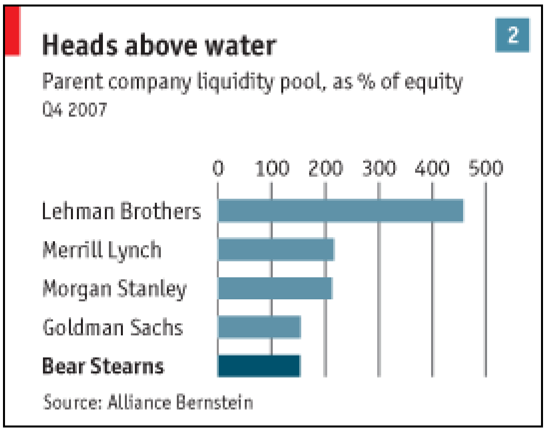
But the deal carries risks. JPMorgan has pledged to honour all of Bear's commitments, despite having had only two days for due diligence. Bear's gross mortgage exposure is still likely to be well over $10 billion after the Fed guarantees the least liquid stuff. And the bank faces piles of lawsuits over the hedge-fund collapses and, now, a takeover that wipes out almost all its perceived value (see article). JPMorgan puts the costs associated with the deal at some $6 billion (though it clearly has an interest in overestimating them). Moreover, Mr Dimon has to weave the two banks together, in an industry with a terrible record on mergers.

JPMorgan's motivation is not purely opportunistic. As the biggest dealer in credit derivatives, it was heavily exposed to Bear. Had the bank gone bust, it would have led to huge uncertainty, and large potential losses, on a variety of contracts.

Investment banks are particularly vulnerable to credit-market turmoil, because they rely on funding not from depositors but from wholesale markets, much of it short-term. Understandably, the other big Wall Street firms—Goldman Sachs, Lehman Brothers, Merrill Lynch and Morgan Stanley—portray Bear as an outlier when it comes to this “liquidity risk”. Its mix of businesses was less diverse and it relied more heavily on overnight funding in repurchase, or repo, markets, in which dealers sell securities to investors then buy them back the next day for slightly more, with the difference being the interest. This vast, $4.5 trillion market usually functions like clockwork, but has come under strain in recent weeks. As doubts grew, Bear was in effect shut out.

Could the same happen to a competitor? All of them felt funding pressure this week. Merrill, which has had to swallow enormous mortgage-related write-downs, is seen by some as vulnerable. But Lehman, the fourth-largest Wall Street bank—and, like Bear, big in mortgage-backed securities—is top of many worry lists. It is going to great lengths to avoid a similar fate, providing unprecedented detail on its levels of cash and reassuring nervous counterparties. Senior managers are sweet-talking supervisors at other firms where traders are reluctant to deal with Lehman. Dick Fuld, Lehman's boss, cut short a trip to India to manage the crisis.

The hope is that the investment banks are safer now that they have emergency funding, thanks to the Fed, which will take a range of securities from them as collateral. And on one measure at least, Lehman's liquidity looks stronger than that of its peers (see chart 2). On March 14th the bank secured a $2 billion, three-year facility with a group of banks. It also says that its holding company has $64 billion of “unencumbered” assets that can be used as collateral to generate cash.



There is much at stake. The new Fed window is untested and the very act of drawing on it could rattle markets. The fear is that if Lehman suffers a Bear-style run, funding will dry up across Wall Street. “If Lehman goes there are no sacred cows,” says a rival. Just in case, others are busily touting numbers that put them in a positive light. Morgan Stanley, for instance, says it has cut its use of repos sharply, to 15.6% of total funding, and that it now has 45% more accessible cash than it did last year. Goldman, too, has reduced its reliance on overnight funding. Across Wall Street, long-term funding has doubled since 2004, to around $800 billion.

Though all this may be reassuring, the nature of liquidity in today's ready-cash funding model of investment banking is that it is strong until it suddenly is not. Only a few days before Bear's desiccation, remember, some analysts embarrassingly pointed out that it had enough liquid assets and borrowing capacity to keep it going for almost two years. Hank Calenti of RBC Capital Markets thinks that, at the Fed's urging, “shotgun weddings” for Lehman and Merrill could be in the planning stages, in case of emergency.

This explains the palpable relief when, on March 18th, both Lehman and Goldman posted first-quarter results that were less bad than feared. Net income dropped by 57% and 53%, respectively, thanks to write-downs of around $2 billion each, but there were no nasty surprises. Share prices stormed ahead on the news, with the financial shares in the S&P 500 gaining 8.5%.

The outlook remains bleak, however. By one estimate, banks will write off a further $50 billion of degraded inventory this quarter. If they are more tightly regulated, they could have less scope to make profits. Using tangible book value as a yardstick, Meredith Whitney of Oppenheimer concludes that financial shares are due a further fall of up to 50%. With house prices still falling, credit deterioration spreading and derivatives markets deeply unsettled, is anyone willing to bet that Bear Stearns is the last of the $2 sales?

The fallout at Bear Stearns

Sore heads

Mar 19th 2008 | NEW YORK
From The Economist print edition

Disaster yields disbelief—and disgruntlement

WALL STREET is often criticised for heaping gold on bankers in fat years, but failing to penalise them in lean ones. Witness the 10% rise in total pay at America's investment banks last year, despite an awful second half. But the fate of Bear Stearns shows that, when things go really wrong, punishment can be severe.

Bear's executives have lost billions. At $2 a share, the 5% stake held by Jimmy Cayne, the chairman and former chief executive, worth $1.2 billion at the shares' peak last year, is now valued at $11m (less than half of what Mr Cayne recently paid—mortgage-free, naturally—for an apartment in the Plaza Hotel). There are reports of managers putting holiday homes on the market. BFdesigns, which tarts up such dwellings before they are sold, has charitably offered to cut its fees for any Bear employees.

Lowlier workers have been hit even harder. Bear encouraged them to buy shares after it went public in 1985. Their purchases have pushed employees' combined stakes to one-third. Some have lost their main nest eggs, others the money to put children through college. Worse, half or more of the 14,000 staff are expected to lose their jobs. Counsellors are on hand. Comparisons are being made with Enron, where the employees lost $2 billion in pensions.

The shock is fast turning to anger: that bosses left it so late to seek capital; that employees were prevented from selling shares because an earnings announcement was coming; and, above all, that JPMorgan Chase has probably got a bargain.

Allied with big shareholders such as Joe Lewis, a Bahamas-based billionaire who spent $1 billion on Bear stock last year, some employees like to think they can muster a majority against the deal when the vote is held in six weeks. On March 18th Bear's shares closed at $6.51, reflecting the chance of a higher offer.

That looks a forlorn hope. JPMorgan is backed by the Treasury, the president and the central bank. It is small solace to Bear's bankers that they will serve as a salutary example to others.

Their fate is also likely to harden resistance on Wall Street to receiving bonuses in shares rather than hard cash. The dollar may be taking a battering, but at least it will be worth something this time next year.

Central banks

A dangerous divergence

Mar 19th 2008 | WASHINGTON, DC
From The Economist print edition

The world's central banks are worryingly far apart—especially when it comes to inflation and currencies

“SOME say the world will end in fire, Some say in ice.” Robert Frost is rarely quoted when central bankers gather. But wise heads nodded when Ken Rogoff, a Harvard professor and former chief economist of the IMF, recited the poet's apocalyptic lines at a recent meeting of monetary policymakers. The Federal Reserve, said Mr Rogoff, thinks the world will end in fire. The European Central Bank (ECB) fears ice.

The Fed is scrambling to douse financial crisis and recession. In recent days America's central bank has flooded credit markets with liquidity, creating new lending facilities apace. It has helped JPMorgan Chase rescue Bear Stearns, America's fifth-biggest investment bank. And on March 18th it cut the federal funds rate by three-quarters of a percentage point, the third big reduction in less than two months. At 2.25%, the Fed's policy rate is three points lower than at the start of the financial turmoil last August.

Other central banks have been doling out liquidity too—the Bank of England, the Bank of Japan and the ECB did so this week—but none has eased monetary policy with anything like the Fed's urgency. Whereas the Fed fears recession and financial collapse, most central banks elsewhere are more worried about inflation. Rates in Britain and Canada have been cut, but by much less than in America. Japanese rates are unchanged. The ECB's policy rate is still 4%, precisely where it was in August. Most other central banks have either kept rates unchanged or raised them. Indeed, central banks outside America, especially in Europe, worry that the Fed may be inviting a new bubble—and that the credibility that central banks painfully built over a quarter of a century is now at risk.

The gap between the Fed and the rest is having its plainest effects in the currency markets. The dollar has tumbled: against other leading currencies, the greenback is at its weakest since the era of floating exchange rates began in 1973. On March 13th it fell below ¥100 for the first time in 12 years. This week it sank to new lows against the euro and the Swiss franc before rallying after the Fed reduced rates (markets had thought a deeper cut possible). As the dollar has fallen, the prices of commodities priced in dollars have jumped: oil fetches well over $100 a barrel. Gold has soared above $1,000 an ounce.

The dollar's frailty is making policymakers outside America increasingly nervous. Speculation is rising that central banks may intervene to halt the dollar's slide, especially since Jean-Claude Trichet, the ECB's president, called recent moves “disorderly” and “undesirable”. Some worry that the Fed's easing will boost global liquidity and inflation. All told, the fear is that America's activism in fighting financial distress will create dangerous instability in the global monetary system.

The case for boldness

With inflation at 4% in the year to February, and the core rate (excluding food and fuel) at 2.3%, America's real short-term interest rates are now negative. In previous downturns, real rates turned negative only at or after the end of the recession. Further cuts are likely—to 1.75% by the end of next month, judging by the price of fed-funds futures. In the euro area, inflation is lower, but at 3.3% is the highest for 14 years and well above the ECB's 2% ceiling.

The Fed has been bolder than other central banks largely because America's economy is in trouble. It is almost certainly already in recession. But differences in central banks' official goals also play a role. The Fed is charged with promoting both growth and stable prices. Most other central banks in the rich world and a fair few in emerging economies are supposed to worry only about inflation. Many have explicit inflation targets.

History also counts. The Great Depression is seared into Americans' minds as the greatest economic catastrophe of the 20th century. In other countries (notably Germany, home of the ECB) the legacy of hyperinflation is every bit as strong.

But there is also an intellectual rift. The Fed has long argued that central bankers should not try to prick asset bubbles, but must mop up the mess promptly when they burst. Other central banks see a direct link between loose policy after the internet bubble popped and the housing bubble that preceded today's bust. The Fed has also set more store than others by monetary policy as an insurance mechanism. Concerns about the risk of deflation led Alan Greenspan, the Fed's chairman until 2006, to cut rates hard in 2001-03 and keep them low.

Ben Bernanke, Mr Greenspan's successor, holds these views even more strongly. As an academic, Mr Bernanke argued forcefully against targeting asset prices. The result, he said, would be unnecessary volatility. In 2003, as a Fed governor, he was one of the loudest advocates of using low interest rates to insure against the calamity of deflation.

The calamity being battled today is financial-market malfunction and the damage it can do to the economy. Mr Bernanke is an expert on the Great Depression and intellectual pioneer of the “financial accelerator”, through which banking distress worsens economic downturns. Lower interest rates, he argues, are an important weapon in stopping this negative spiral.

Once a bubble bursts, this means doing more than implied by standard rules of thumb, such as the Taylor rule, which links appropriate interest rates to the deviations of inflation from its target and output growth from its trend. As Frederic Mishkin, another intellectual heavyweight on the Fed's governing board, puts it: “The monetary policy that is appropriate during an episode of financial market disruption is likely to be quite different than in times of normal market functioning.”

Though dominant, this view is not held by all America's central bankers. Several presidents of regional Federal Reserve Banks have worried openly about inflation. Tom Hoenig, head of the Kansas City Fed, argued recently that “we are placing too much burden on monetary policy in dealing with financial crises.” Two regional Fed presidents, Richard Fisher of Dallas and Charles Plosser of Philadelphia, dissented from the three-quarter-point cut this week. They had wanted a lesser reduction.

These worries are felt far more keenly outside America. But Mr Mishkin and others argue that the dangers are small. First, they say, the weakening economy will reduce inflationary pressure. Second, expectations of inflation remain contained. Third, once the risks of financial catastrophe have passed, rapid easing can be mirrored by equally rapid tightening.

Sadly, none of these arguments is clear-cut. Granted, more economic slack ought to reduce inflation. And core consumer prices were flat in February. But commodity prices and the dollar point to price pressures ahead. With global growth still robust, the link between domestic output and domestic inflation may be waning.

On expectations, some worrying signs are emerging. The Fed admitted as much in its statement on March 18th. Survey-based measures are nudging upwards. Market-based measures, such as the spread between inflation-linked and ordinary Treasury bonds, have risen since the turn of the year. The ten-year expected rate of inflation implied by yields on these two types of bonds has reached 2.5%. An alternative measure from the Cleveland Fed that adjusts for differences in liquidity and the premium for inflation risk in markets for the two has risen even more (see chart).

Finally, it is hard to be sure that swift cuts will be as swiftly reversed, as Mr Mishkin and others say. History suggests otherwise. John Taylor, the Stanford economist who invented the Taylor rule, points out that whenever the Fed has cut rates by more than his rule suggests, it has taken a long time to get interest rates back on track. And the danger posed by dysfunctional credit markets will not disappear overnight. Since rapid tightening may pose renewed financial risks, the Fed's own logic suggests rates will be raised gradually.

Moreover, higher inflation would reduce the real burden of mortgage debt, so alleviating the solvency problems posed by the housing bust. All in all, it is easy to believe that the Fed will tolerate higher inflation, and for longer, than it claims.

Knock-on effects

What does this mean for everyone else? In theory, not much. With floating exchange rates, countries can target whatever inflation rate they choose and currencies will adjust. But reality is more complicated.

For a start, currencies tend to swing around by far more than warranted by differences in interest rates: the euro's recent surge against the dollar is an example. Currency volatility can itself cause panic, especially when the dollar tumbles, given America's reliance on foreign capital (although the current-account deficit shrank in the fourth quarter, it was still 5.3% of GDP last year). And market movements can send exporters in countries with rising currencies screaming for help. These problems can be particularly acute in small, open economies: when Chile or New Zealand, say, raises interest rates to combat inflation, foreign capital pours in, particularly if America is easing policy.

More important, not all exchange rates float freely. The Gulf's oil exporters, for instance, tie their currencies to the dollar: the Saudi riyal is fixed firmly at 3.75 to the greenback. Countries with dollar pegs are in effect importing America's looser monetary policy and with it inflationary pressure. Saudi Arabia's inflation rate is at a 27-year high of 7%.

There are signs that the Fed's policy is prompting some countries to reconsider their links to the dollar. Speculation is rife, for instance, that Qatar and the United Arab Emirates are about to break their pegs. Many Asian countries have already allowed their currencies to rise substantially. China, which abandoned its dollar peg in 2005, has accelerated the pace of the yuan's appreciation. All this is sensible, but in the short term it will make the dollar more volatile as investors worry that emerging-market central banks will be less keen to hold large amounts of dollars.

If American interest rates remain disproportionately low, other emerging markets may resort to controls on capital inflows: last week Brazil's government imposed a 1.5% tax on foreign purchases of fixed-income securities denominated in reais, to assuage the currency's rise. Even so, it will be hard for small, open economies to hit their inflation targets if American policy remains so loose. Inflation targeting itself may be called into question.

Nor are big economies likely to ignore their currencies. The ECB, for all its bluster, may have to loosen sooner than it would wish to in order to stem the euro's rise. Mr Taylor's research suggests that the ECB's deviations from “optimal” policy have been closely correlated with America's short-term interest rates. A percentage-point reduction in the federal funds rate has been associated with a move of a fifth of a point away from the ECB's optimum. Worries about exchange rates, he argues, cause central banks to veer off course.

How worrying all this is depends on its scale. Modestly higher inflation or jumpier currencies seem a small price to pay for preventing the collapse of America's financial system. Alas, modest shifts cannot be taken for granted. The darkest scenario—that investors panic at the Fed's loose policy, sending the dollar into free-fall—is becoming worryingly plausible. A real dollar crash would force the Fed to raise rates, making America's predicament much worse and even sending the global economy into recession. The Fed would face ice as well as fire. And the rest of the world would have a far bigger problem.

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Buttonwood

Apocalypse now?

Mar 19th 2008
From The Economist print edition

Investment havens in a time of panic

IF THE world is going to hell in a handcart, what should you buy? With newspaper headlines dominated by the credit crisis, and with big banking names perceived to be under threat, this is a question all investors need to consider.

Much depends on what form you expect the apocalypse to take. In recent weeks investors have been flocking to buy Treasury bonds, relying on the unimpeachable credit of the American government. But with the dollar falling almost every day, foreign investors may feel the government's credit is about as unimpeachable as Richard Nixon; they will be paid back only in devalued paper. And if, as some observers believe, the Federal Reserve has taken its eye off inflation in its zeal to rescue the financial sector, domestic investors may not find ten-year Treasury-bond yields of just 3.4% (on March 18th) all that appealing.

Perhaps index-linked Treasury bonds would be a better safeguard? After all, they provide protection against inflation. The problem is that other people have already thought of that. Earlier this month, the real yield on America's five-year issue was briefly negative; investors were willing to see their investments not quite keep pace with prices. That does not make them look great value.

Then there is cash. Fortunes have been made by being a cash buyer at the end of a bear market. But where to keep the money? Given the nervousness about banks, many savers will want to keep their holdings below the ceiling for deposit insurance (in America, $100,000 per saver per bank). The past few months have also thrown up doubts about money-market funds, some of which have taken a bit too much risk in the search for higher yields. So far, the fund-management firms have stood behind these funds. Come the real apocalypse, would they be able to do so?

In any case, it is not just a matter of choosing cash; investors must choose a currency too. Chris Watling of Longview Economics suggests they should aim for countries that have demonstrated control of their money supply and have current-account surpluses; that points to the Japanese yen and Swiss franc, both of which have been gaining against the dollar in recent weeks.

The Swiss franc certainly did well in the 1970s, an era that strategists are frequently citing as the model for recent events. At one point, the Swiss were even able to charge investors for the privilege of holding accounts in their currency—a rare instance of negative interest rates.

Gold is another possibility, because it is seen as a hedge against both inflation and the breakdown of the financial system. But as Buttonwood noted two weeks ago (see article), gold can itself be the subject of speculative excess, as it was in 1980: any asset that takes 28 years to reclaim its peak is hardly a reliable store of value. The same is true of other commodities. It was significant that raw-material prices were battered on March 17th, when risk aversion was at its height. Hedge funds may well have been selling their commodity positions to meet demands for cash from other parts of their portfolios.

In a complete meltdown, for example during world wars and revolutions, it is hard to find anything that keeps its value. Stockmarkets collapse. Governments default on their debt. Private property is no longer respected, either because governments seize the assets or because goods cannot be protected from criminals. Jewellery might hold its worth, but you had better have a good hiding-place. Think of all the treasures looted by the Nazis or the Red Army.

In his book “Wealth, War and Wisdom”, Barton Biggs, a Wall Street veteran, suggests that investors should own, as insurance against the apocalypse, “a farm or a ranch somewhere far off the beaten track but which you can get to quickly and easily.” A sheep farm in New Zealand would not really qualify, unless you already live in Wellington. And even land can be grabbed by governments, as has happened recently in Zimbabwe.

But, even on the assumption that war and civil disorder are avoided, Mr Biggs's advice still has some merit. After all, farmland, after many years in the doldrums, is suddenly fashionable again, thanks to revitalised agricultural prices. Those prices may be due for a retreat in the short term, but competition from biofuels and increased demand from Asia may nevertheless mean that the era of cheap food is over. British farmland prices rose by 25% last year, according to Knight Frank, an estate agent. It would be a nice irony if the best hedge against a collapse of the post-industrial economy turned out to be a return to the agrarian past.

Commodities

A bit tarnished

Mar 19th 2008
From The Economist print edition

Wobbles over the Wall Street crisis

ONE of the main selling points of commodities, according to the financiers who have been cheering their vertiginous ascent over the past few years, is that they do not move in lockstep with other assets. And so it had seemed in recent months, as commodity prices continued to climb even as disaster struck property, shares and bonds. Yet on March 17th the turmoil on Wall Street finally spread to the commodities markets.

On that day, oil set a new record of $111.80 a barrel before falling to $103.23 at one point—the biggest drop during a single day in 17 years. It was not alone: Goldman Sachs's main commodity index fell by over 4%. At the Chicago Board of Trade, wheat, maize (corn) and soyabean futures fell by as much as the exchange's rules permit. The price of coffee dropped by 11%. Although most commodities recovered the next day, the episode did call into question their status as a haven.

Michael Lewis, the head of commodities research at Deutsche Bank, attributes the fall to investors seeking to cover losses in other markets, as well as to growing risk-aversion in such tumultuous times. But he does not believe that skittish investors will drive prices down dramatically, thanks to resilient demand for raw materials and meagre supply.

Although the economic outlook for America is grim, most analysts assume that emerging markets will continue to grow relatively strongly. Meanwhile, global copper inventories amount to only two weeks' demand. Lead stocks are closer to one week's worth. Stocks of oil are also unusually low. So even small disruptions to supplies prompt dramatic reactions from the markets. Aluminium prices, for example, have risen in recent weeks because of a shortage of power in South Africa, which has reduced output from several smelters. Fears of a shortage of hydroelectric power in Chile are helping to buoy the price of copper.

Jeff Currie, of Goldman Sachs, sees little prospect of a dramatic increase in the supply of most commodities. Nationalist governments, he argues, are impeding investment in the most promising new mines and oilfields, forcing Western energy and mining firms to spend lots of money developing less accessible and profitable reserves. Higher marginal costs of production, he believes, will sustain higher prices for a long time to come.

The dollar's decline also seems to be fuelling commodities' rise. Gold, in particular, has risen as investors seek a hedge against inflation and turbulent markets. The falling dollar also pushes the prices of other commodities higher, Mr Currie points out, because producers outside America need higher prices in dollar terms to maintain their margins.

Francisco Blanch, of Merrill Lynch, believes there is more to the story than that. He argues that the interest-rate cuts that have prompted the dollar to fall have produced a surge in liquidity in fast-growing emerging markets such as China and the Middle East. At the same time, governments in those countries try to insulate consumers from rising prices with subsidies and price controls. So demand for raw materials from such places continues to grow, despite high international prices.

If Mr Blanch is right the Federal Reserve's latest cuts will only spur faster growth in demand in emerging markets, and so higher commodity prices. That, in turn, will increase America's oil-import bills, which will add to the current-account deficit and therefore heap further pressure on the dollar, setting a vicious cycle in motion. On the other hand, if the dollar starts to rise in value again, the cycle might go into reverse, pushing the price of commodities down again. As in so many other markets, all eyes are on America's beleaguered central bankers.

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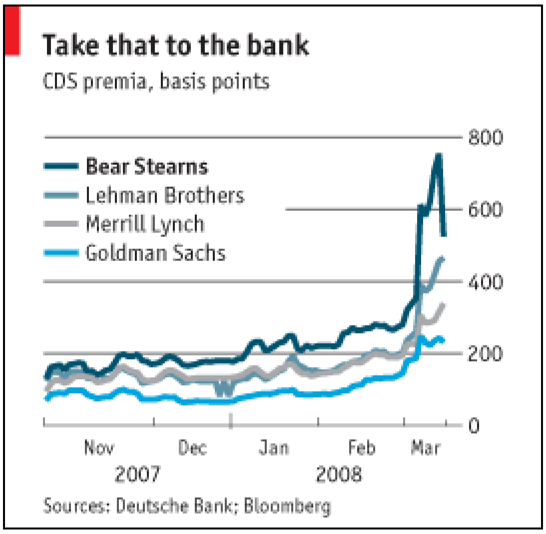
Derivatives

Caveat counterparty

Mar 19th 2008
From The Economist print edition

When banks cannot trust each other



THERE is a lot to worry about when you deal in the financial markets—whether you have made the right judgment about profits, interest rates or the economy. But life gets even harder if you worry that the bank you trade with is about to go bust.

That problem—counterparty risk—has been roiling the markets lately. Traders often insist on some protection in the form of collateral (usually cash or short-term government debt) when dealing in derivatives. But in recent weeks counterparties have been pushing to ensure that collateral gets bigger “haircuts”—that is, they accept assets only at a greater discount. The idea is to make sure they do not end up as the ones being scalped.

Even with collateral, sorting out a counterparty default would be a nightmare. Hence the Federal Reserve's extraordinary measures to keep Bear Stearns from falling into bankruptcy. “If Bear Stearns had failed, banks would not have known where they were for days or weeks,” says a hedge-fund manager. The markets might well have frozen and other banks might have collapsed.

What makes life particularly difficult is that banks have a multitude of offsetting positions with each other. When assessing their market risk, they normally look at their net positions. But if a counterparty is in trouble, that may not be appropriate.

Investors may have taken one position with Bear Stearns as a counterparty, and then hedged its risk through another trade with, say, Morgan Stanley. In the event of a Bear Stearns default, that hedge would have broken down; they would suddenly have found themselves with an unanticipated (and unwanted) market risk. The effect could have been chaotic.

Bear Stearns was particularly active in the credit-default swaps (CDS) market, which has grown exponentially to around $45 trillion. A CDS enables its buyer to separate the risk of default from a bond's other features, such as its interest rate. Like insurance against fire or theft, it protects investors against the risk of default.

But, as often in finance, an instrument designed for insurance became a tool for speculators. In some cases, the amount of outstanding insurance via CDSs is far greater than the underlying value of the bonds. That can be overcome through cash settlements in the event of default. But the auction price of the cash settlement may not represent the eventual recovery rate after the company has been wound up. So the CDS is far from a perfect hedge.

Even more difficult is the question of what constitutes default. Say a brilliant investor had forecast Bear Stearns's troubles last month and bought protection accordingly. Even though Bear Stearns's shareholders have been all but wiped out, the company has not defaulted on its debt. Indeed, once the investment bank becomes part of JPMorgan Chase, the risk of default will fall sharply. The cost of protection on Bear Stearns duly fell by two-fifths on March 17th. And the CDS premiums on the debts of other American banks also dropped, even as their shares were taking a pasting. That suggested investors had decided that the Fed, while penalising shareholders, would not allow another member of Wall Street's finest to fail outright.

Even trickier cases than Bear Stearns may be in store. What if troubled firms are split into good banks and bad banks, with the shaky assets being shovelled into the “bad” entity? The effect on CDS buyers would depend on whether the good or bad bank was deemed to be the counterparty. Before this crisis is over, the CDS market looks almost certain to become a lucrative trade for lawyers.

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Foreign exchange

The yen also rises

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From The Economist print edition

How far can the dollar fall before Japan feels the need to intervene?

Correction to this article

IN RECENT years the yen has been a profitable carry-trade currency, used by investors to borrow cheaply in order to splurge on risky assets around the world. If the carry trade is now part of a bygone era, so is the weakness of the yen. It has soared almost 30% against the dollar since June and on March 17th it hit a 12-year high of ¥95.76. After the Federal Reserve cut interest rates on March 18th, the dollar remained under pressure.

AP

A headache, but not yet a migraine

The yen's strength causes little jubilation in Japan. A strong yen squeezes company profits since Japan is heavily dependent on exports. Toyota, for example, bases its earnings on an exchange rate of ¥105: every ¥1 appreciation against the dollar costs the firm ¥35 billion ($350m) in annual operating profit. That, in turn, hurts the Nikkei 225, which has tumbled even faster than the yen climbs; it has shed more than 20% since the start of the year. Almost 60% of the companies on the exchange's main market are trading at less than their book value. Moreover, a strong yen cuts into economic growth.

Even without a governor for the Bank of Japan, the market is starting to price in a quarter-point rate cut at the bank's next meeting in early April. At the same time, the rising yen is becoming a political issue. Fukushiro Nukaga, the finance minister, called its appreciation "excessive" and worrisome. In the past, the finance ministry has moved fast to prevent the yen from becoming too strong. As recently as 2003-04 it sold ¥35 trillion to prevent a rise in the currency that might derail its nascent economic recovery.

Japan has several reasons to hold fire, however. Although a strong yen hurts exporters, it helps hold down the prices of imports, for such things as oil and food. It is not considered overvalued on a trade-weighted basis or against other currencies. In inflation-adjusted terms, a rate of ¥100 to the dollar is equivalent to ¥125-130 a decade ago, according to Eisuke Sakakibara of Waseda University (who was known as "Mr Yen" for managing Japan's currency interventions from 1997 to 1999 at the Ministry of Finance).

Even if it were to sell yen, America may be an unwilling buyer; its carmakers say the appropriate exchange rate is ¥90-100 to the dollar, notes Yasunari Ueno of Mizuho. He believes the Japanese government won't consider intervening until the rate goes at least to ¥90.

Today it is not even certain how effective intervention might be. Globally, daily foreign-exchange transactions exceed $3.2 trillion, more than twice the value in 2003. For intervention to work, Japan would need to recruit other central banks to the cause. But the dollar may not be weak enough for that—even against the yen.

Correction: We wrongly implied that foreign reserves are necessary to intervene to weaken a currency. This is nonsense: you simply print yen and buy dollars. This article was corrected on March 20th 2008.

China's stockmarket

Earnings up, prices down

Mar 19th 2008 | HONG KONG
From The Economist print edition

Risk aversion hits Chinese stocks

NINE DRAGONS PAPER lies at the heart of China's booming industrial relations with the rest of the world: it packages exports. The strength of the business was abundantly clear on March 17th, when it announced record first-half earnings. Immediately afterwards, however, its share price tumbled by 40%. That reflects a pattern during the latest earnings season, says Alvin Chong of Sun Hung Kai Financial, a Hong Kong brokerage firm. Good results: awful stockmarket performance.

Amid nervousness in global markets about risky investments, over-leverage and slowing growth, even China's once impregnable stockmarkets seem to be hitting reality with a bump. There is as yet none of the panic that has afflicted Wall Street. But China's stockmarkets are off by about 30% this year (see chart)—by comparison, the S&P 500 is down by 13%.

China appears to be suffering from a home-grown liquidity squeeze that is not so different from the one afflicting the West. As inflation pushes higher, the Chinese government has curbed lending by the banks. On March 18th the reserve ratio for Chinese banks was raised to 15.5%, the latest in a string of tightening measures.

Tighter credit is likely to crimp expansion plans and hence revenue growth. Higher inflation is also creeping into costs. At Nine Dragons, net margins fell to 15.8% from 20.4%; for years they had increased on the strength of higher sales and more efficiency. The drop, say analysts, was enough to spook an already nervous market. A year ago, Nine Dragons' shares traded at up to 40 times earnings. Now, they trade at 13 times, similar to paper firms elsewhere in the world.

The froth is coming off in other parts of the market too—even China Mengniu Dairy, a company that transformed the dietary habits of a vast nation by making milk a staple, is no longer trading like an internet stock; its shares have fallen by almost a half this year. Much of the pain has been felt by Chinese property developers. R&F Properties and Agile Property, to name just two, saw their share price double or triple between 2006 and mid-2007. They have since lost two-thirds of their value. There is growing concern that smaller developers may have problems raising money to complete building works, which could trigger fire sales.

Not all the troubles are locally produced, however. Adding to the gloom is the waning enthusiasm of foreign investors. As of March 17th the New York-listed Morgan Stanley China A Share fund was trading at a 30% discount to net asset value—more than almost all closed-end exchange-traded funds listed in America. In Hong Kong investment banks say they have huge pipelines of potential initial public offerings, but investors have lost their appetite. On March 17th Want Want China Holdings, a cracker company, managed to raise $1 billion, but only after the valuation on its shares had been cut by more than a third. By last year's standards, that would have been a flop. This year it was enough for people to think that Want Want had lived up to its name.

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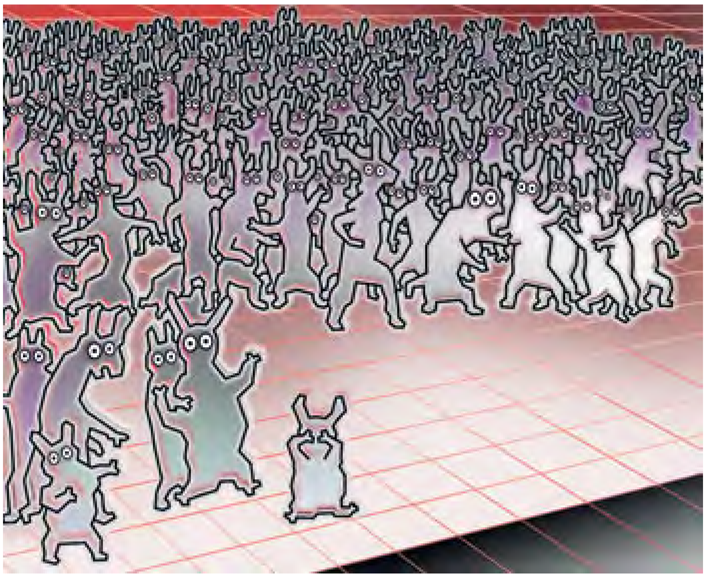
Economics focus

History lesson

Mar 19th 2008
From The Economist print edition

Illustration by JAC



How to deal with banking crises

THE decline and fall of Bear Stearns illustrates both an old truth and a new one. The old truth is that when cash is scarce, he who has deep pockets is king. Bear Stearns is still standing only because JPMorgan Chase was solid enough to prop it up. The new truth lies in the Federal Reserve's role as matchmaker of last resort, smoothing the deal with a temporary loan of $30 billion. This shows just how far a financial supervisor's purview now extends. Even though Bear is not a fully regulated institution, the investment bank was deemed too central to the complex web of America's financial system to be allowed to fail.

Private-sector solutions to banking crises, in which strong institutions buy the weak, demand well-heeled banks. Just now, these are in short supply. Few institutions have been left unscathed by bad mortgage debts; JPMorgan Chase is a rare exception. When banks are threatened with insolvency, it is often the government—with the deepest pockets of all—that has to make good their losses. But how much might the state have to stump up? And how should it go about it? As today's credit crisis widens, commentators are turning to history as a guide.

One lesson is that trouble is all too common. Most members of the IMF have undergone at least some distress since the late 1970s. Crises in poorer countries tend to be deeper and more costly, often because they are twinned with collapsing currencies. According to a 1996 survey of insolvencies by economists at the World Bank, the bail-out of Argentina's banking system in the early 1980s cost a stunning 55% of GDP to fix.

The rich world's banking troubles have not been cheap either. The bill for bolstering Finland's banks in the early 1990s came to 8% of GDP; Sweden's bail-out was scarcely less dear. America spent more than 3% of GDP cleaning up the savings-and-loan crisis, its priciest to date. That suggests that the possible cost of today's troubles, though alarming, is not off the charts. The best, though still highly uncertain, estimate of prospective lending losses is around $1.1 billion, less than half of which would be borne in America by banks, investors and in forgone taxes: $460 billion is equivalent to about 3% of last year's GDP.

Ideally, fiscal support for banks should be targeted, if it is needed at all. Bail-outs are often limited to just one institution. Continental Illinois in America and Johnson Matthey Bankers in Britain were rescued in 1984, because regulators judged that the banks were large enough to rock the whole system should they go bust. When Barings, another British bank, was wiped out by trading losses 11 years later, regulators let it fail, judging that the risk of wider damage was low.

These episodes occurred in times of relative financial calm, so have few lessons for today. The parallels with the Nordic crises of the early 1990s look more useful. Then as now, the banking bust followed economic and asset-price booms fired by the deregulation of credit, low interest rates and lax supervision. Norway's three biggest lenders were nationalised, but research by its central bank puts the fiscal cost at far less than in Finland or Sweden. Once banks were taken into public ownership, shareholders were universally wiped out. And though the cost of working out bad debts was around 2% of GDP, all that and more was recouped when the banks were privatised. In other words, the state made a profit from the crisis. Denmark, meanwhile, avoided the storms altogether because of stricter capital rules—prevention is better than cure.

The Nordic crises were not so long ago, yet they seem a world away. Norway probably avoided a worse fate by acting swiftly once it was clear that its biggest banks were insolvent. The obvious contrast is with Japan, where bad debts were left to fester. But today it is much harder for regulators to tell which banks, if any, are insolvent. That is because bad debt is hidden within complex securities, and the value of those securities is almost impossible to measure when markets have dried up. These days, the trouble lies as much in the financial markets as with the banks that trade in them.

1998 and all that

The growing complexity of links between banks is the reason why Bear Stearns, an investment bank that may not have worried regulators had it failed 15 years ago, could not be left to collapse today. The manner of its rescue recalled the efforts to shore up Long-Term Capital Management, a hedge fund tied intricately into the financial system, in 1998. Bear's demise also shows how the boundary between illiquidity and insolvency is fast dissolving. The bank was sold for a fraction of its book value after it was shut out of lending markets. Yet it is not clear whether it was insolvent in the sense that its assets were worth less than it owed.

By throwing open its discount window to investment banks, the Fed has tacitly admitted that the old rules no longer apply. It was a bold step, but not necessarily a sufficient one. There is still a stigma attached to discount-window borrowing, which means banks may be unwilling to avail themselves of it until it is too late, even when they are truly desperate.

In today's unholy tangle of short-term funding and long-term derivatives contracts, more banks may well fall into the liquidity traps that snared Bear and Britain's Northern Rock. If so, central banks may find they have to go further than ever and provide a floor for asset prices in illiquid markets. Since banks are unwilling to trade in mortgage assets, because they do not have the capital or cannot risk marking losses to market, there may be an opportunity for governments to buy assets at big discounts. Judicious intervention could in principle improve liquidity, bolster confidence and may in the end even make money for taxpayers if asset prices recover. But supporting badly run investment banks should also come with strings attached: regulatory control to reduce the chance that public support will be needed again.

The science of religion

Where angels no longer fear to tread

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From The Economist print edition

Illustration by Stephen Jeffrey

Science and religion have often been at loggerheads. Now the former has decided to resolve the problem by trying to explain the existence of the latter

BY THE standards of European scientific collaboration, €2m ($3.1m) is not a huge sum. But it might be the start of something that will challenge human perceptions of reality at least as much as the billions being spent by the European particle-physics laboratory (CERN) at Geneva. The first task of CERN's new machine, the Large Hadron Collider, which is due to open later this year, will be to search for the Higgs boson—an object that has been dubbed, with a certain amount of hyperbole, the God particle. The €2m, by contrast, will be spent on the search for God Himself—or, rather, for the biological reasons why so many people believe in God, gods and religion in general.

"Explaining Religion", as the project is known, is the largest-ever scientific study of the subject. It began last September, will run for three years, and involves scholars from 14 universities and a range of disciplines from psychology to economics. And it is merely the latest manifestation of a growing tendency for science to poke its nose into the God business.

Religion cries out for a biological explanation. It is a ubiquitous phenomenon—arguably one of the species markers of *Homo sapiens*—but a puzzling one. It has none of the obvious benefits of that other marker of humanity, language. Nevertheless, it consumes huge amounts of resources. Moreover, unlike language, it is the subject of violent disagreements. Science has, however, made significant progress in understanding the biology of language, from where it is processed in the brain to exactly how it communicates meaning. Time, therefore, to put religion under the microscope as well.

I have no need of that hypothesis

Explaining Religion is an ambitious attempt to do this. The experiments it will sponsor are designed to look at the mental mechanisms needed to represent an omniscient deity, whether (and how) belief in such a "surveillance-camera" God might improve reproductive success to an individual's Darwinian advantage, and whether religion enhances a person's reputation—for instance, do people think that those who believe in God are more trustworthy than those who do not? The researchers will also seek to establish whether different religions foster different levels of co-operation, for what reasons, and whether such co-operation brings collective benefits, both to the religious community and to those outside it.

It is an ambitious shopping list. Fortunately, other researchers have blazed a trail. Patrick McNamara, for example, is the head of the Evolutionary Neurobehaviour Laboratory at Boston University's School of Medicine. He works with people who suffer from Parkinson's disease. This illness is caused by low levels of a messenger molecule called dopamine in certain parts of the brain. In a preliminary study, Dr McNamara discovered that those with Parkinson's had lower levels of religiosity than healthy individuals, and that the difference seemed to correlate with the disease's severity. He therefore suspects a link with dopamine levels and is now conducting a follow-up involving some patients who are taking dopamine-boosting medicine and some of whom are not.

Such neurochemical work, though preliminary, may tie in with scanning studies conducted to try to find out which parts of the brain are involved in religious experience. Nina Azari, a neuroscientist at the University of Hawaii at Hilo who also has a doctorate in theology, has looked at the brains of religious people. She used positron emission tomography (PET) to measure brain activity in six fundamentalist Christians and six non-religious (though not atheist) controls. The Christians all said that reciting the first verse of the 23rd psalm helped them enter a religious state of mind, so both groups were scanned in six different sets of circumstances: while reading the first verse of the 23rd psalm, while reciting it out loud, while reading a happy story (a well-known German children's rhyme), while reciting that story out loud, while reading a neutral text (how to use a calling card) and while at rest.

Dr Azari was expecting to see activity in the limbic systems of the Christians when they recited the psalm. Previous research had suggested that this part of the brain (which regulates emotion) is an important centre of religious activity. In fact what happened was increased activity in three areas of the frontal and parietal cortex, some of which are better known for their involvement in rational thought. The control group did not show activity in these parts of their brains when listening to the psalm. And, intriguingly, the only thing that triggered limbic activity in either group was reading the happy story.

Dr Azari's PET study, together with one by Andrew Newberg of the University of Pennsylvania, which used single-photon emission computed tomography done on Buddhist monks, and another by Mario Beauregard of the University of Montreal, which put Carmelite nuns in a magnetic-resonance-imaging machine, all suggest that religious activity is spread across many parts of the brain. That conflicts not only with the limbic-system theory but also with earlier reports of a so-called God Spot that derived partly from work conducted on epileptics. These reports suggested that religiosity originates specifically in the brain's temporal lobe, and that religious visions are the result of epileptic seizures that affect this part of the brain.

Though there is clearly still a long way to go, this sort of imaging should eventually tie down the circuitry of religious experience and that, combined with work on messenger molecules of the sort that Dr McNamara is doing, will illuminate how the brain generates and processes religious experiences. Dr Azari, however, is sceptical that such work will say much about religion's evolution and function. For this, other methods are needed.

Dr McNamara, for example, plans to analyse a database called the Ethnographic Atlas to see if he can find any correlations between the amount of cultural co-operation found in a society and the intensity of its religious rituals. And Richard Sosis, an anthropologist at the University of Connecticut, has already done some research which suggests that the long-term co-operative benefits of religion outweigh the short-term costs it imposes in the form of praying many times a day, avoiding certain foods, fasting and so on.

Leviticus's children

On the face of things, it is puzzling that such costly behaviour should persist. Some scholars, however, draw an analogy with sexual selection. The splendour of a peacock's tail and the throaty roar of a stag really do show which males are fittest, and thus help females choose. Similarly, signs of religious commitment that are hard to fake provide a costly and reliable signal to others in a group that anyone engaging in them is committed to that group. Free-riders, in other words, would not be able to gain the advantages of group membership.

To test whether religion might have emerged as a way of improving group co-operation while reducing the need to keep an eye out for free-riders, Dr Sosis drew on a catalogue of 19th-century American communes published in 1988 by Yaacov Oved of Tel Aviv University. Dr Sosis picked 200 of these for his analysis; 88 were religious and 112 were secular. Dr Oved's data include the span of each commune's existence and Dr Sosis found that communes whose ideology was secular were up to four times as likely as religious ones to dissolve in any given year.

A follow-up study that Dr Sosis conducted in collaboration with Eric Bressler of McMaster University in

Canada focused on 83 of these communes (30 religious, 53 secular) to see if the amount of time they survived correlated with the strictures and expectations they imposed on the behaviour of their members. The two researchers examined things like food consumption, attitudes to material possessions, rules about communication, rituals and taboos, and rules about marriage and sexual relationships.

As they expected, they found that the more constraints a religious commune placed on its members, the longer it lasted (one is still going, at the grand old age of 149). But the same did not hold true of secular communes, where the oldest was 40. Dr Sosis therefore concludes that ritual constraints are not by themselves enough to sustain co-operation in a community—what is needed in addition is a belief that those constraints are sanctified.

Dr Sosis has also studied modern secular and religious kibbutzim in Israel. Because a kibbutz, by its nature, depends on group co-operation, the principal difference between the two is the use of religious ritual. Within religious communities, men are expected to pray three times daily in groups of at least ten, while women are not. It should, therefore, be possible to observe whether group rituals do improve co-operation, based on the behaviour of men and women.

To do so, Dr Sosis teamed up with Bradley Ruffle, an economist at Ben-Gurion University, in Israel. They devised a game to be played by two members of a kibbutz. This was a variant of what is known to economists as the common-pool-resource dilemma, which involves two people trying to divide a pot of money without knowing how much the other is asking for. In the version of the game devised by Dr Sosis and Dr Ruffle, each participant was told that there was an envelope with 100 shekels in it (between 1/6th and 1/8th of normal monthly income). Both players could request money from the envelope, but if the sum of their requests exceeded its contents, neither got any cash. If, however, their request equalled, or was less than, the 100 shekels, not only did they keep the money, but the amount left was increased by 50% and split between them.

Dr Sosis and Dr Ruffle picked the common-pool-resource dilemma because the communal lives of kibbutz members mean they often face similar dilemmas over things such as communal food, power and cars. The researchers' hypothesis was that in religious kibbutzim men would be better collaborators (and thus would take less) than women, while in secular kibbutzim men and women would take about the same. And that was exactly what happened.

Big father is watching you

Dr Sosis is not the only researcher to employ economic games to investigate the nature and possible advantages of religion. Ara Norenzayan, an experimental psychologist at the University of British Columbia, in Vancouver, has conducted experiments using what is known as the dictator game. This, too, is a well-established test used to gauge altruistic behaviour. Participants receive a sum of money—Dr Norenzayan set it at $10—and are asked if they would like to share it with another player. The dictator game thus differs from another familiar economic game in which one person divides the money and the other decides whether to accept or reject that division.

As might be expected, in the simple version of the dictator game most people take most or all of the money. However, Dr Norenzayan and his graduate student Azim Shariff tried to tweak the game by introducing the idea of God. They did this by priming half of their volunteers to think about religion by getting them to unscramble sentences containing religious words such as God, spirit, divine, sacred and prophet. Those thus primed left an average of $4.22, while the unprimed left $1.84.

Exactly what Dr Norenzayan has discovered here is not clear. A follow-up experiment which primed people with secular words that might, nevertheless, have prompted them to behave in an altruistic manner (civic, jury, court, police and contract) had similar effects, so it may be that he has touched on a general question of morality, rather than a specific one of religion. However, an experiment carried out by Jesse Bering, of Queen's University in Belfast, showed quite specifically that the perceived presence of a supernatural being can affect a person's behaviour—although in this case the being was not God, but the ghost of a dead person.

Illustration by Stephen Jeffrey

Dr Bering, too, likes the hypothesis that religion promotes fitness by promoting collaboration within groups. One way that might work would be to rely not just on other individuals to detect cheats by noticing things like slacking on the prayers or eating during fasts, but for cheats to detect and police themselves as well. In that case a sense of being watched by a supernatural being might be useful. Dr Bering thus proposes that belief in such beings would prevent what he called “dangerous risk miscalculations” that would lead to social deviance and reduced fitness.

One of the experiments he did to test this idea was to subject a bunch of undergraduates to a quiz. His volunteers were told that the best performer among them would receive a $50 prize. They were also told that the computer program that presented the questions had a bug in it, which sometimes caused the answer to appear on the screen before the question. The volunteers were therefore instructed to hit the space bar immediately if the word “Answer” appeared on the screen. That would remove the answer and ensure the test results were fair.

The volunteers were then divided into three groups. Two began by reading a note dedicating the test to a recently deceased graduate student. One did not see the note. Of the two groups shown the note, one was told by the experimenter that the student's ghost had sometimes been seen in the room. The other group was not given this suggestion.

The so-called glitch occurred five times for each student. Dr Bering measured the amount of time it took to press the space bar on each occasion. He discarded the first result as likely to be unreliable and then averaged the other four. He found that those who had been told the ghost story were much quicker to press the space bar than those who had not. They did so in an average of 4.3 seconds. That compared with 6.3 seconds for those who had only read the note about the student's death and 7.2 for those who had not heard any of the story concerning the dead student. In short, awareness of a ghost—a supernatural agent—made people less likely to cheat.

Who is my neighbour?

It all sounds very Darwinian. But there is a catch. The American communes, the kibbutzim, the students of the University of British Columbia and even the supernatural self-censorship observed by Dr Bering all seem to involve behaviour that promotes the group over the individual. That is the opposite of Darwinism as conventionally understood. But it might be explained by an idea that most Darwinians dropped in the 1960s—group selection.

The idea that evolution can work by the differential survival of entire groups of organisms, rather than just of individuals, was rejected because it is mathematically implausible. But it has been revived recently, in particular by David Sloan Wilson of Binghamton University, in New York, as a way of explaining the evolution of human morality in the context of inter-tribal warfare. Such warfare can be so murderous that groups whose members fail to collaborate in an individually self-sacrificial way may be wiped out entirely. This negates the benefits of selfish behaviour within a group. Morality and religion are often closely connected, of course (as Dr Norenzayan's work confirms), so what holds for the one might be expected to hold for the other, too.

Dr Wilson himself has studied the relationship between social insecurity and religious fervour, and discovered that, regardless of the religion in question, it is the least secure societies that tend to be most fundamentalist. That would make sense if adherence to the rules is a condition for the security which comes from membership of a group. He is also interested in what some religions hold out as the ultimate reward for good behaviour—life after death. That can promote any amount of self-sacrifice in a believer, up to and including suicidal behaviour—as recent events in the Islamic world have emphasised. However, belief in an afterlife is not equally well developed in all religions, and he suspects the differences may be illuminating.

That does not mean there are no explanations for religion that are based on individual selection. For example, Jason Slone, a professor of religious studies at Webster University in St Louis, argues that people who are religious will be seen as more likely to be faithful and to help in parenting than those who are not. That makes them desirable as mates. He plans to conduct experiments designed to find out whether this is so. And, slightly tongue in cheek, Dr Wilson quips that “secularism is very maladaptive biologically. We're the ones who at best are having only two kids. Religious people are the ones who aren't smoking and drinking, and are living longer and having the health benefits.”

That quip, though, makes an intriguing point. Evolutionary biologists tend to be atheists, and most would be surprised if the scientific investigation of religion did not end up supporting their point of view. But if a propensity to religious behaviour really is an evolved trait, then they have talked themselves into a position where they cannot benefit from it, much as a sceptic cannot benefit from the placebo effect of homeopathy. Maybe, therefore, it is God who will have the last laugh after all—whether He actually exists or not.

Tibet

Mountain forces

Mar 19th 2008
From The Economist print edition

AFP

Two unusual new books analyse Tibet's turbulent past and its uncertain future

CHINA will not hear a word against its imperial claims to Tibet. Any criticism of how it behaves there draws a swift and sometimes brutal response from Beijing. That is what happened this month. On March 10th, the 49th anniversary of the first great uprising against China's military occupation, young Tibetans once again rose up against Chinese control and the takeover of Lhasa and other Tibetan towns by immigrant businessmen and workers. As before, Chinese troops were ordered to put down the rebellion. On March 18th the Chinese premier, Wen Jiabao, accused the Dalai Lama, Tibet's spiritual leader, of masterminding the violence from his home in exile in India.

Tubten Khetsun's "Memories of Life in Lhasa Under Chinese Rule" begins with that first uprising in 1959. The author was then 18 years old. He had recently passed the state entrance examination and was working for the government as a clerk when the rebellion against China began. He was at the Dalai Lama's summer palace on the edge of today's Lhasa when the Chinese responded by bombarding the residence. The Dalai Lama had already secretly left the country. As a member of a prominent Lhasa family of government servants Mr Khetsun was declared a "class enemy" along with the rest of his family and sentenced to five years in jail. All their property, including their house, was confiscated and the family was scattered.

Mr Khetsun was moved from prison to slave-labour camp and back again. When he was finally set free he could work only where his neighbourhood committee ordained. That meant labouring on government hydro-electricity stations or smashing stones on other building sites—under-paid jobs that only requisitioned labour could fill. Each day ten or 12 hours of heavy work was followed by two hours of political indoctrination and "struggle" sessions, a euphemism for the violent personal attacks the Chinese used to destroy dissent.

There is a deep sense of isolation reflected in this depressing and cruel story of men and women being deprived, crushed, starved and exploited. When news reached them of the Indo-China border conflict in 1962 and the Sino-Soviet clashes in 1969 they believed Tibet was about to be liberated. There are also some shocking descriptions of the Mao-induced famines when starving Tibetan prisoners would search the faeces and vomit of fellow prisoners for any food that

Memories of Life in Lhasa Under Chinese Rule
By Tubten Khetsun. Translated by Matthew Akester

Columbia University Press; 318 pages; $32.50 and £19

Buy it at
Amazon.com
Amazon.co.uk

The Open Road: The Global Journey of the Fourteenth Dalai Lama
By Pico Iyer

Knopf; 288 pages; $24. Bloomsbury; £12.99 had not been digested. The only humour in this setting is black. Tibetans who had collaborated in the Chinese takeover and who later fell victim to China's deadly political battles entered the work camps exuding ideological solidarity and eager-beaver enthusiasm, rushing from place to place with their heavy loads of stone. Within a few days they were broken hulks, emaciated and covered in sores, more helpless than the original camp inmates.

Pico Iyer, who is of Tamil origin, has written a very different book. A journalist son of an Indian-born academic, he grew up in Britain and California, was educated at Eton and Magdalen College, Oxford, and now lives in Japan with his Japanese partner. Mr Iyer is a man of many cultures, who has known the 14th Dalai Lama since he was a teenager, when his father first sought out the Tibetan leader in his exile in Dharamsala and took his uninterested son to meet him. This background has given Mr Iyer an access and insight into the Dalai Lama that lifts his writing above the clichés that normally surround him, whether it is Rupert Murdoch's "political old monk shuffling around in Gucci shoes" or the "living god" of some of his followers.

Mr Iyer is not a devotee of Tibetan Buddhism, but he admires the Dalai Lama's constant learning, his philosophy and his spiritual and secular insights. "The Open Road" is not a biography but it probably reveals more about its subject than any formal study. After nearly 30 years of annual visits to Dharamsala, Mr Iyer has met everyone of any significance in the Tibetan exile community. He takes the reader to the Dalai Lama's mass teachings in Japan, Canada, America and India.

The one word most commonly heard in the Dalai Lama's conversations and in this book is dialogue. Modernisation, surprisingly for a leader who is branded a "splittist" and feudalist by the Chinese authorities and has supposedly been reincarnated 14 times over as many generations, comes a close second.

It is easy to understand the Chinese leadership's fear of the Dalai Lama. Half a century after his escape from Chinese occupation his name inside Tibet is still as powerful as ever, perhaps more so given his access to the rest of the world and the support he now has in the West. As the symbol of Tibet's independence, the Dalai Lama is the only recognised international figure with the moral authority to chastise the Chinese authorities for their abuse of their own people as well as Tibetans. For all Tibetans, in exile or living under Beijing's rule, he is their homeland, their faith and their sense of self, as Mr Iyer explains. For this reason the Chinese government seems quite content to stall talks with him and his representatives on the assumption that he will die soon and that will be the end of it.

The Dalai Lama's suggestion that on his death he could be reborn outside Tibet is likely to cause some distress among Chinese rulers, if only briefly. The atheist Communist Party of China insists it is the only authority that can determine whose terrestrial body the soul of a dead monk will move to. But the Dalai Lama may have outwitted them. His latest "modernist" suggestion is an internationally observed referendum in Tibet and among the Tibetan diaspora to decide how or indeed if he should be reincarnated at all. Tibetan nationalism remains a determined and untiring force.

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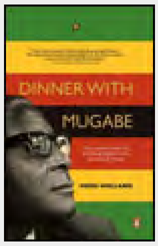
Zimbabwe

The making of a monster

Mar 19th 2008
From The Economist print edition

Get article background

Dinner with Mugabe: The Untold Story of a Freedom Fighter who Became a Tyrant
By Heidi Holland



Penguin South Africa; 250 pages; 210 rand

REVILED by some, hailed by others, Robert Mugabe leaves few people indifferent. In power since 1980, he hopes the election on March 29th will hand him another presidential term. Meanwhile, Zimbabwe's economy is crippled, there are chronic shortages, official inflation is running at 100,000% or more and unemployment at 80%. How could a leader who extended a hand to white Zimbabweans after independence and sought to bring education and health to his own people have turned into the tyrant he is today?

Heidi Holland, a South African author and journalist who was brought up in Zimbabwe, first met Mr Mugabe in 1975, when a friend brought him to her house for a secret dinner as he was about to flee the country to wage a guerrilla war. The polite and considerate fugitive, who telephoned the next day to inquire about her toddler, seems to have little in common with the man she interviewed last December. Ms Holland explores this apparent transformation, interviewing many of the people who have known him over the years.

As a boy Mr Mugabe was shy, sensitive and bookish, apparently without friends. After his carpenter father abandoned the family, the boy became the focus of his depressed and deeply Catholic mother, and a local missionary's protégé. Mr Mugabe's childhood left him with a shaky self-confidence but a ferocious self-discipline. At the same time, his mother's conviction that he was meant for great things helped give him a deluded sense of his own importance.

Ms Holland exposes another side of the man who is now regarded largely as a monster: his devoted marriage to his first wife, Sally, who was Ghanaian; his friendship with Lord Soames, Rhodesia's last British governor; the respectful and frank relationship he developed with Denis Norman, a white farmer who held several portfolios in his early governments. Most impressive was the magnanimous attitude he showed the Rhodesian ruler Ian Smith—who had sent him to prison for a decade and refused to let him travel to Ghana to attend his son's funeral—who was allowed to live on in Zimbabwe after he lost power.

Yet the shy country boy also harboured a vindictive streak and a taste for revenge. When most white Zimbabweans ignored his gestures of reconciliation in the 1980s, he flew into a rage. A letter from Clare Short, then the British minister in charge of foreign aid, pointing out that Tony Blair's new Labour government felt no responsibility towards financing land reform, cemented his dislike of the British prime minister. When white farmers threw their weight behind the opposition in the late 1990s, Mr Mugabe encouraged the war veterans to grab land.

Disappointment fuelled his paranoia. Mr Mugabe apportioned blame to others. His sense of power and entitlement grew as he became more repressive. He abandoned introspection and became increasingly disconnected from reality. The reserved but articulate teacher failed to realise that the liberation movement picked him to provide a respectable image. After 1980 the rest of the world, which had been so keen to see Zimbabwean majority rule as a success, chose to look the other way when he ordered massacres in Matabeleland in the south-west of the country. Many in the Catholic church, unable or unwilling to admit that the golden boy educated by missionaries was turning into a monster, continued to endorse him. And as those around him grew increasingly scared, they told him only what he wanted to hear. Once reserved and humble, Mr Mugabe could no longer tolerate criticism.

Ms Holland has spoken to former guerrillas, government colleagues, relatives and enemies to draw a nuanced portrait that contains much fresh detail about the president. Her interview with Mr Mugabe, who has not talked to a Western journalist for several years, lays bare a troubled personality. From his youth, Mr Mugabe had all the ingredients to become a tyrant. Many failed to read the signs—and to stop him while they still could.

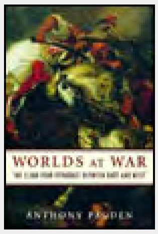
Dinner with Mugabe: The Untold Story of a Freedom Fighter who Became a Tyrant.
By Heidi Holland.
Penguin South Africa; 250 pages; 210 rand

The struggle between East and West

A long line of stand-offs

Mar 19th 2008
From The Economist print edition

Worlds at War: The 2,500-Year Struggle Between East and West
By Anthony Pagden



Random House; 656 pages; $35. Oxford University Press; £20

Buy it at
Amazon.com
Amazon.co.uk

WHEN visiting London in 1931, Mohandas Gandhi was asked by a British journalist what he thought of Western civilisation—and made the famous retort: "I think it would be a good idea."

Anthony Pagden, a British historian who teaches at the University of California, Los Angeles, has no such doubt about the superiority of the "Western" way of life which, on his reading, has been pitted for the past 2,500 years against various forms of "Eastern" despotism, of which militant Islam is only the latest.

It is hardly a coincidence, he suggests, that ancient Athens found itself doing battle with the Persian tyranny of Xerxes, while the modern Western world faces a stand-off with the mullahs' Iran. In his view of history, these are simply related chapters in a single narrative: the contest between liberal and enlightened societies whose locus is Europe (or at least European culture) and different forms of Oriental theocracy and authoritarianism.

"Worlds at War" offers some fine vignettes. It takes the reader to the walls of Constantinople as it fell to the Turks; it describes the millenarian passions which inspired the Crusades (and is commendably frank about their brutality); and details the fierce inter-Christian wars which raged in Europe until the continent had the sense to rise above such nonsense.

Mr Pagden is a scholar, but this is not a scholarly book—more like a long piece of witty, provocative conversation from a sage who knows a lot of things, and is crystal clear about what he doesn't like. He dislikes religion in almost all its forms, while professing a nativist preference for Christianity, and the culture it spawned. That is because, in refreshing contrast with Islam, its adherents were willing progressively (in two senses) to let go of their irrational beliefs; and to let go of any desire to mingle spiritual and political authority.

He is so frank about his prejudices as to be almost endearing. His formative influences include a visit to his brother-in-law who was working for the British rulers of Cyprus. He found the rebellious Greeks sadly different from the classical figures of British schoolrooms, and the Turks much nicer—albeit on closer inspection, especially after a visit to the wild east of Turkey, rather prone to distort history and mistreat women. The idea that Britain might bear some responsibility for the woes of Cyprus seems not to have occurred to him.

Even where the enlightened West did bad things, these were aberrations from a broadly virtuous trajectory; where the tyrannical east (from Darius to Osama bin Laden) committed sins, they were no better than anybody could expect—that is what Mr Pagden implies. He broadly accepts the argument of the al-Qaeda propagandists that today's global *jihad* is a continuation of the civilisational stand-off which began in the early Middle Ages and which is doomed to rage on.

There are, of course, a lot of historical realities which Mr Pagden's portrait of an eternal struggle between a liberal, secularising "West" and the cruel, superstitious "East" fails to capture: above all, the paradoxical ways in which these two worlds have influenced one another. How, on Mr Pagden's assumptions, can anybody understand the ways in which Western powers self-consciously favoured the harshest forms of Islam? If the version of Islam which now prevails in Saudi Arabia (and has spread from the royal house to its bitterest enemies) is uncompromising and intolerant, that owes much to strategic decisions taken by the region's British masters in the 1920s. In the 1980s who was "Western" and who was "Eastern" in the conflict between the Soviet occupiers of Afghanistan and the ultra-fundamentalist warriors who were generously supported by the Americans?

Mr Pagden's book also says relatively little about Russia, a country by turns Asian and European, religious and anti-religious, which defies categorisation as either Eastern or Western, and hence mocks both categories. Like several other non-European powers, Russia has consistently borrowed Western things (technology, cultural forms, ideologies) in order to fight Western power; and as one Russian philosopher put it, it hesitates between the East of Xerxes and the East of Christ. These are open questions (and not just for Russia); Mr Pagden's entertaining dualism isn't much help in grappling with them.

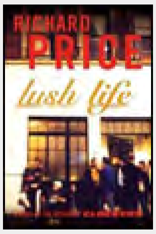
Worlds at War: The 2,500-Year Struggle Between East and West.
By Anthony Pagden.
Random House; 656 pages; $35. Oxford University Press; £20

New American fiction

Murder in Candyland

Mar 19th 2008
From The Economist print edition

Lush Life
By Richard Price



Farrar, Straus and Giroux; 464 pages; $26. To be published in Britain by Bloomsbury in September

Buy it at
Amazon.com
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THE Lower East Side of New York has long been a gateway for sweaty, dreamy immigrants. Its narrow streets feature the residue of older struggles, its tenements and synagogues inhabited by earlier boatloads.

But the pickle shops and leather outlets now share space with fancy French bistros and sleek, glassy condominiums. Chinese immigrants crammed 20 to a room toil alongside young, white artists sporting ironic tattoos and writerly goatees. It is a “Candyland of a neighbourhood,” writes Richard Price in “Lush Life”, his gripping eighth novel, a murder-mystery set in the area. With gritty, rhythmic prose, full of interrogating cops, wry bartenders and street-wise kids, Mr Price captures the complex jumble of race and class in this “checkerboard of demolition and rehabilitation”.

At the centre of the story is a late-night murder: after hours of drinking with two friends, a young, white man is shot and killed on the street. The victim's friends claim they were mugged by two dark-skinned kids from the nearby projects, but some witnesses allege the three white men were alone at the scene. The job of piecing the story together is left to two detectives: Matty, a “shovel jawed, sandy-haired Irisher” with a brusque manner, and Yolanda, a Latina with “huge liquid eyes that seemed perpetually on the verge of tears and a voice like a hug”.

As they work to tease out clues from suspects, they ask their questions with the cunning of poker players. The banter bristles, even if their efforts are fallible. The investigation sends the detectives all over the neighbourhood, into buildings that smell of “fried chicken and piss”, and smart, sepia-toned bars where the ice comes in cocktail-specific categories: “shaved, cubed, slabbed, and fjorded.” The reader is introduced to Eric Cash, a dour wannabe writer trapped in a life of restaurant managing, and William Marcus, a manic, tragic man confounded by the death of his son.

But the book's momentum is all in Mr Price's gifted patter. A writer for “The Wire”, an acclaimed HBO show about urban crime, he is capable of evoking atmosphere in three dimensions. His ear for dialogue is keen, and his language is often sharp and unique. One man falls “as slow as a flip-book”; another has pouches under his “restless eyes” that look “like thumbed clay”; a police captain speaks with a voice “like crusted glue”. “Lush Life” is a rare book—a fast-paced whodunnit with literary heft.

Lush Life.
By Richard Price.
Farrar, Straus and Giroux; 464 pages; $26. To be published in Britain by Bloomsbury in September

Albania in the second world war

More than a sideshow

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From The Economist print edition

IN 1993, shortly after diplomatic relations were re-established between Britain and Albania, an exhibition of photographs taken in Albania during the second world war opened in Tirana. The photographer was David Smiley, an officer with Special Operations Executive (SOE), the agency Winston Churchill set up in 1940 with a mandate “to set Europe ablaze” by supporting anti-German partisans throughout the continent. Mr Smiley, then a captain, had been the first officer SOE sent to Albania. His exhibition in the mausoleum of Enver Hoxha, the partisan leader who became Albania's lifelong dictator, was designed to counter the huge efforts Hoxha had made to efface every trace of Britain's wartime involvement in Albania.

The Wildest Province: SOE in the Land of the Eagle
By Roderick Bailey

Jonathan Cape; 416 pages; £25

Buy it at
Amazon.co.uk

Roderick Bailey tells the story of SOE's work in Albania in admirably balanced fashion. SOE promised arms and gold to any group that was able and willing to fight the occupiers. But the Albanians were more focused on the post-war struggle for power. By the autumn of 1943 the three main resistance groups were attacking each other. Mr Bailey explains how the balance tipped increasingly towards the Communist-backed partisans, who by the spring of 1944 had become the strongest and most effective force in the country.

Mr Bailey also shows how the British liaison officers gradually became the advocates of the groups to which they were attached, even taking on the same bitterness felt by the Albanians towards each other. For example, Reginald Hibbert, who was with the partisans and who later enjoyed a reputation for toughness in the British Foreign Office, could scarcely bring himself to speak to Julian Amery, later a Conservative cabinet minister, and Mr Smiley (both of whom had been stationed with the monarchists), when they all attended the reopening of the British military cemetery in Tirana in 1994.

Should SOE have tried to prevent the Communist takeover of Albania? Amery and Billy McLean, another senior SOE officer, both thought so, which caused some strain with SOE headquarters in Bari, Italy. Some even went as far as to accuse SOE of having been infiltrated by the Soviets. Mr Bailey has examined the evidence carefully and rejects the theory of a Communist conspiracy. The fact was that Hoxha's takeover of Albania in November 1944 could have been prevented only by a British military intervention along the lines of that in Greece the previous month. Intervention was never on the cards. But the horrors Hoxha inflicted on Albania for the next 40 years were such that the question of whether Britain might have done more to prevent his seizure of power is unlikely to go away.

Was the blood expended by SOE in Albania justified by the results achieved? This question too will go on being debated. So far as the military account is concerned, Mr Bailey quotes from the unpublished Cabinet Office history of SOE written in 1948: “This (Albania) was clearly a case in which a small but useful military diversion had been earned by limited investment in the guerrilla movement.” This sums up the situation well, even if it does less than justice to the efforts of a remarkable group of British irregulars who fought for many months in unusually grim and difficult conditions.

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18th-century intellectuals

Clever girls

Mar 19th 2008
From The Economist print edition

An exhibition about bluestockings puts brilliant women in the frame

National Portrait Gallery

Another great Catharine

THINK of the word "bluestocking" and you are likely to conjure up something female, formidable and frumpy—a dingy corner of feminism, the historical equivalent of dungarees. "Brilliant Women", a new show at London's National Portrait Gallery, blows all that away.

Between 1750 and 1790 a high tide of British confidence lifted into prominence a number of intellectual and creative women, some of whom occasionally met for conversation. (The name stuck after an absent-minded male guest once attended wearing the blue woollen stockings of working men instead of the more formal white silk.) The women are portrayed as sometimes fashionable, sometimes casual, but always unencumbered by domesticity. Not a husband, child or dog in sight. Instead there are books and pens, palettes and musical scores.

This was the Age of Enlightenment which looked to the classical world for its symbols of order, reason and inspiration. What could be more rational than that women should be educated and have their work taken seriously? In 1779 Richard Samuel, a painter, sent the Royal Academy exhibition his "Nine Living Muses of Great Britain"—a group of female writers and artists, all robed in classical style, holding scrolls and musical instruments, with Angelica Kauffmann at the easel.

Kauffmann survives, but many of the others are now obscure outside academia: Elizabeth Montagu, a critic—"Queen of the Blues", as Dr Johnson dubbed her—whose portrait by Allan Ramsay shows her looking faintly amused in a froth of lace and pink silk, leaning on a volume by David Hume, the Scottish philosopher and historian; or Anna Seward, a poet who is portrayed turning a page in her Milton—plainly waiting to get back to it; or Elizabeth Carter, poet, classicist, rival of Alexander Pope and translator of Epictetus, helmeted as Minerva, the goddess of wisdom, and carrying a volume of Plato.

These portraits are public statements. But for women then, public meant immodest. A learned woman's morals were always suspect, especially if she earned her living. Catharine Macaulay, a republican historian (pictured above), could pose as a Roman matron all she liked, but that did not stop caricaturists mocking her for using cosmetics and for her male friendships. In fact, the exhibition shows how fragile the whole enterprise was, how conflicted the women were themselves, and how quickly the revolutions in America and France turned the tide against them. There is a portrait of Mary Wollstonecraft in the 1790s holding an open book. Unlike all the rest, this one is blank. Was her “Vindication of the Rights of Woman” unmentionable? Or was this her sense of starting from nothing, with no female forebears?

But just as you leave, near a vicious Thomas Rowlandson etching of fighting bluestockings, there hangs an intriguing silhouette of an elderly Hannah More. The year is 1827, a generation later, and she sits at what looks like a tea table. But look again, and instead of cups and saucers there is a book in her hand, and pen and ink at the ready.

“Brilliant Women: 18th-Century Bluestockings” is at the National Portrait Gallery, London, until June 15th

Lazare Ponticelli

Mar 19th 2008
From The Economist print edition

AP

Lazare Ponticelli, the last French foot-soldier of the first world war, died on March 12th, aged 110

THE business of memory is a solid and solemn thing. Plaques are unveiled on the wall; stone memorials are built in the square; the domed mausoleum rises brick by brick over the city. But the business of memory is also as elusive as water or mist. The yellowing photographs slide to the back of the drawer; the voices fade; and the last rememberers of the dead die in their turn, leaving only what Thomas Hardy called "oblivion's swallowing sea".

The approach of the death of Lazare Ponticelli therefore caused something of a panic in France. This *derdesders*, "the last of the last", was for a while the only man in the country who remembered the first world war because he had fought in it. The suburb of Kremlin-Bicetre, where he lived, had like most other communities in France a memorial to the war dead. But, more important, it had Mr Ponticelli, who up to his 111th year appeared every November 11th in his flat cap and brown coat, lean and bright-eyed, gamely managing the few steps required to lay his small bunch of carnations there. The most astonished and serious observers were always children, to whom—if they wanted—he would tell his stories.

Successive presidents of France strove to honour Mr Ponticelli. It was a way of detaining all the other shadows he represented: the 8.4m workmen, peasants and common folk who, in pointed steel helmets and flapping greatcoats, had gloriously defended the fatherland as *poilus*, or foot-soldiers, between 1914 and 1918. Jacques Chirac suggested a state funeral for him and perhaps interment in the Pantheon, alongside Rousseau and Voltaire. Nicolas Sarkozy proposed a mass at Les Invalides. Mr Ponticelli wanted none of that: no procession, no racket, *pas de tapage important*. He was grateful for his belated Légion d'Honneur, which he kept with his other medals in a shoe-box. But he was keenly aware that he drew such attention only because he was the last.

What had become of the others? The stretcher-bearers in the Argonne, for example, who had told him they didn't dare leave the trench for fear of German fire. The man he had heard from no-man's land, caught in the barbed wire and with his leg severed, screaming to be rescued, until Mr Ponticelli ran out to him with wire-cutters and dragged him back to the lines. The German soldier he tripped over in the dark, already wounded and expecting to be killed, who mutely held up his fingers to show him that he had two children. The comrades who helped him, because he could not read or write, to keep in touch by letter with the milkmaid he had met before the war. Or the four colleagues who held him down when, after the battle of Pal Piccolo, the army surgeon gouged out of his cheek a piece of shrapnel already lodged in gangrene.

With each new round of shelling, he said, they all expected the worst. They would reassure each other by saying, "If I die, you'll remember me, won't you?" Mr Ponticelli felt he had a duty to try, but struggled. These were *mes camarades*, *les gars*, *un type*: faces, not names. And as he faded, even those faces lost their last hold on the living.

Bread for tobacco

In many ways Mr Ponticelli was not typical of the *poilus*. He was an Italian, from dirt-poor Emilia-Romagna, who followed his family to France to find work. Some of his childhood, peacetime memories were perhaps as rare as his wartime ones: catching thrushes by hand in the rocky fields, hand-stitching his own shoes, setting up a chimney-sweep business in Nogent-sur-Marne. He thought France “paradise”, and enlisted in the Foreign Legion at 16, under-age, by way of thanks. When Italy joined the war in 1915 he switched to an Italian Alpine regiment, but only because two policemen marched him bodily to Turin; and he kept his French military passbook carefully on him through three years as a machine-gunner, until he was able to return to paradise again. In 1939 he became a French citizen, and the rest of his life was spent setting up Ponticelli *frères*, a company that still builds and takes down chimneys and makes industrial piping.

Increasingly, however, people wanted to talk to him about the war. He always courteously obliged them, though by the end his thin, scratchy voice came out in gasps. It was as important to him as it was to them to underscore the horror and futility of it. More than anything, he was appalled that he had been made to fire on people he didn't know and to whom he, too, was a stranger. These were fathers of children. He had no quarrel with them. *C'est complètement idiot la guerre*. His Italian Alpine regiment had once stopped firing for three weeks on the Austrians, whose language many of them spoke; they had swapped loaves of bread for tobacco and taken pictures of each other. To the end of his life, Mr Ponticelli showed no interest in labelling anyone his enemy. He said he did not understand why on earth he, or they, had been fighting.

On March 17th he had his wish, or most of it: a state funeral for all the *poilus* at Les Invalides, and then a simple family burial. The government badly wanted this last foot-soldier to be memorialised; but he preferred to be uncelebrated and ordinary, even in some sense forgotten, and thus the more symbolic of all the rest.

Overview

Mar 19th 2008
From The Economist print edition

The **Federal Reserve** cut its benchmark interest rate by 0.75 percentage points, to 2.25%, saying that “the outlook for economic activity has weakened further”. The bank warned that “downside risks to growth remain” even as it acknowledged that “some indicators of inflation expectations have risen”. Two of the Fed's ten-strong rate-setting committee voted against the decision.

Consumer prices in **America** were unchanged in February, but were 4% higher than a year earlier. Prices excluding food and energy rose by 2.3% in the year to February. Housing starts fell by 0.6% in February and were down 28.4% from a year earlier. Building permits for new private houses fell by 7.8%, to reach their lowest level in over 16 years. Industrial production fell by 0.5% in February.

America's **current-account deficit** narrowed from $177.4 billion to $172.9 billion in the fourth quarter. In 2007 as a whole, the deficit shrunk to $738.6 billion (5.3% of GDP) from $811.5 billion (6.2% of GDP) in 2006.

Consumer prices in **Britain** rose by 2.5% in the year to February, up from 2.2% in the year to January. The rise in inflation was largely due to new ways of calculating energy bills.

Canada's consumer-price inflation fell from 2.2% to 1.8% in February, below the central bank's 2% target.

In the **euro area** consumer prices rose by 3.3% in the year to February, revised up from a provisional estimate of 3.2%.

Output, prices and jobs

Mar 19th 2008
From The Economist print edition

Output, prices and jobs

% change on year ago

	Gross domestic product latest	Gross domestic product qtr*	Gross domestic product 2008†	Gross domestic product 2009†	Industrial production latest	Consumer prices latest	Consumer prices year ago	Consumer prices 2008†	Unemployment rate‡, %
United States	+2.5 Q4	+0.6	+1.5	+2.2	+1.0 Feb	+4.0 Feb	+2.4	+3.2	4.8 Feb
Japan	+2.0 Q4	+3.5	+1.4	+1.6	+2.2 Jan	+0.7 Jan	nil	+0.6	3.8 Jan
China	+11.2 Q4	na	+9.8	+9.0	+12.6 Feb	+8.7 Feb	+2.7	+4.5	9.5 2007
Britain	+2.9 Q4	+2.3	+1.9	+2.0	+0.4 Jan	+2.5 Feb§	+2.8	+2.4	5.2 Dec††
Canada	+2.9 Q4	+0.8	+1.7	+2.2	−1.3 Dec	+1.8 Feb	+2.0	+1.9	5.8 Feb
Euro area	+2.2 Q4	+1.6	+1.7	+1.8	+3.8 Jan	+3.3 Feb	+1.8	+2.5	7.1 Jan
Austria	+3.0 Q4	+2.3	+2.5	+2.3	+3.4 Dec	+3.2 Feb	+1.6	+2.1	4.2 Jan
Belgium	+2.4 Q4	+2.0	+1.9	+1.9	−1.9 Dec	+3.6 Feb	+1.8	+2.4	10.9 Jan‡‡
France	+2.0 Q4	+1.2	+1.6	+1.7	+2.7 Jan	+2.8 Feb	+1.0	+2.2	7.5 Q4§§
Germany	+1.8 Q4	+1.1	+1.7	+1.9	+7.0 Jan	+2.8 Feb	−6.0	+2.1	8.0 Feb
Greece	+3.6 Q4	+2.8	+2.4	+2.6	+1.6 Jan	+4.4 Feb	+2.7	+3.3	8.9 Dec
Italy	+1.9 Q3	+1.7	+1.0	+1.4	+0.5 Jan	+2.9 Feb	+1.8	+2.4	5.9 Q3
Netherlands	+4.4 Q4	+4.7	+2.3	+2.1	+2.0 Jan	+2.2 Feb	+1.5	+2.0	4.1 Jan††
Spain	+3.5 Q4	+3.2	+2.4	+2.1	−0.2 Jan	+4.4 Feb	+2.4	+3.5	8.8 Jan
Czech Republic	+6.6 Q4	+7.0	+4.7	+5.4	+9.3 Jan	+7.5 Feb	+1.5	+6.5	5.9 Feb
Denmark	+2.0 Q4	+1.8	+1.6	+1.8	−1.8 Jan	+3.1 Feb	+1.9	+2.2	2.1 Jan
Hungary	+0.7 Q4	+0.8	+2.5	+3.6	+6.6 Jan	+6.9 Feb	+8.8	+5.7	8.1 Jan††
Norway	+5.2 Q4	+5.2	+2.9	+2.6	−1.4 Jan	+3.7 Feb	+0.8	+3.1	2.4 Dec††
Poland	+6.1 Q4	na	+5.1	+4.3	+10.8 Jan	+4.2 Feb	+1.9	+4.0	11.7 Jan‡‡
Russia	+7.7 Q3	na	+7.0	+6.0	+7.5 Feb	+12.7 Feb	+7.6	+12.5	5.7 Jan‡‡
Sweden	+2.8 Q4	+3.1	+2.6	+2.5	+3.8 Jan	+3.1 Feb	+2.0	+2.6	6.1 Feb‡‡
Switzerland	+3.6 Q4	+4.2	+2.0	+1.9	+10.7 Q3	+2.4 Feb	nil	+1.6	2.5 Jan
Turkey	+1.5 Q3	na	+3.7	+5.4	−0.4 Jan	+9.1 Feb	+10.2	+8.4	10.1 Q4‡‡
Australia	+3.9 Q4	+2.4	+3.3	+3.2	+1.6 Q3	+3.0 Q4	+3.3	+3.1	4.0 Feb
Hong Kong	+6.7 Q4	+6.6	+4.0	+4.6	−0.3 Q4	+3.3 Jan	+2.0	+4.0	3.3 Feb††
India	+8.4 Q4	na	+7.8	+7.2	+5.3 Jan	+5.5 Jan	+6.7	+5.8	7.2 2007
Indonesia	+6.3 Q4	na	+6.1	+5.7	+1.6 Dec	+7.4 Feb	+6.3	+6.4	9.8 Feb
Malaysia	+7.3 Q4	na	+5.5	+5.7	+7.0 Jan	+2.7 Feb	+3.1	+2.8	3.1 Q3
Pakistan	+7.0 2007**	na	+5.0	+5.3	−4.1 Dec	+11.3 Feb	+7.4	+9.3	6.2 2006
Singapore	+5.4 Q4	−4.8	+4.4	+4.7	+6.9 Jan	+6.6 Jan	+0.2	+3.3	1.6 Q4
South Korea	+5.5 Q4	+6.3	+4.4	+4.4	+11.8 Jan	+3.6 Feb	+2.2	+2.9	3.0 Feb
Taiwan	+6.4 Q4	na	+4.5	+4.3	+12.3 Jan	+3.9 Feb	−2.2	+1.7	4.0 Jan
Thailand	+5.7 Q4	+7.3	+4.8	+4.3	+12.5 Jan	+5.4 Feb	+2.3	+3.9	0.8 Dec
Argentina	+9.1 Q4	+8.0	+5.7	+4.5	+12.9 Jan	+8.4 Feb	+9.6	+10.9	7.5 Q4‡‡
Brazil	+6.2 Q4	+6.4	+4.3	+4.0	+8.5 Jan	+4.6 Feb	+3.0	+4.5	8.0 Jan‡‡
Chile	+4.1 Q3	−2.5	+4.0	+4.6	+4.4 Jan	+8.1 Feb	+2.7	+5.9	7.2 Jan††‡‡
Colombia	+6.6 Q3	+6.9	+4.5	+4.0	+5.7 Jan	+6.4 Feb	+5.3	+5.3	9.9 Dec‡‡
Mexico	+3.8 Q4	+3.0	+1.9	+3.0	+1.3 Dec	+3.7 Feb	+4.1	+4.1	4.1 Jan‡‡
Venezuela	+8.5 Q4	na	+5.5	+4.6	−2.5 Dec	+25.2 Feb	+20.4	+27.8	6.7 Q4‡‡
Egypt	+8.1 Q4	na	+7.4	+6.9	+7.5 2007**	+12.1 Feb	+12.6	+9.8	8.8 Q3‡‡
Israel	+6.8 Q4	+6.4	+3.5	+4.1	+4.0 Dec	+3.6 Feb	−0.8	+2.9	6.8 Q4
Saudi Arabia	+3.5 2007	na	+6.0	+5.6	na	+7.0 Jan	+3.6	+7.5	na
South Africa	+4.6 Q4	+5.3	+4.1	+4.8	+1.4 Jan	+9.3 Jan	+6.0	+7.0	25.5 Mar‡‡
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*									
Estonia	+4.5 Q4	na	+4.0	+4.3	+4.1 Jan	+11.3 Feb	+4.7	+9.0	5.3 Dec
Finland	+3.7 Q4	+3.8	+3.1	+2.8	+2.3 Jan	+3.7 Feb	+2.2	+2.0	6.2 Feb
Iceland	+4.6 Q4	+1.2	+2.0	+3.3	+0.4 2007	+6.8 Feb	+7.4	+5.0	1.0 Feb‡‡
Ireland	+4.1 Q3	+5.6	+2.4	+2.6	+1.6 Jan	+4.8 Feb	+4.8	+3.0	5.2 Feb
Latvia	+8.0 Q4	na	+5.8	+6.0	−0.1 Jan	+16.7 Feb	+7.2	+10.5	5.0 Feb
Lithuania	+7.9 Q4	−4.3	+7.2	+6.4	na	+10.8 Feb	+4.3	+7.8	4.6 Jan‡‡
Luxembourg	+5.6 Q3	+2.8	+4.9	+4.8	+5.3 Jan	+3.3 Jan	+2.3	+3.1	4.6 Jan‡‡
New Zealand	+3.4 Q3	+1.1	+1.8	+2.6	+1.3 Q3	+3.2 Q4	+2.6	+2.9	3.4 Q4
Peru	+10.1 Jan	na	+6.3	+6.7	+6.5 Dec	+4.8 Feb	+0.4	+3.7	9.4 Jan††
Philippines	+7.3 Q4	+7.4	+5.4	+5.5	−1.8 Dec	+5.4 Feb	+2.6	+4.0	7.4 Q1‡‡
Portugal	+2.0 Q4	+3.0	+1.8	+2.1	−1.4 Jan	+2.9 Feb	+2.4	+2.3	7.8 Q4‡‡
Slovakia	+14.3 Q4	na	+7.5	+5.7	+8.4 Jan	+4.0 Feb	+2.7	+3.0	8.1 Jan††
Slovenia	+4.7 Q4	na	+4.6	+4.0	−0.1 Dec	+6.5 Feb	+2.1	+4.4	7.4 Jan‡‡

*% change on previous quarter, annual rate. †*The Economist* poll or Economist Intelligence Unit estimate/forecast. ‡National definitions. §RPI inflation rate 4.1% in Jan. **Year ending June. ††Latest three months. ‡‡Not seasonally adjusted. §§New series.

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; Centre for Monitoring Indian Economy; OECD; ECB

The Economist commodity-price index (1)

Mar 19th 2008
From The Economist print edition

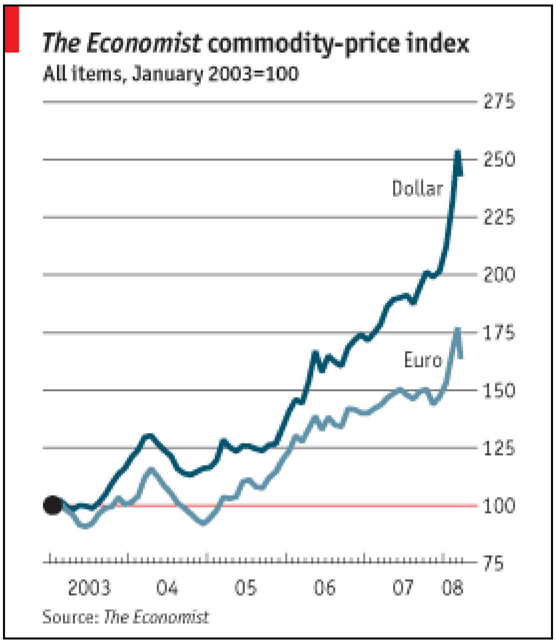
***The Economist* commodity-price index**
2000=100

	Mar 10th	Mar 17th*	% change on one month	% change on one year
Dollar index				
All items	270.1	259.9	+3.1	+33.5
Food	271.2	258.3	+2.6	+62.1
Industrials				
All	268.6	262.1	+3.6	+9.0
Nfa†	191.7	192.8	+1.2	+24.7
Metals	310.7	300.0	+4.4	+4.4
Sterling index				
All items	204.4	197.0	+0.5	+30.7
Euro index				
All items	162.9	152.5	-3.6	+12.6
Gold				
$ per oz	974.90	1011.60	+9.0	+53.3
West Texas Intermediate				
$ per barrel	108.64	105.94	+6.4	+85.0

*Provisional †Non-food agriculturals.

The Economist commodity-price index (2)

Mar 19th 2008
From The Economist print edition



Our commodity-price index reached a new peak on March 4th, as buying by investment funds added to strong demand from consumers in emerging economies. The index has since dropped by 4%, partly because speculators have been selling commodities to cover losses in other financial markets. The boom in commodity prices, which are quoted in dollars, partly reflects the currency's weakness. Since the start of 2003, our dollar index has risen by 143%, but prices have increased by a more modest 64% in terms of the euro. Grain prices have stayed close to record levels, but coffee prices have fallen by 15% since the beginning of March on hopes of a bumper crop in Brazil.

Trade, exchange rates, budget balances and interest rates

Mar 19th 2008
From The Economist print edition

Trade, exchange rates, budget balances and interest rates

	Trade balance* latest 12 months, $bn	Current-account balance latest 12 months, $bn	Current-account balance % of GDP 2008†	Currency units, per $ Mar 18th	Currency units, per $ year ago	Budget balance % of GDP 2008†	Interest rates, % 3-month latest	Interest rates, % 10-year gov't bonds, latest
United States	−819.2 Jan	−738.6 Q4	−4.7	–	–	−2.4	2.26	3.45
Japan	+105.4 Jan	+214.7 Jan	+4.7	98.2	117	−2.7	0.75	1.29
China	+250.0 Feb	+249.9 2006	+10.4	7.08	7.74	0.2	4.50	4.22
Britain	−177.2 Jan	−129.4 Q3	−3.8	0.49	0.51	−3.2	6.00	4.35
Canada	+44.8 Jan	+12.5 Q4	+0.4	0.99	1.16	0.6	2.00	3.57
Euro area	+39.0 Dec	+18.9 Dec	−0.1	0.63	0.75	−1.0	4.65	3.76
Austria	+0.4 Dec	+10.9 Q3	+2.7	0.63	0.75	−0.4	4.65	3.98
Belgium	+15.4 Jan	+13.3 Sep	+2.0	0.63	0.75	−0.5	4.72	4.24
France	−56.3 Jan	−36.9 Jan	−1.3	0.63	0.75	−2.9	4.65	4.00
Germany	+263.5 Jan	+256.7 Jan	+5.2	0.63	0.75	0.8	4.65	3.76
Greece	−57.1 Dec	−48.3 Dec	−12.0	0.63	0.75	−2.7	4.65	4.42
Italy	−14.1 Jan	−51.1 Jan	−2.3	0.63	0.75	−2.8	4.65	4.36
Netherlands	+57.2 Jan	+50.1 Q3	+6.8	0.63	0.75	0.5	4.65	4.03
Spain	−136.0 Dec	−136.9 Nov	−9.1	0.63	0.75	nil	4.65	4.17
Czech Republic	+4.4 Jan	−4.3 Jan	−3.2	16.1	21.0	−2.6	4.06	4.54
Denmark	+3.4 Jan	+3.3 Jan	+1.8	4.73	5.60	3.6	5.00	4.02
Hungary	−0.2 Jan	−6.8 Q3	−5.9	163	186	−4.1	8.22	8.45
Norway	+63.1 Feb	+64.1 Q4	+15.8	5.12	6.16	17.9	6.15	4.14
Poland	−12.2 Jan	−16.2 Jan	−4.0	2.24	2.91	−1.8	6.03	6.00
Russia	+140.6 Jan	+76.6 Q4	+4.0	23.5	26.1	1.2	10.25	6.52
Sweden	+17.7 Jan	+38.1 Q4	+6.1	5.99	6.99	1.5	4.11	3.81
Switzerland	+11.6 Jan	+69.6 Q3	+14.6	0.99	1.21	0.7	2.83	2.81
Turkey	−64.5 Jan	−38.9 Jan	−7.7	1.23	1.40	−2.9	16.73	6.50‡
Australia	−19.7 Jan	−56.4 Q4	−5.6	1.08	1.25	1.5	7.78	5.96
Hong Kong	−23.9 Jan	+27.0 Q3	+8.8	7.77	7.81	3.1	1.80	2.24
India	−75.4 Jan	−10.9 Q3	−2.0	40.5	43.8	−3.1	7.37	7.95
Indonesia	+40.0 Jan	+11.0 Q4	+2.5	9,185	9,155	−1.8	8.10	6.61‡
Malaysia	+30.1 Jan	+28.7 Q3	+13.9	3.17	3.50	−3.1	3.62	3.30‡
Pakistan	−16.9 Feb	−8.4 Q4	−7.0	62.8	60.7	−5.3	10.24	9.81‡
Singapore	+34.8 Feb	+39.1 Q4	+23.5	1.38	1.53	1.0	1.19	2.08
South Korea	+8.3 Feb	+3.8 Jan	+0.5	1,014	942	0.2	5.24	5.25
Taiwan	+15.7 Feb	+31.7 Q4	+5.0	30.7	33.1	−1.6	2.60	2.33
Thailand	+11.5 Jan	+15.0 Jan	+2.6	31.2	32.9	−2.8	3.27	3.79
Argentina	+11.9 Jan	+6.8 Q3	+2.5	3.15	3.10	0.9	10.38	na
Brazil	+36.5 Feb	−1.2 Jan	−0.4	1.71	2.08	−1.8	11.18	6.16‡
Chile	+23.0 Feb	+6.7 Q3	+3.8	432	536	5.4	6.48	3.71‡
Colombia	−0.8 Dec	−5.2 Q3	−4.3	1,823	2,184	−1.6	9.74	5.78‡
Mexico	−11.7 Jan	−7.4 Q4	−1.5	10.7	11.1	nil	7.43	7.46
Venezuela	+23.7 Q4	+20.0 Q4	+4.7	4.20	4.23§	−2.6	14.00	6.55‡
Egypt	−20.5 Q4	+0.5 Q1	+0.9	5.48	5.70	−7.0	5.16	4.94‡
Israel	−11.0 Feb	+5.0 Q4	+2.2	3.39	4.21	−1.4	3.00	4.81
Saudi Arabia	+146.4 2007	+98.9 2006	+22.8	3.75	3.75	12.8	2.87	na
South Africa	−10.0 Jan	−20.6 Q4	−8.0	8.04	7.40	0.6	11.45	9.18
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*								
Estonia	−4.5 Dec	−3.3 Jan	−13.1	9.91	11.8	0.6	6.35	na
Finland	+12.0 Jan	+11.6 Jan	+3.8	0.63	0.75	3.6	4.53	3.98
Iceland	−1.6 Feb	−3.2 Q4	−11.1	76.8	66.9	3.1	13.82	na
Ireland	+36.5 Dec	−11.1 Q3	−3.8	0.63	0.75	−0.5	4.65	4.18
Latvia	−7.2 Jan	−6.4 Jan	−18.2	0.44	0.53	1.0	5.86	na
Lithuania	−7.3 Jan	−5.6 Jan	−12.0	2.19	2.60	−0.6	4.81	na
Luxembourg	−6.1 Dec	+4.7 Q3	na	0.63	0.75	0.9	4.65	na
New Zealand	−3.6 Jan	−10.2 Q3	−7.5	1.24	1.42	3.0	7.30	6.39
Peru	+8.3 Jan	+1.5 Q4	−0.2	2.81	3.19	1.0	5.20	na
Philippines	−5.0 Dec	+6.4 Dec	+4.6	41.5	48.6	−0.2	6.44	na
Portugal	−26.6 Dec	−21.0 Dec	−8.1	0.63	0.75	−2.6	4.65	4.24
Slovakia	−0.9 Jan	−0.5 Nov	−2.8	20.6	25.1	−2.3	4.17	4.33
Slovenia	−3.1 Jan	−2.2 Dec	−2.5	0.63	0.75	−0.8	na	na

*Merchandise trade only. †*The Economist* poll or Economist Intelligence Unit forecast. ‡Dollar-denominated bonds. §Unofficial exchange rate.
Sources: National statistics offices and central banks; Thomson Datastream; Reuters; JPMorgan; Bank Leumi le-Israel; Centre for Monitoring Indian Economy; Danske Bank; Hong Kong Monetary Authority; Standard Bank Group; UBS; Westpac.

Markets

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Markets

	Index Mar 18th	% change on one week	Dec 31st 2007 in local currency	Dec 31st 2007 in $ terms
United States (DJIA)	12,392.7	+1.9	−6.6	−6.6
United States (S&P 500)	1,330.7	+0.8	−9.4	−9.4
United States (NAScomp)	2,268.3	+0.6	−14.5	−14.5
Japan (Nikkei 225)	11,964.2	−5.5	−21.8	−11.1
Japan (Topix)	1,163.6	−5.8	−21.1	−10.3
China (SSEA)	3,850.8	−11.9	−30.3	−28.1
China (SSEB, $ terms)	246.4	−18.1	−34.7	−32.7
Britain (FTSE 100)	5,605.8	−1.5	−13.2	−11.8
Canada (S&P TSX)	13,136.7	−1.6	−5.0	−5.7
Euro area (FTSE Euro 100)	1,121.0	−1.4	−18.5	−12.0
Euro area (DJ STOXX 50)	3,558.7	−1.3	−19.1	−12.7
Austria (ATX)	3,600.4	−3.5	−20.2	−13.9
Belgium (Bel 20)	3,659.8	−0.3	−11.3	−4.3
France (CAC 40)	4,582.6	−1.0	−18.4	−11.9
Germany (DAX)*	6,393.4	−2.0	−20.7	−14.4
Greece (Athex Comp)	3,869.6	−2.9	−25.3	−19.3
Italy (S&P/MIB)	31,437.0	−3.2	−18.5	−12.0
Netherlands (AEX)	427.5	−1.4	−17.1	−10.5
Spain (Madrid SE)	1,411.6	nil	−14.0	−7.2
Czech Republic (PX)	1,504.4	−0.3	−17.1	−6.3
Denmark (OMXCB)	391.0	−0.9	−12.9	−6.0
Hungary (BUX)	21,768.1	−2.9	−17.0	−11.9
Norway (OSEAX)	463.3	−3.1	−18.7	−13.7
Poland (WIG)	46,332.9	−2.1	−16.7	−8.7
Russia (RTS, $ terms)	2,018.8	−1.9	−15.6	−11.9
Sweden (Aff.Gen)	292.0	−1.9	−14.2	−7.5
Switzerland (SMI)	7,013.9	−1.8	−17.3	−5.5
Turkey (ISE)	40,720.3	−6.0	−26.7	−30.3
Australia (All Ord.)	5,163.8	−0.9	−19.6	−14.6
Hong Kong (Hang Seng)	21,384.6	−7.0	−23.1	−22.8
India (BSE)	14,833.5	−8.0	−26.9	−28.9
Indonesia (JSX)	2,339.8	−7.3	−14.8	−12.9
Malaysia (KLSE)	1,180.0	−2.2	−18.3	−14.7
Pakistan (KSE)	14,726.5	−1.5	+4.6	+2.6
Singapore (STI)	2,833.6	−1.0	−18.2	−14.6
South Korea (KOSPI)	1,588.8	−3.2	−16.3	−22.7
Taiwan (TWI)	8,057.8	−3.9	−5.3	nil
Thailand (SET)	812.3	−0.9	−5.3	+2.2
Argentina (MERV)	2,081.7	−2.9	−3.3	−3.1
Brazil (BVSP)	61,932.0	−0.7	−3.1	+1.1
Chile (IGPA)	13,176.7	+1.8	−6.4	+7.8
Colombia (IGBC)	9,109.7	−0.7	−14.8	−5.8
Mexico (IPC)	29,515.6	+0.2	−0.1	+1.8
Venezuela (IBC)	35,297.8	+3.3	−6.9	−52.4
Egypt (Case 30)‡	10,897.1	−3.5	+4.1	+4.7
Israel (TA-100)	898.9	−6.8	−22.1	−11.6
Saudi Arabia (Tadawul)	9,540.7	−3.7	+20.3	+20.3
South Africa (JSE AS)	30,044.1	−0.6	+3.8	−11.8
Europe (FTSEurofirst 300)	1,242.0	−2.2	−17.6	−11.0
World, dev'd (MSCI)	1,424.6	+0.3	−10.3	−10.3
Emerging markets (MSCI)	1,065.2	−4.8	−14.5	−14.5
World, all (MSCI)	359.6	−0.3	−10.8	−10.8
World bonds (Citigroup)	804.4	+2.9	+10.1	+10.1
EMBI+ (JPMorgan)	434.9	+0.3	+0.3	+0.3
Hedge funds (HFRX)	1,288.4	−1.6	−3.1	−3.1
Volatility, US (VIX)	25.8	26.4	22.5	(levels)
CDSs, Eur (iTRAXX)†	110.9	nil	+213.5	+238.4
CDSs, N Am (CDX)†	186.6	−3.8	+135.2	+135.2
Carbon trading (EU ETS) €	21.6	−1.0	−2.7	+5.1

*Total return index. †Credit-default swap spreads, basis points.
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; JPMorgan Chase; Bank Leumi le-Israel; CBOE; CMIE; Danske Bank; EEX; HKMA; Markit; Standard Bank Group; UBS; Westpac. ‡New index.

Taxing wages

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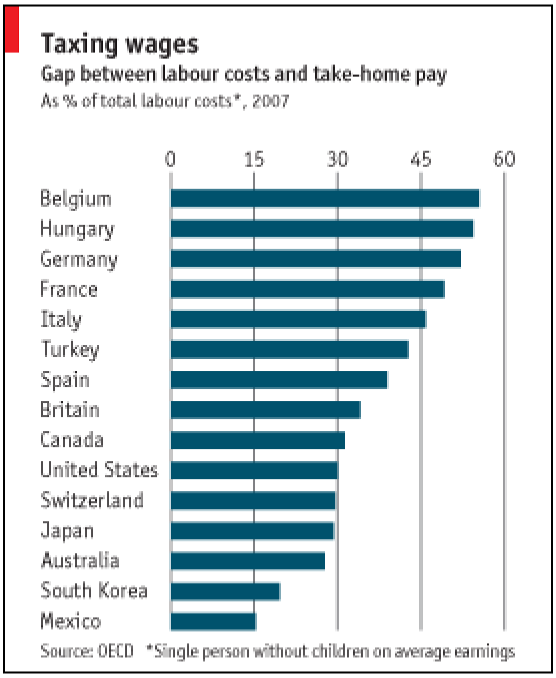

The OECD's annual survey of employment taxes suggests that fiscal policy remains a bar to jobs growth in many rich countries. The study shows big variations in the "tax wedge"—the gap between what employers pay for labour and what workers take home in after-tax pay. The wedge is made up of income taxes and the social-security contributions of both firms and workers. In theory, the larger the wedge, the greater are the barriers to job creation. Tax wedges were widest in continental Europe, where they exceed 50% of labour costs in Belgium, Hungary and Germany. The narrowest wedges were in South Korea and Mexico. America and Japan had thinner tax wedges than most other OECD countries.