INSIDE THIS WEEK: A 14-PAGE SPECIAL REPORT ON THE TWO KOREAS

The Economist

SEPTEMBER 27TH–OCTOBER 3RD 2008 www.economist.com

I WANT YOUR MONEY

Will Paulson's plan work?

Print edition September 27th 2008

I want your money
No government bail-out of the banking system was ever going to be pretty. This one deserves support: leader

China's space programme
Shooting the moon

Middle East & Africa

Rwanda and the Great Lakes region
A pioneer with a mountain to climb

Elephants in Congo
Big and helpless

Sudan
Saving the president

Chad
Breaking the bank

Islam
Try to be nice about each other

Abu Dhabi
Family feeling behind the football

Europe

Europe's economies
Struggling to keep moving

Italy's economy
Creeping along

The Spanish civil war
Bones of contention

Georgia and Russia
Tense times

Turkey and Armenia
Friends and neighbours

Charlemagne
Transatlantic model wars

Britain

The Labour Party
Political alchemy

Labour's electoral prospects
Dead-cat bounce

EDF and British Energy
Nuclear renaissance?

Energy supplies
A chill wind

Lloyds TSB and HBOS
Monster mash

HBOS and Scottish politics
Bye bonnie bank

Stalemate in Northern Ireland
A tongue-twister of a dispute

Bagehot
Gordon Brown's 1,001 hours

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

International

Data mining
Know-alls

Earthquake detection
Shake it all about

The Large Hadron Collider
Call a plumber

Books & Arts

Goldman Sachs
Into the whirlwind

Humanitarian intervention
My brother's keeper

Crowdsourcing
A people business

"Battle in Seattle"
The world was watching

The Bloomsbury group
Pantry power

Andrea Palladio
Songs of stones

Obituary

Frank Mundus

Economic and Financial Indicators

Overview

Output, prices and jobs

The Economist commodity-price index

Economic freedom

Trade, exchange rates, budget balances and interest rates

Markets

Asian growth forecasts

Politics this week

Sep 25th 2008
From The Economist print edition

EPA

South Africa's president, Thabo Mbeki, was forced to resign by the leadership of the ruling African National Congress (ANC). This followed a bitter legal and constitutional struggle with Jacob Zuma, who ousted him as party leader last year. Kgalema Motlanthe, an ANC ally of Mr Zuma, will serve as caretaker president until an election in which Mr Zuma is expected to win the post. Mr Mbeki's deputy and ten ministers also resigned, of whom six said they would not serve in a new government. See article

Nearly two weeks after a power-sharing agreement was agreed on in **Zimbabwe**, ministerial posts in a unity government had yet to be allocated. President Robert Mugabe and a large entourage went to New York to attend the annual opening session of the UN's General Assembly.

Heavy fighting resumed in **Somalia's** capital, Mogadishu, as Islamist fighters attacked African Union peacekeepers. Thousands fled the city; some 50 were killed.

Iraq's parliament passed a long-awaited law providing for provincial elections to be held, probably before the end of January, though they had been due next month. Elections in the disputed city of Kirkuk were to be postponed until a separate agreement could be reached.

Speaking at the UN General Assembly, **Iran's** president, Mahmoud Ahmadinejad, denounced "Zionist murderers" and said that a small number of "deceitful" Zionists were manipulating the West. "The Zionist regime is definitely sliding towards collapse," he said. America's "world empire" was "reaching the end of its road".

Guns and bombs

Finland's prime minister called for tougher gun controls after a gunman shot and killed nine students and a teacher at a college in the west of the country before killing himself.

Three car bombs exploded in **Spain's** Basque country. Eleven people were wounded and a Spanish army officer was killed. Subsequently, police in France arrested at least 12 suspected members of the Basque terrorist group, ETA.

In a sign of post-war tensions**, Georgia** claimed it had shot down a Russian drone over its territory. Earlier a Georgian policeman was shot dead at a checkpoint near Abkhazia, one of its breakaway enclaves. See article

A former Chechen rebel commander, Ruslan Yamadayev, was shot dead in central Moscow. His younger brother, Sulim, is now a fierce rival of **Chechnya's** strongman president, Ramzan Kadyrov.

Suffering and innocent

Getty Images

The number of **Chinese children** admitted to hospital after drinking infant-milk formula tainted with melamine climbed to 13,000. Li Changjiang, the head of China's quality-control watchdog, resigned. Four children in Hong Kong have also been diagnosed with kidney stones after drinking milk from the mainland. Many other countries have started testing Chinese dairy products or taking them off shop shelves. See article

Suicide-bombers detonated an enormous bomb outside the Marriott Hotel in the centre of Islamabad, **Pakistan's** capital. It killed 53 people and wounded more than 260. A previously unknown group, Fedayeen Islam, claimed responsibility. A few hours earlier Asif Zardari, Pakistan's new president, made his first speech to parliament. He promised to protect the country's sovereignty, a message he later conveyed to George Bush in New York. Pakistanis have been incensed by recent American raids on militants on their territory. See article

Among 9,002 prisoners granted amnesties by **Myanmar's** ruling junta were a handful of political prisoners, including the longest-serving one, Win Tin. But more than 2,000 are believed still to be detained, including Aung San Suu Kyi, the leader of the opposition. Most analysts thought the releases had been timed to influence opinion at the UN General Assembly session in New York.

Taro Aso easily won an election to become leader of **Japan's** Liberal Democratic Party and was sworn in as prime minister, the country's third new leader in two years. There was speculation that he might call a snap general election, though one does not have to be held until September 2009. See article

North Korea said it planned to restart its plutonium reprocessing plant at Yongbyon, which it had pledged to dismantle as part of a denuclearisation process agreed with America, China, Japan, Russia and South Korea. UN inspectors were asked to remove seals and surveillance cameras from the plant. See article

Time to talk

Barack Obama and John McCain were due to meet in Oxford, Mississippi for the first of their three eagerly awaited **presidential debates**. But Mr McCain appealed for a delay while Congress attempted to tackle the financial crisis. Mr Obama declined one, leading to impasse. See article

The vice-presidential debate is not until next month, but the Republican nominee, **Sarah Palin**, has been preparing. She was in New York this week, where she met no fewer than seven world leaders, including Afghanistan's Hamid Karzai.

Residents returned to **Galveston**, on the Texas coast, and saw for themselves the devastation wreaked by Hurricane Ike. Much of the city's infrastructure, including its port, was badly damaged. Texan politicians asked Congress for $2.2 billion in emergency aid.

Faraway friends

EPA

Russian warships set off to Latin America to take part in joint manoeuvres with **Venezuela**, for the first time since the cold war. Venezuela's president, Hugo Chávez, said Latin America needed a strong friendship with Russia to help reduce the influence of the United States in the region.

President Rafael Correa of **Ecuador** ordered troops to seize the assets of Odebrecht, a big Brazilian construction company, in a dispute over the country's second-largest dam. Built by Odebrecht, it was forced to shut down just one year after being opened. Ecuador has demanded millions of dollars in compensation.

Officials in **Colombia** reported that a rebel commander of the FARC guerrillas, wanted for hundreds of murders and kidnappings, had been killed by government forces in a bombing raid near the western province of Choco. Among the deaths attributed to Aicardo de Jesus Agudelo, better known as El Paisa, were those of eight hostages, including a former defence minister, in 2003.

Business this week

Sep 25th 2008
From The Economist print edition

America's government unveiled a plan to end the **credit crunch** by spending up to $700 billion buying troubled assets from financial institutions. Hank Paulson, the treasury secretary, and Ben Bernanke, the chairman of the Federal Reserve, argued that swift and forceful action was needed to stem growing panic about the soundness of the financial system. But many members of Congress, which must approve the plan, complained variously that the government was seizing too much power, letting reckless bankers off too lightly and failing to help struggling homeowners. See article

The Federal Reserve gave America's last two big investment banks, **Goldman Sachs** and **Morgan Stanley**, permission to change their status to bank holding firms. They will be subject to stiffer regulation, but allowed to take deposits. Goldman Sachs raised $5 billion to shore up its capital by selling shares to Berkshire Hathaway, the firm run by Warren Buffett, a celebrated investor. The next day, it raised $5 billion more from a share offering. Mitsubishi-UFJ, Japan's largest bank, agreed to buy up to 20% of Morgan Stanley for $8.4 billion. See article

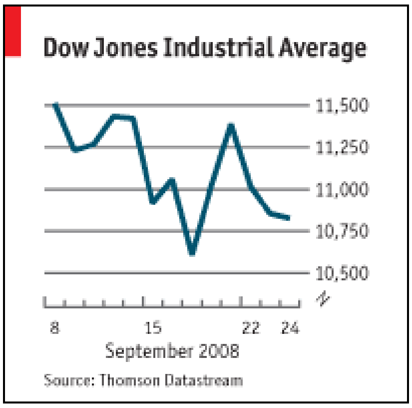
Nomura, a Japanese investment bank, offered to buy bits of the European, Middle Eastern and Asian divisions of **Lehman Brothers**, an American rival that declared itself bankrupt last week, for an undisclosed sum. **Barclays**, a British bank, bought Lehman's main American unit for $250m, and several of its properties for $1.29 billion. See article

The Federal Bureau of Investigation said it was looking into 26 cases of potential **fraud** related to the collapse of America's mortgage industry. The financial institutions under investigation are said to include the now-defunct Lehman Brothers, as well as three failing firms recently taken over by the American government: American International Group, Fannie Mae and Freddie Mac.

In a bid to attract more investment to America's struggling financial sector, the Fed relaxed rules on **bank ownership**. Private-equity firms will now be allowed to own bigger stakes.

White knuckles

It was another tumultuous week for the world's **stockmarkets**. They had been tumbling because of Wall Street's woes, but rallied at the news of the Treasury's planned bail-out. Then Congress's obstreperous response to the plan sent them sliding again. **Money-market** rates, which had been falling, also registered alarm.



Moody's, a rating agency, lowered its outlook for 12 **Russian banks,** despite a government rescue package worth$120 billion. The state-owned Development Bank said it would take over Svyaz Bank, a struggling private one. Meanwhile a fund controlled by Mikhail Prokhorov, a former mining magnate, agreed to buy half of Renaissance Capital, a big Russian investment bank, for $500m.

EDF, a French utility, struck a deal to buy **British Energy**, a partially state-owned nuclear-power firm, with a slightly improved offer of £12.5 billion ($23 billion). EDF said it was involved in talks to sell a stake in British Energy to **Centrica**, a British utility. Meanwhile the board of **Constellation**, an American utility and energy-trading firm, rejected EDF's offer to buy it for $6.2 billion. Instead it accepted a much lower offer from Berkshire Hathaway on the ground that it could be completed more quickly. The decision prompted lawsuits from several disgruntled shareholders. See article

Shell shock

The government of **Iraq** and **Royal Dutch Shell**, a big energy firm, plan to set up a joint venture to collect and sell gas from Iraq's southern oilfields. The deal is the first in the country involving a Western oil firm since Iraq nationalised its oil industry in 1972.

Chrysler, America's third-biggest carmaker, said it had lost $400m so far this year. At the same time, it tried to dispel doubts about its future by unveiling prototypes for three different electric vehicles, including a sports car.

Warm up

Six American states were due to set the country's first mandatory **cap-and-trade** scheme to combat global warming in motion on September 25th with an auction of permits to emit greenhouse gases. The Regional Greenhouse Gas Initiative will impose a limit on emissions from big power stations in ten north-eastern states from the beginning of next year.

T-Mobile, a telecoms firm, unveiled the first mobile phone to use Android, operating software developed by **Google**, an internet-search giant. Android is designed, among other things, to make it easier for people to access the internet from their phones. Google also plans tie-ups with other handset-makers. See article

KAL's cartoon

Sep 25th 2008
From The Economist print edition

Illustration by KAL

America's bail-out plan

I want your money

Sep 25th 2008
From The Economist print edition

No government bail-out of the banking system was ever going to be pretty. This one deserves support

SAVING the world is a thankless task. The only thing beyond dispute in the $700 billion plan of Hank Paulson, the treasury secretary, and Ben Bernanke, chairman of the Federal Reserve, to stem the financial crisis is that everyone can find something in it to dislike. The left accuses it of ripping off taxpayers to save Wall Street, the right damns it as socialism; economists disparage its technicalities, political scientists its sweeping powers. The administration gave ground to Congress, George Bush delivered a televised appeal and Barack Obama and John McCain suspended the presidential campaign. Even so, as *The Economist* went to press, the differences remained. There was a chance that Congress would say no.

Spending a sum of money that could buy you a war in Iraq should not come easily; and the notion of any bail-out is deeply troubling to any self-respecting capitalist. Against that stand two overriding arguments. First this is a plan that could work (see article). And, second, the potential costs of producing nothing, or too little too slowly, include a financial collapse and a deep recession spilling across the world: those far outweigh any plausible estimate of the bail-out's cost.

Mr Market goes to Congress

America's financial system has two ailments: it owns a huge amount of toxic securities linked to falling house prices. And it is burdened by losses that leave it short of capital (although the world has capital, not enough has been available to the banks). For over a year, since August 2007, central bankers, principally Mr Bernanke, have been trying to make this toxic debt liquid. But by September 17th, following the bankruptcy of Lehman Brothers and the nationalisation of American International Group earlier that week, the problem started to become one of the system's solvency too. The market lost faith in a strategy that saved finance one institution at a time. The economy is not healing itself. If credit markets stay blocked, consumers and firms will enter a vicious spiral.

Mr Paulson's plan relies on buying vast amounts of toxic securities. The theory is that in any auction a huge buyer like the federal government would end up paying more than today's prices, temporarily depressed by the scarcity of buyers, and still buy the loans cheaply enough to reflect the high chance of a default. That would help recapitalise some banks—which could also set less capital aside against a cleaner balance sheet. And by creating credible, transparent prices, it would at last encourage investors to come in and repair the financial system: this week Warren Buffett and Japan's Mitsubishi-UFJ agreed to buy stakes in Goldman Sachs and Morgan Stanley. Some banks would still not have enough capital, but under Mr Paulson's original plan, the state could put equity in them, or, if they become insolvent, take them over and run them down.

The economics behind this is sound. Government support to the banking system can break the cycle of panic and pessimism that threatens to suck the economy into deep recession. Intervention may help taxpayers, because they are also employees and consumers. Although $700 billion is a lot—about 6% of GDP—some of it will be earned back and it is small compared with the 16% of GDP that banking crises typically swallow and trivial compared with the Depression, when unemployment surged above 20% (compared with 6% now). Messrs Bernanke and Paulson also have done well by acting quickly: it took seven years for Japan's regulators to set up a mechanism to take over large broke banks in the 1990s.

Could the plan be better structured? Some economists want the state to focus on putting equity into the banks—arguing that it is the best way to address their lack of solvency. In theory you would need to spend less, because a dollar of new equity would support $10 in assets. Yet the banks might not take part until they were on the ropes and, if house prices later fell dramatically more, the value of the banks' shares would collapse. The threat of the government taking stakes would scare off some private investors. And in the charged atmosphere after this bail-out meddling politicians, as part-owners, would have a tempting lever over the banks.

Mr Paulson's plan also has its shortcomings. He will find it hard to stop sellers from rigging auctions, if only because no two lots of dodgy securities are exactly the same. Taxpayers may thus pay over the odds and banks may be rewarded for their stupidity. Yet these costs seem small against the benefit of putting a floor under the markets. And fine calculations about moral hazard are less pressing when investors are fleeing risk.

If the economics of Mr Paulson's plan are broadly correct, the politics are fiendish. You are lavishing money on the people who got you into this mess. Sensible intervention cannot even buy long-term relief: the plan cannot stop house prices falling and the bloated financial sector shrinking. Although the economic risk is that the plan fails, the political risk is that the plan succeeds. Voters will scarcely notice a depression that never happened. But even as they lose their houses and their jobs, they will see Wall Street once again making millions.

Buckle a little, but do it briefly

In retrospect, Mr Paulson made his job harder by misreading the politics. His original plan contained no help for homeowners. And he assumed sweeping powers to spend the cash quickly. He was right to want flexibility to buy a range of assets. But flexibility does not exclude accountability. As complaints mounted, Mr Paulson and Mr Bernanke buckled—agreeing, for instance, to more oversight. Now that Messrs McCain and Obama have returned to Congress to forge a deal, more buckling may be necessary. Ideally, concessions should not outlast the crisis: temporary help for people able to stay in their houses, a brief ban on dividends in financial firms, even another fiscal package. They should not be permanent or so onerous that the programme fails for want of participants—which is why proposed limits on pay are a mistake (see article).

Mr Paulson's plan is not perfect. But it is good enough and it is the plan on offer. The prospect of its failure sent credit markets once again veering towards the abyss. Congress should pass it—and soon.

Economist.com OPINION LEADERS

Pay and the financial crisis

Questions of equity

Sep 25th 2008
From The Economist print edition

Salary caps are a rotten idea; but the crisis also carries lessons for regulators and workers

Illustration by David Simonds

IT IS easy to understand why many in Congress and beyond have demanded salary caps on bank executives as a condition of approving the Bush administration's bail-out of the financial system. After all, many of the people who will be leading the effort to get the banks back on their feet were the very same masters of the universe whose greed and myopia brought the industry to its knees in the first place. Nonetheless the lawmakers' apparent decision to impose some form of still unspecified wage limit, a demand reluctantly accepted by Hank Paulson and the Bush administration this week, is a mistake.

Just now, it is a struggle to keep a straight face when you read the words "talent" and "Wall Street" in the same sentence. And yet, precisely because it is in a mess, the financial system will need decent managers if it is to return to the health that benefits the rest of the economy. The sort of sums that would satisfy Congress as a cap may be far above the incomes of average Americans, but there is no surer way of driving finance offshore or into hedge funds where it is beyond the gaze of regulators. Besides, if ever there was a time when pay in banking and broking is likely to be depressed by the market, it is now. The bubble did not only inflate asset prices, it also inflated pay. Now the bubble has burst and hundreds of thousands of finance professionals want work.

American politicians have a lamentable record of intervening in setting executive pay. In the early years of the Clinton administration, Congress imposed a salary cap of $1m, beyond which firms faced a tax penalty. Pay rose, as one set of executives, beneath the cap, realised that they were "underpaid" and another set gained from an outpouring of creativity, as consultants invented myriad option schemes, perks and pension benefits to get around the limit. This only made it harder for shareholders to know who was getting what.

If the foolishness of Congress setting corporate pay levels is an old lesson, the financial crisis is teaching some new ones to shareholders. First, forget the received wisdom that paying people in large amounts of shares in their own firm ensures they take sensible value-maximising decisions. In the collapse of Lehman Brothers and Bear Stearns, the management did not just take reckless gambles with other people's money. Dick Fuld and Jimmy Cayne took reckless gambles with their own—and still they failed to do the right things and ended up losing most of their fortunes. Outside shareholders should remember that loading up the people at the top with shares can be an aid to corporate governance, but not a substitute for it.

Esop's fables

For employees, the tale of Lehman, especially after Enron, is a reminder of the danger of having too many savings tied up in the firm where you work. More of the truly talented will now demand their bonuses in cash, or perhaps ask for even more shares. That surely will have an effect on the way that firms recruit staff and on employee share-ownership schemes. Paying ordinary workers in shares is expensive—because equity is costly to issue and discounted by employees. And the idea that ordinary workers who own shares in their firm will stop senior managers taking bad decisions has taken another knock.

The structure of bonus schemes is more important than their level—especially in finance. Foolish short-term risk-taking could be discouraged by matching the timing of bankers' pay to the timing of the risks they are trading. Britain's Financial Services Authority may ask banks to put up more capital if their pay structures are dangerously risky. That makes far more sense than capping pay. But in the end companies and shareholders are better at setting salaries than bureaucrats.

South Africa

Queasy about the future

Sep 25th 2008
From The Economist print edition

Thabo Mbeki was a rotten president. Fingers crossed that Jacob Zuma, plainly flawed, will be better

Reuters

Get article background

FOURTEEN years after apartheid was flushed down the sewer of history, South Africa has entered a less-than-fragrant era of murky internecine politics inside the ruling African National Congress (ANC). A bad president, Thabo Mbeki, has been ousted by his own party, which is almost certain to replace him, after an awkward hiatus that may last until a general election in the summer, with Jacob Zuma, a canny populist with a rackety personal and financial record (see article). It is a far cry from the early years of a newborn rainbow nation under the magnificent healing presidency of Nelson Mandela.

South Africa is the continent's most successful country. It has a vibrant economy. Its GDP amounts to a third of all of sub-Saharan Africa's 48 countries. It has a fine constitution, robust institutions, a strongish judiciary, open political debate and an array of good people from all points of its multicoloured spectrum bent on making it a beacon for the rest of Africa. Its influence as a continental peacemaker and economic engine has generally been beneficial. But it sorely needs better leadership.

It is good that Mr Mbeki has gone. He has been a grave disappointment. He started well as Mr Mandela's chief technocrat, playing an impressive part in the early years in getting the ANC to chuck its old Soviet-sponsored socialism. But he lost his way, surrounded himself with yes-men and became grossly intolerant of opposition, in the ANC and beyond.

Several things stand out. First, his bizarre reluctance to respond rationally to the plague of HIV/AIDS, dabbling instead in the dottiest fringes of unscientific hocus-pocus, may have caused millions of needless deaths; 5.5m of South Africa's 49m people are afflicted by the virus. Only belatedly has a proper antiretroviral treatment programme been rolled out.

The second big blot on his record has been his failure to bring South Africa's diplomatic, economic and moral weight to bear on Robert Mugabe's tyranny in Zimbabwe. Mr Mbeki's defenders claim that his perseverance has brought about the recent power-sharing agreement. Not so. If he had acted more firmly from the start, Zimbabwe could have been saved years of misery.

Third, Mr Mbeki has squandered much of the interracial goodwill created miraculously by Mr Mandela. When faced with legitimate criticism on issues such as AIDS and crime, all too often Mr Mbeki has responded with unwarranted accusations of racism at any white person who disagrees with him. Yet if he disenchanted many of South Africa's whites (see article), he has also signally failed, because of his aloofness and arrogance, to win the trust of South Africa's black masses.

Will the next man be better?

By comparison, Mr Zuma, his presumed successor, has many admirable qualities. He is better with people. He can listen and empathise. His inner toughness was honed during ten years as a political prisoner on Robben Island. Later, as head of the ANC's intelligence service in the anti-apartheid struggle, he proved a wily operator. In the early years of freedom he helped calm tension between the ANC and a party backed by many Zulus, his own ethnic group. He is liked by the poor, the trade unions and the Communist Party. But he is a pragmatist who has sought, so far successfully, to reassure the country's capitalists that he will not lurch to the left. It is important that the laudable finance minister, Trevor Manuel, keeps his job.

Yet Mr Zuma has grave defects too. He alters his tune to please his audience. Though charges of fraud have twice been dropped on technicalities, a cloud of financial impropriety hangs over him. He was acquitted of rape but revealed, during his trial, a striking ignorance of HIV/AIDS, not to mention a chauvinist attitude to women, to put it mildly. His friends have reviled the independent judiciary in virulent terms, with little reproach from Mr Zuma. It is unclear, after many years at the heart of a liberation movement that tends to identify the interests of party and state as much the same, how genuinely he accepts the constraints of a pluralist parliamentary system.

In the longer run, the country needs a more competitive democracy, for it is in danger of becoming a de facto one-party state under the ANC. It may be better if the ANC splits (which could yet happen). If Mr Zuma is a true democrat, he should seek to change South Africa's party-list system which means that MPs are elected on the basis of party loyalty rather than directly by the ordinary voters. This has helped engender a culture of patronage, sycophancy and authoritarianism.

Ideally, a better person should succeed Mr Mbeki. The caretaker president, Kgalema Motlanthe, may do so well in the next few months that calls could grow for Parliament to elect him as Mr Mbeki's permanent successor. That is improbable. The ANC looks set to replace a bad leader with one who will make South Africa's well-wishers more than a little queasy.

North Korea

Dealing with an impossible regime

Sep 25th 2008
From The Economist print edition

North Korea is changing from the bottom: it needs more delicate handling than ever

Reuters

IN HIS last such speech as president, George Bush told the UN General Assembly this week that the world must stay vigilant against nuclear proliferation. And so it must. For on his own watch, Mr Bush has so far been unable to stop Iran from enriching uranium in what many presume to be a quest for a bomb, or to make North Korea give up the nuclear weapons it has already tested. Indeed, on September 24th, the day after Mr Bush spoke, North Korea barred nuclear inspectors from its reprocessing plant at Yongbyon, and said it intended to reintroduce nuclear material in a week's time.

Dismantling Yongbyon was a central part of the disarmament deal hammered out in six-party talks between North Korea, United States, China, Japan, South Korea and Russia. But the North's threats to restart the complex are no surprise. The regime of Kim Jong Il is capable of extreme brutality towards its own people, whom it uses as hostages to extort aid. It is also a master of nuclear brinkmanship, which it also uses for extortion. It was angry that America has not yet removed it from the list of states sponsoring terrorism. But that is because the North has not yet come clean about its proliferation activities.

So far, so familiar. However, two things make dealing with North Korea even more delicate than usual right now. One is that the autumn harvest has brought mounting signs of a new famine. This will make it difficult to apply the pressure needed to make Mr Kim honour his nuclear deal. Outsiders can hardly just stand by and watch millions starve. The hungry will need help, even if some of the help is filched by the country's bloated armed forces. America is still providing food and energy aid. To minimise diversion, as much food as possible should be monitored, not just handed over on trust.

The end of the line?

The second complication is that North Korea is changing. Rumours have it that Mr Kim is ill, maybe following a stroke. His passing would be no tragedy in itself, but it is far from certain that the regime would collapse like a puffball as a result of it. A successor might crack down with renewed vigour, or rival factions might fight it out, causing a humanitarian disaster.

Even if Mr Kim is in fact in rude health, the country is changing in other ways. As our special report in this week's issue argues, the North's largely improvised response to the last famine has brought some dramatic shifts. Informal markets have sprung up across the country, while cross-border exchanges with China have transformed what North Koreans know about the outside world. Mr Kim's country is no longer quite the closed-off Stalinist place it was. The state no longer has all the means it used to have to shape “correct” behaviour.

This makes Mr Kim vulnerable—in ways the outside world should exploit. That will be easier if America, China, Japan, South Korea and Russia, the five countries that pushed for the deal with Mr Kim, stand tough together against the North’s attempts to renege on it. Indeed, there is value in their sticking together even if the North has no intention of giving up its bomb. The six-party framework is as good as anything yet tried with North Korea; it also draws together the countries that will have to co-operate in the event of the regime’s collapse.

One of the worst-kept secrets in North-East Asia is that its neighbours dread the regime’s collapse, given the costs that picking up the pieces will entail. But such a regime cannot last for ever. In the meantime, the policy of outsiders should be neither to prop it up nor shatter it to pieces, but to use a mix of hard and soft power to guide it to a soft landing.

China has the most influence, if only it chose to use it, but the West could do more as well. Now that short-wave radios are common in the North, broadcasts from outside should be stepped up. The growing number of defectors leading a second-class life in the South should get the training that will enable them to help when the regime finally falls. And both China and the West should be offering the North’s bureaucrats and students every possibility to visit or study abroad.

Some will say that such actions pander to a repellent elite. But they will also more quickly convince its members that their archaic system is living on borrowed time—and mean that some competence is on hand when time is called.

British politics

No time for old hands either

Sep 25th 2008
From The Economist print edition

Neither Labour nor the Conservatives are offering the economic leadership they should

AFP

BRITONS who poke fun at the endless reality show that is America's presidential race might spare a thought for their own party-conference rituals. For three weeks (following a long summer holiday) parliamentary business is suspended while politicians go off to contemplate their partisan navels. This week it was the turn of ruling Labour: Gordon Brown enlisted his nice wife to help him make the speech that would buttress his beleaguered premiership (see article). Next week David Cameron will seek to fire up the Conservative Party he leads (with, no doubt, the fragrant Samantha by his side).

The sense of unreality in all this is dumbfounding. Most obviously, the revels seem out of touch with what is actually happening on the ground: banks are tottering, share prices plummeting and a mood of paralysed pessimism grips the country. But there is also something rather delusional in the way both parties imagine they are profiting from the crisis.

Take Mr Brown first. “This is no time for a novice,” he claimed this week—a pointed reference to Mr Cameron's slim curriculum vitae in economic management. In Mr Brown's view, he is the experienced hand. As chancellor of the exchequer before becoming prime minister, he sailed the (admittedly benign) seas of his decade at the Treasury in some style. Now that Britain has been assailed by storms beyond anyone's control, how lucky the nation is to have a captain at the helm who knows these seas—who can recalculate derivatives in his head, who has the telephone numbers of the world's financial establishment on his mobile. The great man duly disappeared off to New York after his conference to add some intellectual weight to the regulators gathered there.

Alas for Mr Brown, there are more holes in this picture than in Lehman Brothers' balance sheet. The global credit crunch and high commodity prices may indeed have been beyond his control, but the depletion of the Treasury he ran and the erratic supervision of financial services that he set up emphatically were not (there must surely be a time limit on the praise he deserves for freeing the Bank of England). The fact that he showed some resolve over the forced merger of HBOS with Lloyds TSB announced on September 18th does not make up for his dithering over Northern Rock last year. It is welcome that he has belatedly apologised for his role in the 10% tax fiasco; but this was also the man who assured the country that the boom-and-bust era was over. Whatever that meant, it did not mean taking credit for the boom and disowning the bust.

Hornblower or horn blower

If Mr Brown is an old sea dog with a questionable memory and a suspiciously large number of shipwrecks behind him, the Tories' problem is they do not seem to have put to sea at all. They have skimped on details when it comes to explaining what they would do differently from Mr Brown (other than saying he is handling the crisis badly). This is surely in part because they once believed Mr Brown: when the young Tories began to refashion their party three years ago, they accepted his notion that a smooth economy was a done deal, so they deployed their energies ridding their party of the nasty illiberal image on social issues that Mr Cameron's predecessors had managed to cultivate. But it also seems to be because, until recently 20 points ahead in the polls, they think staying relatively mum is the safe option. They are wrong for two reasons.

First, the economy could still hurt the Tories. Mr Brown is probably destined for Davy Jones's locker, but his attacks on Mr Cameron's lack of economic conviction will still score points; and that front could be broadened if Mr Brown were replaced by another, less tarnished, Labour figure. Second, the economic crisis has opened up a debate about the role of the state in the economy. The left, understandably, sees the current turmoil as an opportunity to extend that role.

This is a dangerous moment for capitalism. It needs all the friends it can get. The reaction to the crisis is bound to go too far, and allow the state to get too big. The Tories need to show that they believe in capitalism, and stand up for it clearly and loudly. Next week would be a good time to start.

On global warming, Islamic finance, Biogen Idec, traffic jams, the Balkans, American rednecks

Sep 25th 2008
From The Economist print edition

Cooling the planet

SIR – Your assertion that "global warming is happening faster than expected" exhibits a disturbing degree of cognitive dissonance ("Adapt or die", September 13th). Since 1998 the world's average surface temperature has exhibited no warming, according to all the main temperature records. The trend has been a combination of flatlining and cooling, with a marked plunge over the past year; many countries, including Australia, Canada, China and the United States, experienced severe winters.

Moreover, recent work demonstrates that the Earth's temperature may stay roughly the same for at least a further decade through the impact of the Atlantic Multidecadal Oscillation. In addition, the next 11-year cycle of solar storms—Solar Cycle 24—is late by more than two years. The sun is currently spotless, conditions that obtained during the "Dalton Minimum", an especially cold period that lasted several decades starting from 1790 and which was implicated in the rout of Napoleon's Grand Army during the retreat from Moscow in 1812.

Finally, one expert, Victor Manuel Velasco Herrera of the National Autonomous University of Mexico, has gone so far as to give warning that the Earth may enter a new "Little Ice Age" for up to 80 years because of decreases in solar activity. The immediate portents thus point in the direction of a cooling period.

Whatever one thinks about longer-term trends in world average temperatures and their possible relationship with carbon emissions, it cannot be claimed that currently "global warming is happening faster than expected". It troubles me when a publication with the standing of *The Economist* permits such a gap between observed reality and political rhetoric.

Philip Stott
Emeritus professor of biogeography
University of London
London

SIR – In tackling climate change, there is no need for a crystal ball to see which technologies would set us on the road to reducing carbon emissions ("The world in a test tube", September 6th). More efficient vehicles, better building-control systems and the next generations of offshore wind-power and biofuels are at, or near, commercial deployment. These technologies, which will deliver emissions cuts within the next ten years, should be fast-tracked to receive R&D funding.

In the medium term, a robust carbon market will help to drive investment in low-carbon technologies. To reduce the uncertainties of the longer term, key technologies, such as marine power (both wind and wave), should be the focus of investment, rather than trying to pick individual winners within these areas.

Neil Bentley
Director of business environment
Confederation of British Industry
London

Financial products

SIR – I was surprised at your positive treatment of Islamic finance ("Savings and souls", September 6th). Islamic finance taps into a captive market where people pay a premium in order to buy products that differ mostly in semantic terms from their mainstream alternatives.

These products are sanctioned by a select group of self-appointed scholars, who receive a tidy fee for their troubles, and have an interest in maintaining strict barriers to entry. Most users of such products doubtless do so sincerely, but I expected you to condemn those who sell them as old-fashioned rent-seekers.

Philip Blue
London

Biogen Idec

SIR – Your article about some recent attempts to buy big biotech firms mentioned Biogen Idec's decision to seek a buyer in 2007 ("Convergence or conflict?", August 30th). Biogen Idec's board decided to explore a sale to deliver greater value for shareholders through an acquisition. It made that decision only weeks after Carl Icahn disclosed his stake in Biogen Idec and shortly after he made a purported offer to buy the company. We conducted a thorough and professional sale process, but after two months no offer was received. Three independent proxy advisory services reviewed the sales process and concluded it was fair and earnest.

Shareholders voted overwhelmingly to elect the board's nominees and rejected the candidates Mr Icahn put forward in his proxy contest. May I add that Biogen Idec's board maintains its commitment to deliver significant shareholder value.

Timothy Hunt
Vice-president for public affairs
Biogen Idec
Cambridge, Massachusetts

Join the queue

SIR – It may be of interest to your readers to know that it was actually economists who first figured out that an individual's selfish behaviour when selecting an optimal travel route would yield different traffic flows and times than if one were to assign flows in a centralised manner to try and minimise the cost to society ("Queuing conundrums", September 13th). Arthur Pigou wrote "The Economics of Welfare" in 1920, by which time he was well aware of the distinction between different traffic behaviours.

Curiously, traffic and queuing problems keep on getting (re)discovered by different disciplines; now it seems to be the turn of the physicists.

Anna Nagurney
Director
Virtual Centre for Supernetworks
Isenberg School of Management
University of Massachusetts
Amherst, Massachusetts

The empire strikes back

SIR – That many in the Balkans still harbour fond memories of the Austro-Hungarian empire is quite clear from your review of a book about the assassination of Archduke Franz Ferdinand, the heir-apparent to the imperial throne ("Starting pistol", September 6th). Emperor Franz Josef, who ruled the enlightened multi-ethnic empire from 1848 to 1916, is still remembered by many in Slovenia, Croatia, Bosnia and parts of Serbia with surprising fervour. One can see why the Sarajevo taxi driver quoted was angry about a memorial erected to Gavrilo Princip and his co-conspirators.

What your reviewer misses, perhaps in line with the author of the book, is that the taxi driver's lament offers the best hope for the European Union in the Balkans, where such sentiments are rife. Although foreign rule is widely resented in the region, it nonetheless offers the best hope for the future. The union's authorities would be well advised to exploit these Balkan sentiments as best they could.

Ranko Bon
Motovun, Croatia

Local delicacies

SIR – In America, the redneck is not as homogeneous as Bagehot presumes (September 13th). In Sarah Palin's state of Alaska, there are only two species of tree squirrel. They are both classified as "fur" animals: one has a very minimal amount of meat and the other is nocturnal. Hunting for either, while legal, is non-existent. Consequently, if you did come across someone eating "squirrel gumbo" it would be a very rare occurrence indeed.

By the way, gumbo is a dish of the American South, and is thus less likely to be found on the table of an Alaskan redneck than bear bourguignon.

Douglas Syverson
Newcastle, Washington

South Africa

Dropping the helmsman

Sep 25th 2008 | JOHANNESBURG
From The Economist print edition

AP

As South Africa's president steps down amid a bitter power struggle, we look at his achievements, the doubts about his successor and the souring mood of the country

Get article background

THABO MBEKI, South Africa's president (above right), has had a spectacularly bad year. First came a humiliating defeat in December, when the ruling African National Congress (ANC) elected Jacob Zuma (above left), the country's former deputy president, to replace him as the party's head. Mr Mbeki had sacked Mr Zuma in 2005. Then, on September 20th, the ANC decided he should step down "in the interest of making the country move forward". This cut short his term as president; Mr Mbeki was supposed to stay until the general election, expected in April. Instead, he unprotestingly bowed out.

ANC leaders, desperate to calm things down, talked of continuity and stability and asked cabinet members to stay. Instead, two days after Mr Mbeki announced that he was going, the deputy president and ten ministers followed, shocking the ANC to the core. The ministers included Trevor Manuel, in charge of finance and responsible for South Africa's impressive economic performance. The rand and the stockmarket swayed for a while, until Mr Manuel—and some of the others—said they were willing to be reappointed under the new president. The dipping of the rand betrayed the increasingly febrile atmosphere in South African politics, and the worries, both at home and abroad, that the present turmoil in the ANC may yet undermine the economic progress that South Africa has made over the past decade.

On September 25th Parliament elected Kgalema Motlanthe, the ANC's deputy president, to succeed Mr Mbeki. The arrangement is expected to last until the election, after which Mr Zuma—who currently holds no seat in Parliament—will most probably become South Africa's president.

Mr Motlanthe, a former political prisoner and trade unionist, is well respected within both the ANC and the opposition. Soft-spoken and self-effacing, patient and accessible, he has been cast as the voice of reason in the past few months, especially for his put-downs of firebrands such as Julius Malema, the new leader of the ANC Youth League. Mr Motlanthe, whose dream job is to scout young football talent for the ramshackle national team, also seems to have little ambition of his own. If he does well in his interim post, he may become an alternative to Mr Zuma. But the ANC said some time ago that Mr Zuma was its candidate, and Mr Motlanthe himself is a Zuma ally.

The decision to eject Mr Mbeki follows a court ruling earlier this month that struck down, on a technicality, fraud and corruption charges against Mr Zuma. The judge believed that Mr Mbeki and some of his ministers might have leant on the National Prosecuting Authority (NPA) over Mr Zuma's prosecution. Both Mr Mbeki and the NPA say the allegation is nonsense. But it spurred some of Mr Zuma's supporters into thinking him a victim of political conspiracy, and calling for Mr Mbeki's head.

Mr Zuma himself argued at first that there was no point in beating "a dead snake". Instead, the ruling party should focus on uniting itself. But a few days later, after a heated meeting that went on until the early hours of the morning, the ANC's National Executive Committee (NEC) decided that Mr Mbeki had to go. The decision, said Mr Zuma, was "one of the most difficult…the NEC has ever had to take". Scrabbling to mend the obvious cracks, he called Mr Mbeki a comrade and a friend.

In a televised address on September 21st, Mr Mbeki, with his usual poker face, repeated that he had never interfered with the prosecuting authority. (He is now keen to clear his name, and is trying to appeal against part of the judgment.) He also thanked South Africans for the chance to serve, and reminded them that they had some things to thank him for.

Reuters

Can Manuel calm nerves?

During his almost 15 years at the helm—first as Nelson Mandela's deputy, before succeeding him as president in 1999—he was a chief architect of the country's economic recovery. Apartheid left South Africa isolated, divided and stagnant; today the public finances are in good shape, and the government is even running a surplus. South Africa's economy has been growing by an average of over 4.5% a year since 2004, and has so far weathered the global turmoil relatively well. Unemployment, which rose sharply after 1994, has been falling slightly over the past few years, although it is still around 25%, and almost 40% if using a broader measure.

Mr Mbeki helped to put Africa back on the global map, and encouraged an African renaissance which, ideally, was meant to inspire the continent to find African solutions to Africa's problems, instead of always depending on Western aid. Since the end of apartheid, South Africa has moved from pariah to regional champion: an achievement to be crowned, in this football-mad country, by hosting the 2010 World Cup. Mr Mbeki himself has helped mediate conflicts across the region, from Burundi to the Congo. Earlier this month he presided over a power-sharing deal in imploding neighbouring Zimbabwe.

But there are big shadows on this picture. Mr Mbeki's resistance to the scientific evidence on HIV/AIDS has cost countless lives in a country where 5.5m carry the virus and where AIDS is thought to kill more than 800 people a day. Antiretroviral drugs are now available through public clinics and hospitals, but Mr Mbeki's revisionist stance has sowed deadly confusion and fear. Violent crime and deep social inequalities continue to plague the country (see article). The crippling power cuts that shut down the country's mines earlier this year exposed unforgivably poor planning. Abroad, Mr Mbeki appeased Zimbabwe's Robert Mugabe for far too long while the country sank into ruin.

But it was his leadership style, more than anything else, that brought him down. Mr Mbeki was accused of centralising power in his own hands and criticised for his arrogance and aloofness. Mark Gevisser, his biographer, depicts a troubled man often racked by political paranoia. He rewarded loyalty over competence and ruthlessly sidelined rivals and dissenters, creating a coalition of the wounded that coalesced around Mr Zuma. The ANC's trade-union and communist allies felt increasingly ignored.

The watershed came with Mr Mbeki's firing of Mr Zuma in 2005, after Mr Zuma's financial adviser was indicted for fraud and corruption. A growing number of ANC activists and heavyweights began to oppose him. Mr Mbeki's shielding of Jackie Selebi, the country's police chief, who is himself facing corruption charges, only added fuel to the fire. His decision to run for a third term as president of the ANC against Mr Zuma was the last straw. Mr Mbeki ignored the fact that most of the party's provincial structures had endorsed Mr Zuma, and suffered a sharp defeat. Since then, the government has sunk into semi-paralysis. But despite that, many South Africans feel that Mr Mbeki should have been allowed to finish his term.

The ruling party, still squabbling over power and positions after the change of guard in December, is not keen on an early general election for which it does not feel ready. It is certain to win the next poll, but the opposition, which has won back the city of Cape Town, could wrest at least the Western Cape province from the ruling party. An increasing number of voters, disheartened by the ANC's in-fighting and Mr Mbeki's departure, may also decide to stay home on election day.

Rumours abound that supporters of Mr Mbeki, led by Mosiuoa Lekota, the minister of defence (who has just resigned) may split and form a new party to contest next year's election. Several of the ministers who have resigned are outraged, and will not serve in the new government. Serious discussions are said to be under way, and money available. A number of middle-class ANC supporters, not necessarily fans of Mr Mbeki's, are also appalled at the idea of a Zuma administration. But they may have neither the courage nor the strength to split the former liberation movement now, with so little time left before the elections. And the ANC leaders, if they manage the transition wisely, should be able to keep the party together for a while. The ANC has been predicted to split many times before, but never has.

The Zuma road

What should be expected of the new administration, especially when Mr Zuma takes over after next year's election? The ANC president is everything Mr Mbeki is not: expansive, relaxed, and with his political ear to the ground. His negotiating skills came in handy when KwaZulu Natal was on the brink of civil war in the 1990s. His leadership of the ANC since he was elected president in December appears far more collegial than Mr Mbeki's, and he is likely to be a less interfering president.

At best, this could mean a more inclusive leadership. But it could also mean no leadership at all. Mr Zuma has shown little desire to rein in, let alone speak against, some of his supporters' intemperate remarks, both about his trial for rape in 2006 (he was cleared) or his corruption charges. His supporters, who include trade unionists but also business heavyweights such as Tokyo Sexwale, may be left fighting for fiefs unless he provides clear direction.

So far, Mr Zuma has been working hard to repair relations with those who felt alienated under Mr Mbeki, from trade unions to poor Afrikaners (whites of mainly Dutch descent). The new ANC team has been making all the right noises about the country's creaking public services, although it is unclear how they will overhaul them. They have repeated that there will be no change of economic direction. But Mr Zuma finds it easier to tell people what they want to hear than to articulate a vision. He may also have to concede ground to his left-wing allies. Once in power, he will have to disappoint some among his motley band of supporters; it is unclear who he will choose to ignore.

With a lot of new ministers to appoint, the new ANC leaders will have to show their hand earlier than expected. About half of the ministers who walked out say they would be willing to serve under a new president. The main test will be whether Mr Motlanthe reappoints Mr Manuel as finance minister, which would clearly indicate that the government intends to stay its economic course. It looks likely: the ANC has said it wants to keep all the ministers in place. Trade unions and the Communist Party have been pushing to have more say over appointments, but may not get their way.

Less clear is what will happen to the corruption and fraud charges against Mr Zuma. The new ANC leadership wants the whole thing dropped, arguing that he has been treated unfairly and that this is dividing the country. This may explain why Mr Zuma is not becoming president straight away; the ruling party is hoping that, by the next election, the charges will be buried for good. But the opposition says he still has a case to answer. The wheels of justice have been grinding so slowly that there is no chance of Mr Zuma standing in the dock before the election, if at all. Although the NPA has said it intends to appeal against the invalidation of the charges, no papers have been filed yet. The next few months will show whether the ruling party's new leaders are able to resist doing what they accuse Mr Mbeki of: meddling with the prosecution for political ends.

Economist.com WORLD MIDDLE EAST & AFRICA

White flight from South Africa

Between staying and going

Sep 25th 2008 | JOHANNESBURG
From The Economist print edition

Violent crime and political turmoil are adding to South Africa's brain drain

Get article background

FIRST he thought it was a mouse, then a rat—and then the rat shot him in the face. That is how André Brink, one of South Africa's most famous novelists, described the recent killing of his nephew Adri, at home at 3am in the morning. The young man was left to die on the floor, in front of his wife and daughter, while his killers ransacked the house.

Such murders are common in South Africa. According to Mr Brink's account, published later in the *Sunday Independent*, 16 armed attacks had already taken place in a single month within a kilometre of the young couple's plot north of Pretoria, South Africa's capital. Soon afterwards—this is more unusual—the police arrested a gang of six. They recovered a laptop and two mobile phones. That was the haul for which Adri paid with his life.

A decade-and-a-half after the end of apartheid, violent crime is pushing more and more whites out of South Africa. Exactly how many are leaving is impossible to say. Few admit that they are quitting for good, and the government does not collect the necessary statistics. But large white South African diasporas, both English- and Afrikaans-speaking, have sprouted in Britain, Australia, New Zealand and many cities of North America.

The South African Institute of Race Relations, a think-tank, guesses that 800,000 or more whites have emigrated since 1995, out of the 4m-plus who were there when apartheid formally ended the year before. Robert Crawford, a research fellow at King's College in London, reckons that around 550,000 South Africans live in Britain alone. Not all of South Africa's émigrés are white: skilled blacks from South Africa can be found in jobs and places as various as banking in New York and nursing in the Persian Gulf. But most are white—and thanks to the legacy of apartheid the remaining whites, though only about 9% of the population, are still South Africa's richest and best-trained people.

Talk about "white flight" does not go down well. Officials are quick to claim that there is nothing white about it. A recent survey by FutureFact, a polling organisation, found that the desire to emigrate is pretty even across races: last year, 42% of Coloured (mixed-race) South Africans, 38% of blacks and 30% of those of Indian descent were thinking of leaving, compared with 41% of whites. This is a big leap from 2000, when the numbers were 12%, 18%, 26% and 22% respectively. But it is the whites, by and large, who have the money, skills, contacts and sometimes passports they need to start a life outside—and who leave the bigger skills and tax gap behind.

Another line loyalists take is that South Africa is no different from elsewhere: in a global economy, skills are portable. "One benefit of our new democracy is that we are well integrated in the community of nations, so now more opportunities are accessible to our people," Kgalema Motlanthe, now South Africa's president, told *The Economist*. And to some extent it is true that the doctors, dentists, nurses, accountants and engineers who leave are being pulled by bigger salaries, not pushed by despair. But this is not the whole story. Nick Holland, chief executive of Gold Fields, a mining company, says that in his firm it is far commoner for skilled whites to leave than their black and Indian counterparts. "We mustn't stick our heads in the sand," he says. "White flight is a reality."

Another claim is that a lot of leavers return. Martine Schaffer, a Durbanite who returned to South Africa herself in 2003 after 14 years in London, now runs the "Homecoming Revolution", an outfit created with help from the First National Bank to tempt lost sheep back to the fold. And, yes, a significant number of émigrés do come home, seduced by memories of the easeful poolside life under the jacaranda trees, excited by work opportunities or keen—perhaps after having children themselves—to reunite with parents who stayed behind.

In some cases, idealism remains a draw. Whites who left in previous decades because they were repelled by apartheid, or who expected apartheid to end in a bloodbath, can find much to admire. Whites build tall walls around their houses and pay guards to patrol their neighbourhoods; they consider some downtown areas too dangerous to visit. But on university campuses and in the bright suburban shopping malls it is still thrilling to see blacks and whites mingling in a relaxed way that was unimaginable under apartheid.

Reasons not to panic?

So South Africa certainly has its white boosters. Michael Katz, chairman of Edward Nathan Sonnenbergs, a law firm in Johannesburg, hands over a book with the title “Don’t Panic!”, a collection of heartwarming reflections by disparate South Africans on why there is, even now, no better place than home. Mr Katz ticks off the pluses as he sees them: minimal racial tension (a third of his own firm’s 350 professionals are black); a model constitution that entrenches the separation of powers and is “revered” by the people; a free press and free judiciary; a healthy Parliament; a vibrant civil society; good infrastructure and a banking system untouched by the global credit crunch. The “one major negative” Mr Katz concedes is violent crime. If only this could be brought under control, he says, the leavers would return.

But would they? Violent crime is undoubtedly the biggest single driver of emigration, the one factor cited by all races and across all professions when people are asked why they want to go. Police figures put the murder rate in 2007-08 at more than 38 per 100,000 and rape at more than 75 per 100,000. This marks a big fall over the past several years, but is still astronomical by international standards (the murder rate was 5.6 per 100,000 in the United States last year). It has reached the point where most people say they have either been victims of violent crime themselves or know friends or relatives who have been victims. Typically, it is a break-in, carjacking, robbery or murder close to home that clinches a family’s long mulled-over decision to leave.

All the same, crime is far from being the only cause of white disenchantment. Some say that 2008 brought a “perfect storm”. A sequence of political and economic blows this year have buffeted people’s hope. Added together they provide reason to doubt whether the virtues ticked off by the exuberant Mr Katz—a model constitution, separation of powers, good infrastructure and so on—are quite so solid.

Good infrastructure? At the beginning of the year South Africa’s lights started to go out, plunging the thrumming shopping malls and luxury homes into darkness and stopping work in the gold and diamond mines. This entirely avoidable calamity was caused by a distracting debate about the role of the private sector in electricity supply. Eskom, the state-owned utility in which many experienced white managers had been too quickly pushed aside, is now investing again in new plant under a new chairman, Bobby Godsell, a veteran mining executive. But for the time being power will remain in short supply and rationing and blackouts will continue.

As for that model constitution and the separation of powers, Desmond Tutu, the retired Anglican archbishop of Cape Town, was moved this week to describe the sordid battle between Jacob Zuma, Thabo Mbeki, the party, government, prosecuting authority and courts as suggestive of a “banana republic”. As well as being appalled by events at home this past year, whites have watched Robert Mugabe’s pauperisation of neighbouring Zimbabwe and wonder whether South Africa will be next to descend into the same spiral.

Besides, fear of crime cannot be separated from the other factors that make South Africans consider emigration. People who do not feel safe in their homes lose their faith in government. John Perlman, who worked for the SABC, the state broadcaster, before resigning in a quarrel over political interference, does not believe that most people leave because they are afraid. “I think they leave when they lose heart,” he says. One white entrepreneur about to leave for New York says that it was not being held up twice at gunpoint that upset him most: it was the lack of interest the police showed afterwards. Tony Leon, the former leader of the opposition Democratic Alliance, claims that policing has been devastated by cronyism and that the entire criminal-justice system is dysfunctional. The head of the police, Jackie Selebi, is on leave pending a corruption investigation.

How much does the outward flow of whites matter? South Africa can ill afford the loss of its best-trained people. Iraj Abedian, an economist and chief executive of Pan-African Capital Holdings, says a pitiful shortage of skills is one of the main constraints on economic growth. He concedes that the ANC has pushed hard to give every eligible child a place in school, but argues that a “politically correct” focus on expanding access has come at the expense of quality. With virtually no state schools providing adequate teaching in science or maths, he says, the country has added to its vast problem of unemployment (every other 18-24-year-old is out of work) a no less vast problem of unemployability.

The gap they leave behind

On Mr Abedian's reckoning, about half a million posts are vacant in government service alone because too few South Africans have the skills these jobs demand. Not a single department, he says, has its full complement of professionals. Local municipalities and public hospitals are also desperately short of trained people. Dentists are "as scarce as chicken's teeth" and young doctors demoralised by the low standards of hospital administration. Last May Azar Jammine, an independent economist, told a Johannesburg conference on the growing skills shortage that more than 25,000 teachers were leaving the profession every year and only 7,000 entering.

A blinkered immigration policy makes things worse. Nobody has a clue how many millions of unskilled Africans cross into South Africa illegally. But skilled job applicants who try to come in legally are obstructed by a barricade of regulations. Mr Abedian says that the ANC used to think that relying on foreigners would discourage local institutions from training their own people. Now at least the government earmarks sectors where skills are in short supply and for which immigration procedures are supposed to be eased. In April, however, an internal report by the Department of Home Affairs showed that fewer than 1,200 foreigners had obtained permits under this scheme, from a list of more than 35,000 critical jobs.

In fairness, South Africa has been through far worse times before. Whites streamed out during the township riots of the 1980s. It is far from clear how much of the present dinner-table talk about leaving ends with a family packing its bags. Alan Seccombe, a tax expert at PWC in Johannesburg, says that many affluent whites have moved money offshore and prepared their escape routes, but that his firm's emigration practice is doing less business today than it did in 1995.

Perspective is necessary in politics, too. Raenette Taljaard, previously an opposition member of Parliament and now director of the Helen Suzman Foundation, a think-tank, says that events this past year have raised profound concerns about the rule of law and the durability of the constitution. But Allister Sparks, the author of several histories of South Africa (and a former writer for *The Economist*), maintains that the ANC has done as well as anyone had a right to expect after apartheid's destructive legacy. Some whites even express enthusiasm about the advent of Mr Zuma. How many other African liberation movements, they ask, have been democratic enough to vote out an underperforming leader, as the ANC has Mr Mbeki?

For the average white person, South Africa continues to offer a quality of life hard to find elsewhere. And there are other compensations. Mr Brink says in the article on the murder of his nephew that people who ask when he will be emigrating are perplexed to hear that he intends to stay. There is, he says, an "urgency and immediacy" about life in South Africa that lends it a sense of involvement and relevance he cannot imagine finding elsewhere.

All the same, he is staying on bereft of some former illusions.

> The myopia and greed of the country's new regime of rats have eroded my faith in the specific future I had once believed in. I do not foresee, today, any significant decrease in crime and violence in South Africa; I have serious doubts that our rulers can even guarantee a safe and successful soccer World Cup in 2010; I do not believe that the levels of corruption and nepotism and racketeering and incompetence and injustice and unacceptable practices of "affirmative action" in the country will decrease in the near future.

The famous novelist will stay. Many other whites are making plans to leave, and will be taking their precious skills with them.

The politics of the bail-out

The candidates intervene

Sep 25th 2008 | WASHINGTON, DC
From The Economist print edition

The battle to save the financial system has now become part of the presidential race

AP

JOBS will be lost, homes will be foreclosed, America will stumble into a recession and the economy will not recover in a normal, healthy way. All this will happen, Ben Bernanke warned members of Congress, if they do not approve a $700 billion bail-out for the financial sector. Mr Bernanke, the chairman of the Federal Reserve, and Hank Paulson, the treasury secretary, spent this week trying to persuade lawmakers to stump up the cash. But they met angry resistance from both parties.

The plan (see article) is for the Treasury to spend up to $700 billion to buy up mortgage-related assets, with the aim of getting credit flowing again. Given the urgency of forestalling a financial meltdown, a rescue package of some sort is likely to emerge, but the details are unclear. Will the government simply mop up toxic securities, or will it buy equity in ailing institutions? Will Congress sign a cheque for $700 billion, or start with a smaller sum and see how it goes? With the election—for all of the House of Representatives and a third of the Senate, not just for the presidency—barely a month away, no one wants the blame for failing to prevent a deep recession. But no one wants to be accused of showering taxpayers' cash on bankers in $5,000 suits, either.

On September 24th John McCain weighed in. “If we do not act, every corner of our country will be impacted,” he declared. He said he would suspend his campaign until the crisis is resolved. Instead of holding a debate with Barack Obama on September 26th, as planned, he said he would come to Washington. He asked President George Bush to convene a meeting with him, Mr Obama and congressional leaders to hammer out a deal. Mr Bush agreed to do it.

Mr Obama said he would be happy to help if congressional leaders asked him to, but that the debate should go ahead. A president, he said, should be able to deal with more than one issue at a time. The result was an impasse, throwing the whole calendar for presidential and vice-presidential debates into confusion.

Critics were quick to accuse Mr McCain of grandstanding, and noted that his intervention came on the day he recorded his lowest poll rating against Mr Obama yet. The Democratic leadership said bringing presidential politics into the bail-out discussions would only complicate and delay things. But Mr McCain contended, with some justification, that the bail-out was in big trouble. If he can help find a solution, he will emerge as a hero: if not, he will indeed look as though he has put politics above country.

Throughout the crisis, both candidates have sought to strike a tricky balance between raging on behalf of the little guy and reassuring panicky investors. At first, Mr McCain erred on the side of apoplectic fury, accusing unnamed crooks of corruption and regulators of being “asleep at the switch”. In a crass attempt to find a scapegoat, he also said that he would sack Christopher Cox, the head of the Securities and Exchange Commission. But he made some sensible points, too.

He balked at the unchecked discretion Mr Paulson sought over how to allocate $700 billion of public cash. “We will not solve a problem caused by poor oversight with a plan that has no oversight,” he said. Mr Obama made the same point. Mr Paulson backed down and agreed to accept greater oversight.

Both presidential candidates warned against rewarding overpaid fools for their folly. Mr McCain urged that no executive at a firm bailed out by the government should be paid more than the president, who makes $400,000 a year. Since the chief executive of Goldman Sachs makes that in two days, that would make it hard to hire the necessary financial talent to make the bail-out work. But pay caps for fat cats are popular in Congress. Some form of them may well be included in the final deal, assuming that there is one.

Mr Obama said he would support a bailout if it includes bipartisan oversight, pay curbs for Wall Streeters, help for people to avoid foreclosure and a way of returning any profits on the government’s investments to taxpayers. Mr McCain stressed that the bail-out should be transparent and include no earmarks. Neither would specify the circumstances under which he would vote against the plan.

Both candidates tried to blame each other for the crisis. Mr Obama accused Mr McCain of obstructing unspecified “common-sense rules” that supposedly could have prevented it. Mr McCain fulminated about Mr Obama’s ties to Fannie Mae and Freddie Mac, the government-backed mortgage behemoths whose reckless shepherding of loans towards un-credit-worthy borrowers helped create the crisis. In 2005, Mr McCain supported a bill to curb Fannie and Freddie’s excesses. Mr Obama did not, and his party blocked it in the name of helping poorer Americans to own houses.

Few voters understand how the proposed bailout would work, and polls reflect this confusion. A Bloomberg survey found that 55% of Americans thought the government should not bail out private companies with taxpayers’ money even if their collapse could damage the economy, while only 31% thought it should. A Pew poll found pretty much the opposite. It all depends on how you ask the question.

Nonetheless, the financial crisis is likely to help Mr Obama, who tends to sound cooler and better-informed than his rival. In the Pew poll, 47% of voters thought him more capable of addressing the crisis, while only 35% preferred Mr McCain. In a poll of polls by RealClearPolitics.com, he now leads by 3.5 points overall.

But whoever wins in November, the bailout will make many campaign promises moot. Even without the costs of shoring up Wall Street, either candidate will have to struggle with large and growing deficits, yet both are offering tax cuts and Mr Obama in particular has made some expensive spending pledges. He said in an interview that some of these might have to go. He was careful not to say which ones.

The election campaign

Heard on the stump

Sep 25th 2008
From The Economist print edition

Illustration by KAL

Candyman
"I called him John, but also my dear and my coconut sweet."

Maria Gracinda Teixeira de Jesus, a former Brazilian beauty queen, met John McCain in 1957. O Globo*, September 20th*

Wine, women and song
"It was our bestselling wine."

The owner of a wine bar in San Francisco complains about the drop in sales of Palin Syrah, a certified organic wine from Chile. SeriousEats.com, September 22nd

Cold dead hands
"I guarantee you, Barack Obama ain't taking my shotguns, so don't buy that malarkey...I got two, if he tries to fool with my Beretta, he's got a problem."

Joe Biden reacts to anti-Obama National Rifle Association ads. FoxNews.com, September 20th

I feel pretty
"People shouldn't make a decision this time based on, 'I like that guy' or 'She's cute'—and I'm talking about me."

Michelle Obama asks Americans to make considered decisions when voting. Jezebel.com, September 18th

Sore loser
"I bet he'd probably get pretty angry and lit up if his team was losing."

Fifty per cent of voters would prefer to watch football with Mr Obama, 47% with Mr McCain; some feared the latter would be a bad loser. AP, September 19th

Easy rider
"Sarah and I are going to get on that chopper and ride it straight to Washington!"

John McCain was given a motorbike honouring POWs. AP, September 22nd

Special ed
"It's the public school system. Let's be honest, it's full of liberal loons."

An 11-year-old was suspended for wearing an anti-Obama T-shirt. His father is suing. MyFoxColorado.com, September 22nd

Boy crush
"I like the idea that this guy does those long-distance races. Stayed in the race for 500 miles with a broken arm. My kind of guy."

Bill Clinton admires Sarah and particularly Todd Palin. AP, September 22nd

Rural voters

Bucolic ballots

Sep 25th 2008 | WHITESBURG
From The Economist print edition

Could the economy trump the Palin effect?

THE population of Whitesburg, Kentucky is "1,534 friendly people plus two grouches", according to the sign outside. The people here are warm and talkative and wry. They are also quite conservative.

Astor Blair sits on an old deck chair in his front yard, with a majestic view of the Appalachian mountains and a pile of cigarette butts on the ground beside him. He says he will not vote for Barack Obama because liberals are always trying to change things, and "when you shake things up too bad, bad things happen."

A coal train thunders by. Liberals want to do away with coal and "put a windmill on every square acre," he grumbles. "You'd destroy the countryside. It'd cost [trillions of dollars]. And it won't work." Mr Blair, who mows lawns for a living, worries that Mr Obama will raise taxes on the rich, thereby damaging the economy.

He also frets about social issues. Gay marriage does not bother him: "It's not my choice of lifestyle, but God never called me to do his judging and I ain't going to." But he favours school prayer and is "dead set" against abortion. "Who has the right to take somebody's life over nothing? Especially your own young." Mr Blair pats his 21-year-old son on the head, grins and adds: "Although, sometimes..."

A new poll for the Centre for Rural Strategies, a think-tank in Whitesburg, shows John McCain leading Mr Obama by ten percentage points among rural voters in swing states. The poll, conducted in New Hampshire, Pennsylvania, Ohio, Michigan, Wisconsin, Iowa, Minnesota, Missouri, Florida, Virginia, Colorado, New Mexico and Nevada, found that 51% of rural voters said they would vote for Mr McCain, while 41% preferred Mr Obama.

Only a fifth of Americans live in rural areas. And Mr McCain's advantage among rural voters is slimmer than George Bush's 13-point lead over John Kerry in a similar poll in 2004. But it is still a useful vote bank in a very close election. And the reasons rural voters give for preferring the Republican ticket are revealing.

Asked who would deal better with problems facing rural areas or the economy more generally, rural voters are about evenly divided. But when asked who shares their values, they prefer Mr McCain by a 14-point margin. And they love his running-mate, Sarah Palin, the governor of Alaska. Fully 65% of rural voters in swing states think she "represents the values of rural communities".

Though many urban voters were repelled by Mrs Palin, many rural Americans were instantly attracted, and for similar reasons. She kills and skins her own food. She talks a lot about her faith. She rides big machines. A campaign button juxtaposes a photo of her in a short skirt leaning on a motorbike outside a log cabin with one of Mr Obama bicycling in a dorky helmet, with the caption: "This settles it."

"I really like her. [And] it would be great to have a woman vice-president," says Karen McAuley, who runs a general store near Whitesburg that also sells enormous lunches (Today's special: sausages, sauerkraut, bean stew and corn bread). Her husband Jim agrees. "She's untested," he concedes, but "I've enjoyed listening to her."

"This country has been in a mess since [John Kennedy's] time," contends Mr McAuley. "Any time you reward people for not working, you're creating a monster." Mr McAuley says he disagreed with the occupation of Iraq, because "we're not trained to be policemen." And he worries about the economy: the family store is selling less ice cream and candy these days. But he still backs Mr McCain because he is pro-gun and anti-taxes. As for Mr Obama: "His character is whatever he wants you to see. I don't think there's a whole lot of substance there."

A quarter of voters in the survey say their neighbours are not ready for a black president. A few are blunter. “I don’t like Barack Obama at all,” says Glenna Smith, Mr Blair’s 72-year-old former mother-in-law. “I don’t sugarcoat things. I don’t like black people.” However, Mrs Smith says she gets on well with her niece, who is half-black.

If Wall Street’s explosion rains shrapnel on rural heads, the polls may change. For many voters, economic issues are growing more urgent. “Prayer is important,” says Thomas Ilowiecki, an Obama fan from rural Virginia. “But feeding your family is also important. And if you don’t have gas for your car, you can’t go to church.”

Among rural Americans, distrust of big government is mixed with widespread dependence on it. Shannon Ferrell, who runs a shop selling video games in Whitesburg, says he gets his health insurance through his wife, who works for the government. “You can’t find a good job round here that’s not a state job,” he sighs. Mr Ferrell says that at first he did not “buy the whole ‘change’ thing”, but he looked at Mr Obama’s plans and they seemed better for the middle class, so he’ll vote for him.

In November, rural voters who care most about the economy are more likely to vote Democratic; those who care most about cultural issues are more likely to vote Republican. People want their president to be someone they might enjoy breaking cornbread with. For many rural folk, Mr McCain passes the test. Mr Obama is like no one they have ever met.

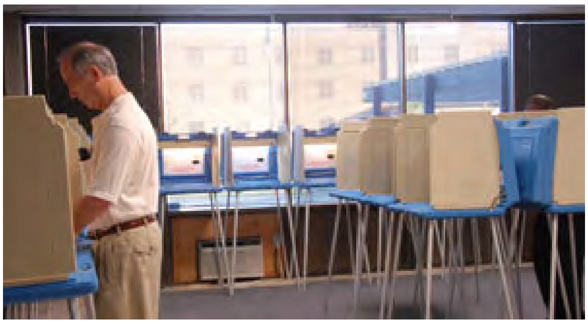
Early voting

The beginning of the end

Sep 25th 2008 | AUSTIN
From The Economist print edition

The polls are opening; soon this election will be decided

AP



Take your time

ELECTION day is on November 4th, more than a month away. Anything could happen between now and then. There is a crisis unfolding on Wall Street, and Congress is not sure what to do about it. Barack Obama and John McCain meet for their first debate on September 26th. There is still plenty of time for the running-mates to get in trouble. Joe Biden might make one of his famous gaffes. Sarah Palin might even give her first press conference.

All of this is irrelevant to the thousands of Americans who have already cast their votes, and the millions who will do so before election day. No fewer than 34 states are allowing early voting in person this year, and only a handful require an excuse. Campaigns can find this a challenge. A prolonged voting season requires a sustained effort, not just a last-minute frenzy of phone calls and ads. But the early option is good for voters. It lets them avoid queues on election day itself, and, should a problem arise, they can just come back later. Paul Gronke, who runs the Early Voting Information Centre at Reed College in Oregon, reckons that a third of all voters will vote early this year, up from 20% in 2004.

Will this affect the election? The Obama campaign hopes that the relaxed schedule will help ensure that young voters, who can be flaky, find a time to hit the polls. However, studies suggest that early voting options do not increase turnout much. The people who vote early are, in most cases, the ones who would have voted anyway. Similarly, early voting seems to have only a modest effect on the outcome of the election. Undecided voters tend not to rush to the polls, so the people who vote early were in the bag anyway.

Still, early voters should not be dismissed. They can help insulate candidates from eleventh-hour stumbles or revelations. The cautionary tale here comes from the bitter 2000 race. Five days before the election, the story bubbled up that George Bush had been arrested in 1976 for drunken driving. This disgusted many voters: Karl Rove, Mr Bush's chief strategist in the election, later remarked that the arrest probably cost them the popular vote. But with millions of votes cast in advance, Mr Bush squeaked by in key states like Florida.

This time around, early voting could help Mr Obama. He has opened small but significant leads in several western swing states where lots of people vote early. In Colorado, where 47% of voters weighed in early in 2004, Mr Obama has been beating Mr McCain since late August. He leads in New Mexico by six points, according to the Real Clear Politics average of polls. Early votes made up 51% of the 2004 total in that state, and Mr Bush won it by a nose. There is still time for Mr McCain to rally these western states, so close to his Arizona home. But he may find that by the time he gets there the contest is already over.

Campaign finance

And the money came rolling in

Sep 25th 2008 | WASHINGTON, DC
From The Economist print edition

Surprisingly, John McCain is doing as well as Barack Obama

DESPITE America's complex campaign-finance laws, the country's presidential candidates still bring in a lot of money. More than $1 billion dollars (a record) has found its way to the candidates so far in this election.

Mr Obama's fund-raising machine gets much of the credit. His success even convinced him to reject public financing for his campaign, leaving him to raise and spend as much as he likes. Mr McCain, meanwhile, took $84m in public funds at the beginning of the month and cannot raise another dollar for himself. But that hasn't stopped him. To the surprise of pundits, Mr McCain's team has creatively managed to catch up with Mr Obama.

Since he began campaigning, Mr Obama has raised $455m. Last month alone he took in $65m, according to reports filed by his campaign on September 20th. Two-and-a-half million Americans have given to Mr Obama in the past 19 months, his campaign says, and many of them have not yet contributed the full $2,300 each they are allowed to give, leaving a vast pool of untapped donors. The Democratic National Committee (DNC)—which is allowed to help Mr Obama, though not without fetters—can accept plenty more from individual donors, too. Between the two of them, the Democrats had $95m on hand at the end of last month.

Mr McCain, meanwhile, has raised only $210m since the start of his campaign, but he did not have to pay for a long primary battle as Mr Obama did. And his fund-raising has picked up, particularly in the wake of naming Sarah Palin as his running-mate. Mr McCain raised $48m last month, $9m of it in the three days after he chose her. His team has put together a "victory" fund that raises large donations for the Republican National Committee (RNC) and state party organisations, which will supplement Mr McCain's cash from the Treasury. Between Mr McCain and the RNC, the Republicans had about $94m on hand at the end of last month, with the candidate's $84m infusion still to come.

Mr Obama, however, spent $53m last month, Mr McCain only $41m. Part of the difference, probably a wise investment, went to much bigger staffing expenses on the Democrat's side for ground operations in swing states. Mr Obama may also take a bigger lead yet in the money race in the final weeks. Still, rejecting federal campaign financing means that he will have to spend a lot more time fund-raising than Mr McCain. And in hard economic times, donors may become stingier.

No surprise, then, that each candidate hardly murmurs as unaffiliated spending groups—which can spend lots of money as long as they do not co-ordinate with the campaign they favour—run attack ads against his opponent. Those extra millions will no doubt finance some of the blackest mud slung in this election year.

New York City finances

Economic fallout

Sep 25th 2008 | NEW YORK
From The Economist print edition

When Wall Street sneezes, New York catches cold

DESPITE a bit of grumbling that the federal bail-out of Wall Street is a handout to the wealthy, most New Yorkers realise the crisis affects everyone, from the trader making a six figure salary to the coffee vendor stationed outside the old Lehman Brothers building. As David Paterson, New York's governor recently said, "every time you hear Wall Street's having a bad day, just know that New York is having a worse day."

The securities industry, according the city's Independent Budget Office (IBO), accounts for 25% of the wages paid in the city. It generates 27% of its direct tax revenue. The city's unemployment rate rose last month to 5.8% from 5% in July, the largest monthly increase on record. Some 40,000 of the city's 185,700 Wall Street jobs could be lost. Doug Turetsky, of the IBO, says every thousand jobs lost on Wall Street translates into a roughly $50m loss in tax revenue.

Even before the crisis, City Hall was predicting a budget deficit in the 2010 fiscal year of $2.3 billion. Nicole Gelinas, of the Manhattan Institute, thinks this could increase by between $1 billion and $2 billion. The budget, as it stands, assumes a $7.1 billion securities industry profit, which is no longer possible.

Michael Bloomberg, New York's mayor, has directed all city agencies to cut their budgets by 2.5% this year and 5% next fiscal year. He also wants to increase property taxes by 7% in January. The mayor got New York out of its last downturn, in 2002. But he must leave office next year, unless the mayoral two-term limit is scrapped. Now there's a thought.

Giving

Billanthropy squared

Sep 25th 2008 | NEW YORK
From The Economist print edition

A big week for Bill Clinton and Bill Gates

AROUND this time every year, New York's traffic grinds to a halt as the police make the city safe for an influx of global dignitaries. It was bad enough when the visitors were limited to heads of state attending the annual United Nations General Assembly, but for the past four years they have been accompanied by a gathering of business leaders and philanthropists pledging to save the world at the Clinton Global Initiative.

This year, the UN is reviewing progress (mostly slow) towards the various Millennium Development Goals it wants to achieve by 2015. Bill Gates is flying in to tell the delegates that, thanks not least to his giving, he now believes that malaria is likely to be eradicated ahead of schedule.

Meanwhile, the CGI will focus on poverty reduction, improving water supply and sanitation in the developing world, education and climate change. Despite the financial crisis, which its founder, Bill Clinton, feared may mean smaller pledges than in past years, it has attracted a bumper crowd. But Dick Fuld, the erstwhile billionaire philanthropist boss of Lehman Brothers, cancelled.

It marks a rehabilitation of sorts for the former president. There were fears that Hillary Clinton's failure to secure the Democratic nomination would remove one of the main reasons for attending the CGI—cosying up to the next occupant of the White House. Some also feared that being too friendly with the Clintons might annoy the Obama campaign.

Thankfully, Barack Obama agreed to address the CGI, albeit by satellite, as did John McCain, accompanied by Sarah Palin as she visited New York in an apparent attempt to overcome her lack of foreign policy experience by breaking the world record for meeting the most heads of state in 48 hours.

Mr Clinton seems relieved that he can now concentrate on building the CGI into a powerful philanthropic marketplace, where wealthy donors meet social entrepreneurs with bright ideas, and a platform for his post-presidential career as a relatively non-partisan international statesman. He is disappointed that his wife is not about to become president, he says, "but it's not a disappointment to me that I'm not going to be back in the White House. I like the life I have now. It is a bit easier for me to play the role I am playing." Every cloud, it seems, has a silver lining.

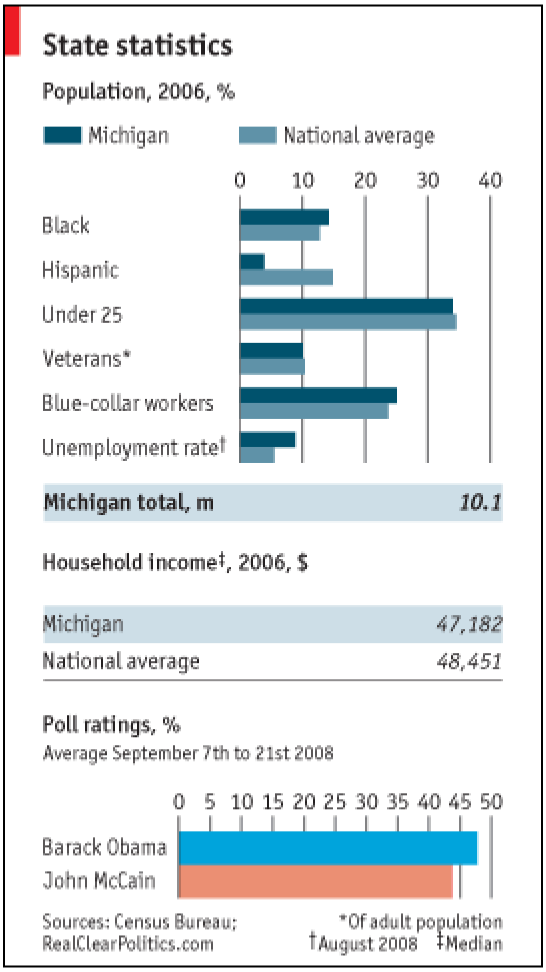
Swing states: Michigan

The centre of the storm

Sep 25th 2008 | DETROIT
From The Economist print edition

Michigan is at the heart of the debate over the economy

ECONOMIC gloom is no stranger to Michigan's cities. A house in Detroit was recently sold for one dollar. But now despair extends to the suburbs, too. Orchard Lake, a main drag of shops in Farmington Hills, has "for lease" signs planted like tombstones on the side of the road. The national unemployment rate reached a dismal 6.1% in August. Michigan's rate is almost three points higher, at 8.9%.



It is not surprising then, that in the war over which candidate can revive America's economy, Michigan is the front line. On a recent rainy night in Farmington Hills, Barack Obama tried to persuade voters that Michigan could be pulled out of the gloom. The crowd cheered wildly—"I'm absolutely positively sold on Obama!" gushed Ninevah Lowery. But not everyone is so convinced. Al Gore won Michigan by five points, John Kerry by just three. Mr Obama leads in the polls, but victory is by no means certain.

Much of Michigan's bleak outlook is caused by the car industry, which remains at the heart of the state's identity. Each August residents line Woodward Avenue, which runs north of Detroit, to watch the Dream Cruise, when vintage cars buzz by and conjure memories of glories past. The present is more of a nightmare. Since 2000 Michigan's car industry has shed more than 300,000 jobs. Within the past year, Ford and GM have posted their worst quarterly losses ever, with dire effects for suppliers and small businesses.

Both candidates entered this mess awkwardly. John McCain won the Republican primary in 2000, but lost this year's contest to Mitt Romney, the son of a former governor. Crowds trudged through the January cold to see Mr McCain; the senator, still in his straight-talk days, told them that "some of the jobs that have left the state of Michigan are not coming back." It was honest, but hardly a rallying cry.

Mr Obama had an equally awkward introduction. On visiting the Detroit Economic Club in May 2007, he extended not a handshake but a wagging finger, lecturing local executives about fuel efficiency. Later Mr Obama withdrew from the primary because the state held its contest early, in defiance of party rules.

Now, however, the candidates are scrapping for Michigan's 17 electoral votes (270 are needed to win the presidency). To pull the state out of its hole, Mr McCain offers low taxes, retraining and an all-inclusive energy policy. For the car industry, he has moved from tough love towards the unconditional sort. He still favours an unpopular cap-and-trade scheme for emissions (like Mr Obama), but this month courted carmakers by supporting low-interest government loans to them.

Mr Obama, meanwhile, has done his best to "kiss and make up" with the car industry, says Bill Ballenger, editor of *Inside Michigan Politics*. He has wholeheartedly supported the loans to the carmakers. He is also promising to end tax breaks for companies that ship jobs overseas and to revise trade agreements to "level the playing field". A second stimulus package would help families pay for food and fuel. A $150-billion clean-energy plan would invigorate the state's manufacturing sector.

To spread these messages, each campaign has covered the state with staff. In the past two weeks the Republicans and Mr McCain have increased their 14 local offices to more than 30. The Democrats and Mr Obama have 45 offices and plan to open at least five more.

Michigan is a diverse state, with posh suburbs, grim industrial cities and 3,200 miles (5,150km) of shoreline along the Great Lakes. The northern and western parts of Michigan have traditionally leant to the right, though there are pockets of Democrats in cities such as Muskegon and Saginaw. The most crucial region, however, is the Detroit area in the south-east, home to almost half the state's population. Detroit itself is reliably Democratic. The main fight is for its suburbs.

Oakland County is a bellwether. Though more than 80% white, it is a diverse place. A ten-minute drive will take you from Birmingham, a chi-chi suburb where Margot's European Day Spa offers a pedicure for $115, to Pontiac, an industrial city where Main Street Pawn Shop will buy your watch for $20. The Democrats have carried the county since 1996, but by falling margins. Mr McCain's main office is in Farmington Hills, in Oakland's heart.

Though the economic debate remains paramount in Oakland and other suburban counties, other factors are at play too—namely, whether Mr Obama will be able to woo the white blue-collar voters he had trouble winning in primaries elsewhere. This question is most acute in the swing county of Macomb, a bastion of socially conservative white workers. Two factors have made Mr Obama's task even harder.

The first is Sarah Palin. Macomb, explains Saul Anuzis, head of the state Republican Party, "is the home of the Reagan Democrat, the blue-collar worker who happens to be a hunter who rides a snowmobile." Mr McCain's first rally after his convention was in Macomb County, to show off Mrs Palin.

The second concerns Kwame Kilpatrick, Detroit's black former mayor, who has pleaded guilty to two felonies. South-east Michigan is deeply segregated: Detroit is more than 80% black, its suburbs mostly white. Macomb, for instance, is almost 90% white. Mr Kilpatrick's debacle has stirred festering racial tensions, and an independent group is running ads in Macomb that show Mr Obama praising Mr Kilpatrick last year. Lingering racism could yet tip a very tight contest.

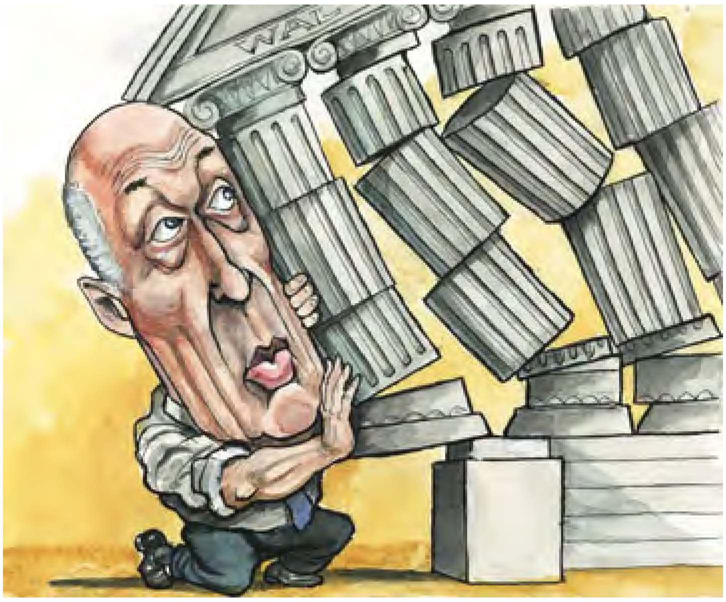
Lexington

President Hank

Sep 25th 2008
From The Economist print edition

Henry Paulson is the most important man in Washington

Illustration by KAL



THE Treasury was always intended to be at the heart of the American government. George Washington's first Cabinet appointment was his treasury secretary. The Treasury building is connected to the White House by an underground tunnel.

Yet for most of the Bush years the Treasury has been a backwater. Paul O'Neill disagreed with the Bush administration about the central thrust of its economic policy—deficit-boosting tax cuts—and was first neutered and then sacked. John Snow went to the other extreme and functioned as a travelling salesman for policies cooked up in the White House. The people who mattered in Washington were the war hawks, not the money men.

The Treasury is now back at the heart of government. Hank Paulson has been the dynamo behind everything from the $168 billion stimulus package to the latest plan for a $700 billion bail-out of Wall Street. Mr Paulson may go down in history as the man who saved American capitalism or the man who mishandled the worst financial crisis since the 1930s. But he will certainly not go down as the third in a succession of empty suits.

A whiff of the old American establishment hangs about Mr Paulson; the establishment of well-bred WASPs with Ivy League educations and muscular Christian views. His six-foot-one frame is rendered more imposing by his iron self-belief. He was educated at Dartmouth, where he studied English and distinguished himself on the (American) football field, earning the nickname "the Hammer" for his relentlessness. He spent his career working for the premier investment bank on Wall Street, Goldman Sachs.

But in fact Mr Paulson is very far from being a member of the old establishment. He was brought up on a farm in Barrington Hills, Illinois. He is a devout Christian Scientist who does not drink or smoke. In calmer times, he spends his weekends back home in Illinois rather than playing golf or hobnobbing in the Hamptons.

Mr Paulson made his career at Goldman Sachs at a time when the company was transforming itself into a global meritocracy. He led the company's drive into the Asian market (he has visited China more than 70 times). His forte at Goldman, above all, was deal-making. But he was also a hard-edged office politician. He became chairman in 1999 after helping to lead a palace coup against John Corzine.

For all its global ambitions Goldman Sachs remains at the heart of the American establishment, packing its employees off to public service after stuffing their pockets with gold. Mr Paulson's three predecessors as CEO of Goldman, Robert Rubin, Stephen Friedman and Mr Corzine, all went on to have political careers: Mr Rubin as a highly successful treasury secretary and Mr Friedman as the director of the National Economic Council in 2002-05. Mr Corzine is now governor of New Jersey. Mr Paulson was persuaded to move to the Treasury only after prolonged wooing by a fellow Goldman Sachs executive, George Bush's chief of staff, Josh Bolten. He brought a tightly knit group of Goldman alumni with him when he moved.

Mr Paulson is also an unusually unideological figure in today's Washington. He is a long-standing Republican who raised money for Mr Bush in 2004. But he is more of a Rockefeller Republican than a Southern-fried conservative (by an odd coincidence he shares his nickname with that quintessential Southern conservative, Tom DeLay). Perhaps his greatest passion outside work is for the environment. He is a former chairman of the board of the Nature Conservancy, an organisation that strongly supported the Kyoto protocol. Under his leadership Goldman became the first Wall Street institution to acknowledge officially that global warming is a man-made problem; it also bought thousands of acres of Chilean forests. Mr Paulson plans to leave much of his fortune to environmental causes.

His lack of ideology has been on display in his handling of the financial crisis. The right accuses him of selling out free-market principles. The left accuses him of bailing out his old friends on Wall Street ("cash for trash"). People on both sides point to the inconsistency of throwing Lehman Brothers to the wolves while bailing out AIG.

But sticking to principles may be the last thing that the market needs at the moment. Andrew Mellon, the treasury secretary at the time of the 1929 crash and another ex-banker, was a model of consistency, preaching a policy of "liquidate, liquidate, liquidate", to "purge the rottenness out of the system". This helped to plunge the economy into the Great Depression. Mr Paulson's pragmatism has given him a degree of flexibility in deciding who to save and who to allow to go under. He has also displayed the same flexibility in altering his bail-out plan in the light of the opposition it ran into on Capitol Hill: whether he has shown enough to close the deal is still unknown. Critics say he alienated Congress by initially refusing to submit to any oversight, supporters that this was only an opening bid.

Continuity please

This pragmatism will also make it easier to ensure some continuity in policymaking. The current crisis has hit at a particularly difficult moment in the political cycle. The November election will drain the Bush administration of what power it has left, but the new administration will not take over until January. The two candidates must explain what they will do to deal with this problem. John McCain would be wise to keep Mr Paulson in his job for the time being (he hardly has an embarrassment of talented replacements waiting in the wings). Barack Obama has plenty of talent to choose from, including Tim Geithner, the president of the New York Fed, who has worked closely with Mr Paulson, and Larry Summers, a former treasury secretary, who has plenty of experience of past crises. But he should consider finding some role for Mr Paulson, at least for a while.

Argentina

Better late than never

Sep 25th 2008 | BUENOS AIRES
From The Economist print edition

Ms Fernández tries to charm the markets by revisiting the 2005 debt swap

EPA

WHEN Argentina conducted the biggest sovereign-debt restructuring in financial history in 2005, it made clear that creditors who rejected the government's proposal would receive no mercy. The terms were harsh: holders of the $81 billion in Argentine bonds that defaulted in 2001 would lose a whopping 65% if they accepted the government's offer. But even a 65% "haircut" represented a better outcome for investors than a 100% loss, the fate Argentina insisted would await creditors who held out for a better offer. Told simply to take it or leave it, owners of 76% of the defaulted bonds accepted the swap.

For three and a half years, the government stuck to its guns, and the holders of the remaining debt received not a cent. But on September 22nd Argentina's president, Cristina Fernández de Kirchner, made a surprise announcement that her government would "analyse" a proposal it had received from three banks to reach a settlement with these holdouts, clearly implying she was now ready to negotiate.

Although many technical aspects of the deal have not been made public, it will probably entail the creditors giving Argentina both their defaulted paper, with a face value of $31 billion (including all past due interest), and a fresh $2.5 billion in cash, in exchange for a series of new bonds. The banks say they have nearly half of the holdouts already on board, and it is likely that a big majority will eventually accept such a settlement.

Ms Fernández's about-face represents a belated recognition of Argentina's deteriorating financial situation. In 2007, when the presidency was held by her husband, Néstor Kirchner, the country began doctoring its official inflation statistics to keep them in single digits, while the true rate rose to around 25%. This enabled the government to save some $500m in payments on its bonds linked to the consumer price index, but destroyed its credibility.

Meanwhile, the state's previously robust budget surplus began to dwindle. Mr Kirchner, who chose to have his wife replace him rather than run for re-election himself, drastically increased spending on pensions and public works to support her candidacy, and the global spike in fuel prices caused Argentina's expenditure on energy and transport subsidies to soar.

Once Ms Fernández was elected in October, the government twice increased its taxes on the country's farm exports in a bid to strengthen its balance sheet. But the higher levies prompted a virtual rebellion in Argentina's rural provinces and, after a bruising political battle, she was forced to cancel the measure in July.

Thus, less than a year into her presidency, Ms Fernández found herself in an unenviable position: economic growth was slowing, prices for Argentina's agricultural commodities had fallen, and the country had to refinance some $23 billion of debt that would mature in 2009 and 2010. Clearly, she would need to borrow money. But only Hugo Chávez, the leftist Venezuelan president, was willing to provide it—charging (in August) a swingeing interest rate of 15% for the privilege.

Rather than continuing to rely on Mr Chávez, Ms Fernández quietly began to implement a number of measures that orthodox economists had long suggested would be necessary for Argentina to stabilise its economy and regain market confidence. In recent months, the growth in public-works spending has slowed, while utility tariffs have risen modestly, enabling the government to cut its subsidy bills this year by around 10%. The central bank has raised interest rates and strengthened the peso. And earlier this month Ms Fernández announced that Argentina would pay off its defaulted debt with the Paris Club group of creditor nations.

Although each of these moves should benefit Argentina's growth in the long run, none of them succeeded in bringing down the country's stubbornly high interest payments. So Ms Fernández began to reconsider the government's intractable position on the holdouts.

Local economists estimate that a successful exchange—one that would elevate the overall acceptance rate of the restructuring from its current 76% to 95% or better—could reduce Argentina's interest rate from 15% to between 10% and 13.5%, producing savings that would easily compensate for the expansion of the debt burden. Moreover, the deal as currently structured would provide the extra cash Argentina needs now to meet its financial obligations for 2009. Reaching a settlement with the holdouts would be an important landmark for Argentina, enabling the country to remove the last vestige of its 2001-02 economic collapse. But if Ms Fernández is hoping that the decision will serve as a panacea for her woes, the markets are bound to disillusion her.

Argentina still suffers from a yawning credibility gap with investors, due to its shortsighted economic policies in general, and its meddling with the inflation figures in particular. Bridging that gap will require an explicit and believable plan to reduce inflation, eliminate price controls and subsidies, and attract investment, rather than a continuation of the somewhat chaotic series of ad hoc measures Ms Fernández has implemented so far. Although in recent months she has taken some very welcome moves to right a foundering ship, she still has a long way to go before convincing the markets that Argentina will at last get serious on her watch.

Canada

If you go down to the woods...

Sep 25th 2008 | OTTAWA
From The Economist print edition

And bears do not just picnic on honey

THIS has been a horrific summer for bear attacks in Canada. Earlier this month, a 52-year-old fisherman on Vancouver Island was badly mauled after a black bear swam over to his boat, scrambled on board and began attacking him, refusing to let go—despite being repeatedly struck with a gaff, beaten with a hammer and stabbed with various sharp objects—until a rescuer finally managed to slit its throat with a filleting knife.

Last month, a woman trimming bushes in her garden in a Vancouver suburb was likewise severely clawed and bitten. In May, Brent Case, a 53-year-old surveyor, was taking pictures of a coastal river 700km (430 miles) north of Vancouver when a grizzly bear seized him from behind. The bear bit both his arms before gnawing on the back of his head, "eating my brains", says Mr Case, who survived by playing dead. The same month an elderly woman fishing in western Quebec was killed by a black bear before being dragged back into the woods.

Such stories have inevitably grabbed the headlines. Increased sightings of bears near homes have also fuelled public fears. But, in fact, bear attacks are exceedingly rare and fatal ones even more so. Although exact figures are hard to come by, Stephen Herrero, a bear expert at the University of Calgary, reckons that there have been only 13 attacks by black bears resulting in injury (including one death) in the whole of North America this year. Grizzlies have carried out a further 11 attacks, resulting in no deaths. Neither species has averaged more than two kills a year since the 1950s.

With an estimated 70,000 grizzlies and 900,000 black bears sharing the continent with 440m people, that puts bear attacks well below bee stings, lightning bolts, spider bites and dogs as threats to human life, not to mention more familiar killers in the form of alcohol, cars and drugs. Yet few of these excite anything like the same media interest as tales of fierce fanged and clawed woolly predators springing from the woods in a snarling fury.

All the lurid publicity has had one beneficial side-effect, however. Since it is invariably accompanied by advice on what to do when you meet a bear, it is at least helping to reduce the number of deaths. Climbing trees or running is not advised as bears are better at both than humans. Playing dead, as Mr Case did, sometimes works, but not if a hungry bear sees you as food. Attacks, though still relatively rare, are rising as people penetrate further into bear country, either for recreational purposes using all-terrain vehicles and mountain bikes, or in helicopters and bush planes in search of timber and minerals.

It is a trend that has reached the Arctic. This month the national parks service started training Inuit in Nunavut to help researchers, geologists and tourists avoid close encounters of the polar-bear kind.

Brazil

Real-politik

Sep 25th 2008 | SÃO PAULO
From The Economist print edition

Why elections, even to lowly office, are so expensive

ONE of the most popular laws passed by some city *vereadores*, members of the legislative arm of Brazil's municipal governments, has been to make any bank queue lasting longer than 15 minutes illegal. No matter that their authority is meant to be limited to duller things, like the mayor's budget or zoning laws. The *vereadores*, who along with mayors are up for election in more than 5,000 cities on October 5th, reject such constitutional leg-irons. Competition for the office is fierce—strangely so, perhaps, given that this is the lowliest political post in the land—and can be very expensive.

Transparência, an NGO, has examined the last set of races in three state capitals (São Paulo, Rio de Janeiro and Belo Horizonte), which took place in 2004. Of 55 *vereadores* elected in São Paulo, 40 declared that they had spent more than 100,000 reais (then $35,000) on their races. One candidate spent over five times that amount. In Rio de Janeiro, some campaigns were even more expensive in terms of votes gathered per real spent. Certain successful candidates in the city spent more than $15 for each vote they won. (In comparison, George Bush spent $5.60 per vote he garnered in the American presidential election that year, and John Kerry, the Democratic candidate, $5.20 for each of his.) If undeclared spending were added, the sums would be even greater.

Why is it worth spending such sums just to become a member of a municipal council? In the big cities, the mayor controls a substantial budget. In smaller ones, money from the federal government, funnelled through the municipality, is often the mainstay of the local economy.

Until the Supreme Court banned the practice, states were able to create new municipalities almost at will. As a result, the number of places designated as cities grew by more than a thousand in a couple of years. Each new city brought its own administrative structure, which in turn provided new jobs and the right to tap federal funds. In such places, control of the local machine this time around may be vital in securing success in 2010, when the next presidential election will be held.

Although many candidates are no doubt motivated solely by public spiritedness, the moneymaking opportunities afforded to a *vereador* are also appealing. The combined salary and office expenses of a São Paulo *vereador* amount to 94,000 reais a month, making the job very well paid. Much of the office expenses seem to go on "consultancy", which is particularly sought after in an election year. There is also the possibility of making some money on the side: a few years ago *vereadores* were found to be behind an organisation that extorted money from street vendors. Power over zoning makes *vereadores* of interest to property developers, who often provide campaign contributions too.

As is the case with deputies at both state and federal level, a sizeable proportion of *vereadores* have cases against them pending in either the electoral or the ordinary criminal courts. The municipalities also share two further afflictions with the two tiers of government above them. The first is party switching: 14 of Rio's *vereadores* changed party after the last local elections. The second is the lack of electoral districts. A candidate standing in São Paulo, for example, must appeal to some 10m voters, rather than to a prescribed chunk of the city. Once elected, a *vereador* therefore lacks responsibility for any particular group of voters, further undermining his accountability.

The system is made even more unbalanced by a rule that allows candidates who get more votes than they need to win to transfer some of them to someone else on their party list. As a result, some *vereadores* are elected with very little support. The most popular *vereador* in the Rio election was voted in with 99,900 votes. Another candidate sneaked into the same chamber with a mere 6,800.

From time to time, and particularly when there is a big political scandal, the federal government makes noises about electoral reform to remedy these glaring faults. But so far, nothing has been forthcoming. And the spending goes on.

Chile

A force for good, now

Sep 25th 2008 | SANTIAGO
From The Economist print edition

A newly streamlined army polishes its democratic credentials

AFP

The bad memories are fading

Get article background

TEN years after General Augusto Pinochet stepped down as commander-in-chief, Chile's army is at last emerging from the shadow of its murky past. For a quarter of a century it laboured under the baleful influence of the man who came to power in a military coup in 1973, its once proud reputation sullied by the blood of thousands of innocents tortured and murdered under his 17-year dictatorship. The army was unable to start reforming itself until he finally stepped down as its leader another eight years later.

Despite hundreds of court cases (though few convictions so far), many questions about the army's role in the human-rights abuses remain unanswered. The remains of some 3,000 people killed or "disappeared" by the regime have never been found. Many Chileans still wonder how such a highly disciplined force could have resorted to such appalling violence. "There is a weight of history," admits José Goñi, Chile's defence minister. "But the new generation doesn't have to be held responsible." Only six of those in the army at the time of the 1973 coup remain in service.

General Óscar Izurieta, the army's commander, says that the army will not be accepted fully as part of democratic society until questions over its past can finally be laid to rest. The courts have to do their job, he agrees, and it is legitimate for people who suffered at the army's hands to want to keep the issue open. "But I don't know if it's good for them or the country," he says. "Every day, they put me face to face with a problem of the past."

The army has tried hard to regain legitimacy over the past decade. It has seized on natural disasters, such as earthquakes, to play an active civil-defence role. It has used its field hospitals to take medical services to remote areas and help the national health service cut waiting lists. And it has sought to reduce its social isolation by such measures as sending cadets from the Santiago military academy to one of the city's universities for some of their courses.

Some of the excess fat has been shed, too. Currently 40,000-strong, down from around 70,000 in the mid-1990s under Pinochet's command, it is leaner and more professional. Unpaid military service has been scaled down and, unlike General Pinochet's conscript-packed army, all national-service places are now filled by volunteers. And under a law passed by Congress this summer their number will drop even further as they are gradually replaced by professional soldiers.

Thanks to record prices for copper, Chile's main export, and an odd arrangement (predating Mr Pinochet) under which Codelco, the state copper producer, transfers 10% of its export revenues (amounting to $1.4 billion last year) to the armed forces for capital expenditure, there has been money to spend. The finance ministry has the last word, but the army has been able to shop extensively, with acquisitions including German tanks and better electronics. Today, Chile's is the most modern and best-equipped army in Latin America, says Armen Kouyoumdjian, an adviser to the Stockholm International Peace Research Institute.

But what exactly does the country need such an army for? In the 1970s Chile faced a real threat of war with Argentina and Peru, but relations with both have improved a lot since then. Indeed, Chile's military ties with Argentina are so close that the two countries have created a joint standby unit for international operations. Although political instability in Bolivia is a worry, the main risk to Chile from that direction—an exodus of Bolivian refugees—is hardly a military problem. On the other hand, having a strong army may help to ensure that relations with Peru stay peaceful. Chile and Peru have had a long-standing dispute over maritime borders, and Ollanta Humala, the Peruvian populist who almost won his country's most recent presidential election, found it convenient to stir up sentiment against Chile.

For its part, the army emphasises that it is available for international peacekeeping. It is already part of the United Nations force in Haiti—its first significant peacekeeping role. Some Chileans reckon that the army is still bigger than necessary for a peaceful country of only 16m people. But a rational plan for slimming should be based on the needs of the future, not the misdeeds of the past.

Japan

Grandfather's footsteps

Sep 25th 2008 | TOKYO
From The Economist print edition

Aso steps up to the plate; but perhaps not to stay very long

AP

AFTER trouncing his opponents to lead the Liberal Democratic Party (LDP), Taro Aso, a 68-year-old former foreign minister, was sworn in on September 24th as Japan's third (unelected) new prime minister in two years. Mr Aso, a Catholic, is the grandson of Shigeru Yoshida, a former prime minister (seated above; the young Mr Aso is standing in the centre) and as blue-blooded as they come. But he has a populist appeal, and in this leadership bid, his fourth, managed to reassure colleagues that his sometimes brashly expressed hawkish views would not jeopardise Japan's improved ties with China and South Korea. His straight-talking, upbeat style contrasts with his morose, short-tenured predecessors, Shinzo Abe and Yasuo Fukuda. Unlike both, Mr Aso says he will put pocketbook issues to the fore.

Mr Aso has two main aims in a special session of the Diet (parliament). The ruling coalition says that the global financial crisis makes it more pressing than ever to pass a stimulus package worth ¥11.5 trillion ($106 billion, though only one-fifth is new spending). Second is the renewal of the navy's refuelling operation in the Indian Ocean, part of the international effort in Afghanistan and a main symbol of Japan's readiness to play a bigger part in the world.

On September 29th Mr Aso will present his agenda to the Diet. The make-up of his cabinet appears to dispel any doubts that he will call a snap general election. With the chief exception of Kaoru Yosano, a fiscal conservative reinstated as economy minister, the cabinet talent is astonishingly thin. Mr Aso cannot be serious.

Shigeru Ishiba is a defence expert, but he has been put in charge of farms. Hirofumi Nakasone, the new foreign minister, is notable chiefly for being the son of a former prime minister. The new internal-affairs minister is Kunio Hatoyama, another grandson of a prime minister, seen even by his friends as the most incompetent justice minister in memory. And Mr Aso has chosen Shoichi Nakagawa, a potential budget-buster like himself, as finance minister. When this correspondent recently called after lunch on the man now responsible for coping with the global financial crisis, he found him in erratic form, with his shirt unbuttoned to the waist. Japan needs more women in the workforce, but Mr Nakagawa has said that they have their “proper place” and their “own abilities” in, for example, “flower arranging, sewing, or cooking”. Countering this view has been left to Yuko Obuchi, 34-year-old daughter of another prime minister, who is in charge of reversing Japan’s declining birth rate.

The opposition Democratic Party of Japan (DPJ), led by Ichiro Ozawa, controls the Diet’s upper house and vows to oppose the LDP’s measures, raising the odds of a poll in early November. Much is at stake for the LDP, which for half a century has been in near-continuous power. It and its allies in the bureaucracy are seen as incompetent and out of touch. On top of the welfare ministry’s gross mismanagement of the country’s pensions system comes a growing scandal over tainted rice.

Mr Ozawa is now urging his forces to bring about an upheaval in Japanese politics. There is little noble in his approach, rallying the disaffected from every quarter. Supposedly a party of reform, the DPJ has tried to forge an alliance with a reactionary group, the People’s New Party, whose members broke with the LDP because they opposed the privatisation of the postal system. Socialists and Communists also form part of the DPJ’s ragbag rebellion.

Mr Ozawa promises to restore the pension system, help the working poor and the old, and revitalise the countryside. The DPJ’s proposals for paying for this are not credible. But in his own policy address on September 21st Mr Ozawa aimed squarely at a rotten target: the murky national budget. Mr Ozawa will try to convince voters that the LDP and its allies in the bureaucracy are congenitally incapable of revamping the way taxpayers’ money is taken in and spent in unaccountable ways. Many voters will sit up and listen. Others will think that to return the LDP to the lower house would be to continue the mess of a hung Diet. Mr Ozawa’s hopes for an upheaval look entirely plausible.

Indonesia

The lady is for returning

Sep 25th 2008 | JAKARTA
From The Economist print edition

Ex-President Megawati and her party seek a comeback

AFP

New-style Mega

HER record as president, in 2001-04, was mixed, to put it generously. But Megawati Sukarnoputri and her Indonesian Democratic Party of Struggle (PDI-P) are on the comeback trail and, so far, the opinion polls look favourable. Campaigning has already started for next year's presidential and parliamentary elections in the world's most populous mainly-Muslim country, with around 174m voters. There will be thrills and spills along the way, but it looks quite possible that the final round of the presidential race will be a repeat of 2004's, pitting Miss Megawati against Susilo Bambang Yudhoyono—only this time with President Yudhoyono as the incumbent and Miss Megawati as the challenger.

Mr Yudhoyono's popularity has been dented by the rising cost of living and, in particular, by his sensible but controversial slashing of fuel subsidies (something Miss Megawati had tried but failed to do). A string of polls earlier this year put Miss Megawati in a clear lead. Now, the gap has closed, though her party remains well ahead of all others in popularity. There are likely to be a handful of other presidential candidates, including General Wiranto, a former army chief indicted by a United Nations-backed tribunal over the violence that accompanied the breakaway of the former East Timor in 1999. But he and other potential challengers are way behind the two front-runners.

One of Miss Megawati's main failings during her presidency was her aloofness. She still gives few press interviews. But the PDI-P's secretary-general, Pramono Anung, insists she has "changed her style". For almost a year now she has been touring the country, meeting small groups of voters in places such as village markets.

Vice-president Jusuf Kalla, chairman of Golkar, the largest party in Mr Yudhoyono's governing coalition, is keen on the presidency. But Mr Kalla is not from Java, the country's most populous and politically dominant island. So Golkar, even if it offers a presidential candidate in the first round, may again end up seeking the vice-presidential slot on Mr Yudhoyono's ticket in the run-off.

Mr Yudhoyono's Democrat Party is likely, again, to get fewer seats than Golkar or the PDI. But his personal popularity should recover as he increases spending on anti-poverty programmes. Wolfgang Fengler, an economist in the World Bank's Jakarta office, reckons around 19m households are now getting welfare payments of 100,000 rupiah ($11) a month. This will cost only a fraction of the $15 billion in combined annual savings from the several rounds of cuts in fuel subsidies. These, and improved tax collection, have left the president with lots left over for a bumper election-year budget, including a huge boost in education spending.

No fewer than 38 parties are registered for the elections but most will be weeded out by a new law requiring them to get 2.5% of the national vote to be allotted any parliamentary seats. Only eight of the 17 parties that won seats in 2004 would have passed that test. And several midsized parties are fading. So the next parliament may be dominated by just four parties: the PDI-P, Golkar, the Democrats and the mildly Islamist Prosperous Justice Party (PKS).

Though pragmatism trumps principles in all the parties, it is possible to discern differences in ideology. Rully Azwar, a senior Golkar official, admits the party (which supported Suharto, an authoritarian president from 1966-98) is seen as close to big business, but he is seeking to recast it as the party of small business too. The PDI-P is leftish—opposing privatisation and favouring stronger labour rights. Golkar tends to be supported by business people and civil servants, ie, those generally happy with the status quo—with the Democrats appealing to much the same electorate. The PDI-P is strong among farmers and workers. The PKS, which has overtaken longer-established Islamist parties in the polls, appeals to the pious middle-class.

The economy—joblessness and the cost of living—is expected to be the main campaign issue. Mr Pramono says the PDI-P will remind voters of Mr Yudhoyono's broken promises, such as his failure to build the roads, power stations and other infrastructure that is sorely needed. Mr Rully says Golkar will be happy to compare the achievements of the Yudhoyono government, which it has been supporting, to the Megawati years—notably a growth rate that has recently topped 6% and begun to make a dent in unemployment.

The president will also proclaim his progress against deeply entrenched corruption (see article). The PDI-P, embarrassed by a parliamentarian's admission of bribe-taking, plans to replace perhaps 70% of its candidates with newer and, with luck, cleaner faces. Some recent provincial elections, in which established figures lost to newcomers, suggest that the voters want change. They will get it in parliament, even if the presidential race features the same old faces.

It is notable, hearing the main parties' campaign chiefs speak, that they start from the assumption that the voters are not dumb. Paul Rowland, in Jakarta for the National Democratic Institute, an American think-tank, says: "One of the things that gives me hope here is that voters are rational, whatever their level of education, and the parties are catching up with that." With democracy teetering in Thailand and still absent or weak in much of the rest of South-East Asia, the region's biggest country is indeed a cause for hope.

Indonesia's anti-corruption drive

The graft-busters strike again

Sep 25th 2008 | JAKARTA
From The Economist print edition

The previously untouchable start getting their collars felt

AT LAST it is possible to detect signs that Indonesia is making progress against its rampant corruption. In the latest in a series of spectacular busts by its Corruption Eradication Commission (KPK), on September 16th investigators pounced on a director of the anti-monopoly agency at a Jakarta hotel, as a businessman allegedly bunged him 500m rupiah ($53,000). This week the mayor of Medan, one of Indonesia's biggest cities, was jailed for five years for a fiddle over the procurement of fire engines.

In Transparency International's annual Corruption Perceptions Index, published this week, Indonesia improved its lowly ranking, coming 126th out of 180 countries; last year it was 143rd out of 179 countries surveyed. Its "cleanliness" score has risen modestly since the KPK was created in 2002. Buoyed by public support, the agency is calling for those convicted of graft to be dressed in garish uniforms and thrown into the same special jail that houses terrorists.

No institution now seems beyond the KPK's grasp. In June Burhanuddin Abdullah, until recently head of the central bank, was charged over the alleged bribery of parliamentarians. This followed a showdown in which the KPK proved that it could and would raid the offices of members of parliament. An opposition lawmaker now being questioned says he and 40 others trousered 500m rupiah each for approving the appointment of a central-bank director in 2004. A senior prosecutor was recently jailed for 20 years for taking bribes to hide embezzlement at a bank-rescue fund created after the 1997-98 Asian economic crisis.

Allegations have recently been made against the ministers for planning, fisheries and forests, and a relative by marriage of President Susilo Bambang Yudhoyono. Opposition politicians say the KPK has been slow to act in such cases, but Mr Yudhoyono, generally thought to have clean hands himself, insists that no one will enjoy impunity.

Hindu-Christian tensions in India

Marching as to war

Sep 25th 2008 | DELHI
From The Economist print edition

The politics of communal violence

Reuters

A faith under fire

WHEN Swami Laxmanananda Saraswati, a charismatic Hindu priest fond of railing against Christian missionaries, was shot dead in the eastern state of Orissa in August, police blamed "Naxalite" Maoists. But hardline Hindu groups decided Christians were responsible. In an ensuing rampage, dozens of churches were burned, tens of thousands of Christians fled their homes, and at least 20 people died. By this week the violence had touched four more states. In Karnataka in the south, 20 churches have been desecrated in a few days.

India's Hindu majority and its tiny Christian minority mostly rub along peacefully. But since the early 1990s, the rise of ideological Hindutva ("Hinduness") and of the Hindu-nationalist Bharatiya Janata Party (BJP), now the main opposition, has seen intermittent outbreaks of sometimes vicious agitation against Christian missionaries. They are accused of forcibly converting poor Hindus. Gauri Prasad Rath, general secretary of the Vishnu Hindu Parishad, or World Hindu Council, in Orissa, says that the thuggery was caused by, "the fraudulent conversions Christians are doing. They burned their own churches."

It is true that missionaries are busy in much of India, especially the tribal belt that runs through Orissa. Here, traditionally nature-worshipping forest dwellers, among India's poorest people, have found institutional Christianity, with its free schools and health care, especially attractive. Indeed many church leaders believe that the proportion of Indian Christians is a couple of percentage points higher than the census reckoning of 2.3%. In six of the 12 states ruled by the BJP, either on its own or in coalition, laws designed to discourage Hindus from switching faiths by banning forced conversions have been introduced. Convictions, however, are rare. Mohammed Shafi Qureshi, chairman of the government-appointed National Commission for Minorities, says he asked how many people had been convicted under the state's 1967 law; the answer was none.

Tensions have been exacerbated by a row over "reservations", the affirmative-action benefits, such as privileged access to government jobs and education, afforded to low-caste Hindus. Most Hindu converts to Christianity come from the lower castes but lose these benefits when they switch faiths. Their calls for inclusion in the system have infuriated many Hindus.

With general elections due by next May, such issues have proved effective rallying cries for Hindu groups aligned with the BJP. Mr Qureshi points out that Karnataka, scene of some of the worst violence, this year voted in its first BJP government. The party is also part of the ruling coalition in Orissa. "This madness", he says, "is political."

Sri Lanka

The last battle?

Sep 25th 2008 | COLOMBO AND VAVUNIYA
From The Economist print edition

Civilians in the crossfire

Get article background

THE police served them toffee and sweet drinks as they queued up to register at designated centres in Colombo. But for many of the thousands of Tamil civilians obliged to turn up, this was scant consolation for a violation of their rights. Guru, a 23-year-old law student from Jaffna, called the toffee “a trade-off on my dignity”. The orders to register were given on September 20th by police with loudhailers moving slowly along the streets of Colombo’s Tamil areas, which have recently been receiving swarms of civilians fleeing the intensifying war in the north.

The government labelled the exercise a “census”, to determine whether there had been a change in the ethnic balance of the Western province, where the capital is located. It is increasingly edgy about attacks in the capital by the rebel Liberation Tigers of Tamil Eelam. For 25 years the Tigers, who have a history of terrorist atrocities, have been fighting for a separate homeland for the Tamil minority in the north and east of the island. But Tamil civilians fear the real objective is to weed out anybody suspected of Tiger links. The government of President Mahinda Rajapaksa says the war is entering its final stages. And the president’s brother, Gotabhaya Rajapaksa, the defence secretary, maintains that stringent security measures are an “inconvenience” that the minority Tamil community will have to endure.

Some 250km (160 miles) to the north, Vavuniya, a government-controlled town in the Wanni region (see map), is expecting a throng of civilians fleeing the nearby rebel territory. No toffee here. Local authorities are struggling to provide the bare essentials to those displaced by war. The government continues to send food and medicine into the Wanni—distributed by a few harried government officials, in danger from the air-force bombing, crossfire and the Tigers.

Fighting between the army and the Tigers is intense on at least four fronts: Vavuniya, Welioya, Mannar and Mullaitivu. Both sides have suffered heavy losses. But the government claims the army has made inroads into Tiger strongholds as never before. This week an army spokesman said its soldiers, advancing from Akkarayankulam in the east, were just 4.5km from the Tigers’ headquarters at Kilinochchi, and that 201 Tiger cadres had been killed in the preceding week, compared with 22 government soldiers.

Both sides tend to exaggerate their victories, and such claims are unverifiable. Journalists are excluded from the region and on September 15th the UN and foreign aid agencies evacuated rebel-held territory, after the government said it could not ensure their safety. Aid agencies estimate that 200,000 civilians are still trapped by the fighting in the Wanni.

About 160,000 in the region have already been displaced, and people are sleeping at the roadsides, under trees, or in schools, churches and empty buildings in Kilinochchi. The Christian Solidarity Movement, an NGO, says some, displaced several times, are carting timber and other materials for shelters from place to place.

The government air-dropped leaflets into the Wanni advising civilians to leave through a “ humanitarian corridor” from Kilinochchi to Vavuniya through Puthukkudiyiruppu and Oddusuddan. But much of that area is still controlled by the Tigers, who want civilians to stay, so response has been tepid. Officials say people are now leaving Kilinochchi but NGOs give warning that this poses new challenges because Vavuniya does not have the food, water, sanitation or health care to cope with an influx. Jeevan Thiagarajah, of the Consortium of Humanitarian Agencies, says “we haven’t reached a crisis yet.” But, as a showdown in Kilinochchi looms, there are fears of a humanitarian disaster.

Terrorism in Pakistan

Friends like these

Sep 25th 2008 | ISLAMABAD
From The Economist print edition

America and Pakistan try to remember they are on the same side

EPA

The front desk becomes the front line

WHEN George Bush met his Pakistani counterpart, Asif Zardari, at the UN General Assembly in New York this week, Pakistanis wanted to know one thing: is America going to invade Pakistan again? American special forces had launched a botched raid into Pakistan on September 3rd and Mr Zardari was supposed to take the American president to task. The response was less than clear. “Your words have been very strong about Pakistan’s sovereign right and sovereign duty to protect your country, and the United States wants to help,” said Mr Bush. It could be the sort of help Mr Zardari cannot refuse.

The two countries face a common challenge: Taliban insurgencies are burgeoning in both Afghanistan and Pakistan; al-Qaeda poses a threat from sanctuaries in the lawless border regions between the two countries. But America is frustrated at Pakistan’s reluctance to wage all-out war against the militants and has conducted a spate of missile strikes on the border region. This has stoked anti-American feeling, already rife in Pakistan.

A massive suicide-bomb attack on the Marriott Hotel in Islamabad on September 20th, which killed at least 53 people and wounded more than 260, seems not to have swung popular opinion against the militants. Many Pakistanis blame the atrocity on the government, for its pro-American policies, on India or on America itself. After the blast, which pulverised the international hotel, the rupee sank to a new low. For the average Pakistani, struggling with high food prices, it was simply a harbinger of yet more insecurity. The bombing bore the hallmarks of al-Qaeda, though a previously unknown group, Fedayeen Islam (Partisans of Islam), claimed responsibility. But some experts have pointed to terrorists with links to Pakistan’s military-intelligence establishment.

The army has stepped up operations in the tribal area of Bajaur and in Swat, in North-West Frontier Province (NWFP). This week it struck back at militants harassing security forces around NWFP’s capital, Peshawar. Afghanistan’s most senior diplomat in Pakistan, Abdul Khaliq Farahi, was this week kidnapped by militants in one of the town’s well-heeled suburbs. But the army risks repeating the mistakes made by NATO forces in Afghanistan—killing civilians and failing to protect locals. On September 23rd police killed five people and wounded several others when they opened fire on protesters in Swat, who were demanding basic amenities and an end to military operations.

As the leader of a political party that has won an election, Mr Zardari is better placed than his predecessor, Pervez Musharraf, to try to galvanise popular and parliamentary support for battling extremists. Just hours before the Marriott bombing, Mr Zardari made his first speech to parliament as president. He pledged to hold a parliamentary debate to forge a national counter-terrorism policy. And, in an attempt to win over the opposition, he promised to cede some of his sweeping presidential powers, such as the authority to dismiss parliament—though many doubt he will actually do so. After the blast, he went on television, promising to rid Pakistan of the “cancer” of terrorism. But there is little he can do to make America’s regional strategy popular. And just as, abroad, he lacks the power to reject Mr Bush’s “help”, so at home he is too weak to take on pro-Taliban hardliners in Pakistan’s army.

Economist.com WORLD ASIA

China's space programme

Shooting the moon

Sep 25th 2008 | BEIJING
From The Economist print edition

After a successful Olympics, China's next spectacular

HAVING put three men into orbit without a hitch since 2003, the scientists and policymakers behind China's space programme are gaining confidence. Their latest extraterrestrial project will include a space walk, the nation's first. If all goes to plan, the event will be shown live on national television. Abroad, however, applause will be tinged with misgivings.

Reuters

Ready for lift-off

As *The Economist* went to press on September 25th, the *Shenzhou VII* spacecraft was ready for launch on a Long March II-F rocket from a launch centre in western Inner Mongolia. Three astronauts were on board, with their mission expected to last about three days. China's first manned space flight five years ago carried just one astronaut, and the second in 2005 bore two. This time, say Chinese press reports, one of the crew will walk in space. And he will do so wearing a Chinese-made suit.

It is 43 years since the first such feat was performed by the Soviet Union, but the Chinese leadership clearly hopes that the sight of a Chinese man floating in space will give cheer to a domestic audience (just in case he needs any help, another astronaut wearing a Russian suit will be standing by in the airlock).

The timing of the launch was clearly intended to round off a summer filled with patriotic pride at China's staging of the Olympic games and its world-beating haul of gold medals. It has also proved a fortuitous distraction from a growing scandal involving tainted milk that has embarrassed China's leaders (see article).

Space litterbug

For the first time since China began its manned space flights, the authorities have allowed foreign journalists (albeit only a handful of them) to witness the launch. Even getting anywhere near the remote launch site is normally tricky for foreigners. The nearest city is Jiuquan, some 200km (125 miles) to the south-west. Taxi drivers there say they can be fined for taking unauthorised non-citizens along the desert road towards the base, run by the People's Liberation Army. Foreigners who visited Jiuquan on August 1st to view a total solar eclipse from a site nearby had to register with the police to use the road. A notice in their hotel warned them not to use their satellite-navigation devices to engage in any mapping.

Live television broadcasts, shunned at the time of the first launch in 2003, apparently because of fears of failure, and a flicker of friendliness towards the foreign press are unlikely to impress the Americans. This is China's first manned venture since it tested an anti-satellite missile in January 2007. It blasted a disused weather satellite into tiny fragments that threaten the safety of other man-made objects in space. Joan Johnson-Freese of the Naval War College in Rhode Island says there had been "positive signs" of possible space co-operation between China and America. But these, she says, "pretty much went away" after the test. American politicians still fume.

Worries in America are likely to grow if China's space programme keeps up its steady pace of development. Subsequent *Shenzhou* missions are expected to focus on building a space station. Another programme, which began last October with the launch of a lunar probe called *Chang'e*, aims to put an unmanned rover on the surface of the moon around 2017 and return it to earth with samples.

Jiao Weixin of Peking University says that with the development in the next few years of a new rocket, the Long March V, with a heavier lift capability, “it’s a matter of time” before China formally announces plans for landing a man on the moon. According to the *Washington Post*, Michael Griffin, the head of America’s space agency, NASA, has given warning that if China were to achieve this before the return of a manned American spacecraft to the moon for the first time since 1972, “the bare fact of this accomplishment will have an enormous, and not fully predictable, effect on global perceptions of US leadership in the world.” The newspaper said this comment appeared in a draft of a statement Mr Griffin was preparing to submit to Congress this year, but it was deleted by White House budget officials.

During the cold war between America and the Soviet Union, the two were closely matched in their struggle for supremacy in space. Now, however, America remains far ahead of China in military and civilian space capabilities. Chinese officials, anxious not to appear threatening, are at pains to stress this. But Japan and India have space ambitions that are similar to China’s, and, like America, have uneasy political relations with it. Gaining an edge on its neighbour, Japan launched a lunar probe shortly before China did last year. India plans to do the same next month.

First Taiwan, then Mars

National pride is at stake. “Some of the concerns are prestige-based,” says Adam Segal of the Council on Foreign Relations in New York, “viewing the manned Chinese space programme as a symbol of China’s power in the region, possibly at the expense of Japan.” As for security worries, he says, Japan, like America, is wary of China’s efforts to improve its ability to cripple or destroy enemy satellites. It also worries that China’s (still fledgling) *Beidou* satellite-positioning system could improve the accuracy of its weapons.

Such anxieties, along with the perennial worries about North Korea, helped prompt Japan’s parliament, or Diet, in May to rescind a 1969 resolution mandating that Japan only pursue peaceful uses of space. The new policy allows space technologies to be used for “national security” as well. This is seen as a green light for the deployment of new spy and early-warning satellites used for missile-defence systems.

Russia still holds a few cards. China has drawn extensively on its neighbour’s expertise to get its manned space programme going. It has even sent its astronauts for training by Russians. In October next year a Russian rocket will launch a Chinese probe to Mars. Some Americans fret that they too may have to depend on Russia between the scheduled retirement of the Space Shuttle programme in 2010 and the introduction of a new launch vehicle, which will probably not appear before 2015. Vincent Sabathier, of the Centre for Strategic and International Studies in Washington, says this would be a good opportunity for America to look to China for help. But nobody in Washington, he says, wants to talk about it.

Economist.com WORLD MIDDLE EAST & AFRICA

Rwanda and the Great Lakes region

A pioneer with a mountain to climb

Sep 25th 2008 | KIGALI
From The Economist print edition

Paul Kagame, the ambitious president of a small but well-regarded country, wins another election in a landslide. But doubts persist about his belief in democracy

AP

TWO questions are regularly asked of Rwanda: how important is a tiny mountainous country of 10m people? And can it really transform itself, as its leader proclaims, into the Switzerland of Africa?

The answer to the first is clear. Rwanda is a key to the stability of the Great Lakes region at the heart of Africa. The 1994 genocide in Rwanda, in which at least 800,000 Tutsis and moderate Hutus were slaughtered, helped ignite a war in the neighbouring Democratic Republic of Congo which led to the loss of 4m lives and still rumbles on in the country’s east.

The answer to the second question is a lot fuzzier. President Paul Kagame, who is among the most austere and inscrutable of Africa’s leaders, is trying to turn landlocked Rwanda, devoid of oil and minerals, into a trade and technology hub. Many see Rwanda’s experiment in development as a test-case for the rest of Africa, which has enabled the country to draw on a lot of foreign goodwill and cash. But progress is patchy. Just as important, big doubts remain about Rwanda’s political direction.

Mr Kagame’s loyal officials say he is the “pillar” of national reconstruction. And he continues to impress at the polls. Last week Rwanda completed its second general election since the genocide. As expected, Mr Kagame’s Rwandan Patriotic Front (RPF) won in a landslide, taking 42 of the 53 contested seats in a proclaimed turnout of 98.5%. Even allowing for the sometimes creepy pressure on rural Rwandans to toe the government line, there was clearly a sense of unity and purpose. A further 23 women, two youths, and one disabled member of parliament were selected indirectly, making the assembly remarkably balanced between the sexes. International election observers said the vote was clean and well organised. Mr Kagame himself looks certain to be re-elected president for a final seven-year term in 2010.

His detractors, however, say his rule is increasingly dictatorial. An umbrella opposition group in exile, the United Democratic Forces, called the election a “smokescreen”, pointing out that the so-called opposition, the Social Democratic Party, which won seven seats, and the Liberal Party, which won four, backed Mr Kagame in the last presidential election and serve in his cabinet. His critics also highlight his past as the military commander of the RPF, which was accused of torture and killings following the genocide in Rwanda and of further looting and killing in Congo between 1998 and 2003.

Western diplomats in Kigali, the capital, applaud the country’s stability but worry that the RPF is suffocating democracy. On radio talk shows and in person across the country, Mr Kagame hammers away with a simple message: one Rwanda, one people, one future. Debate is conducted exclusively on the

RPF's terms: to oppose the party is to oppose Rwanda's development. A new media law was meant to have improved the training of journalists but has stifled critical voices. The BBC's local Kinyarwanda service is under pressure. A senior government official says the BBC is biased towards "[Hutu] fugitives in Europe and in the forests of Congo".

Though several important ministries are run by Hutus, the government still includes a privileged core of English-speaking Tutsis, most of whom, like Mr Kagame, grew up in exile. But for a Rwandan to resent that openly is to invite trial on charges of "divisionism" that could lead to up to 20 years in jail.

Still, the government hails progress in all the areas that have bedevilled most other would-be reforming African governments. It has cracked down on corruption and had RPF officials imprisoned for pilfering public funds. The police are professional, even enforcing laws on litter to make Rwanda the cleanest country in Africa; plastic bags are confiscated at the airport. Those and other achievements in poverty-reduction and education, as well as guilt over the 1994 genocide, have attracted generous aid. Foreign governments generally overlook the nasty politics and focus on the improving statistics on poverty.

Britain, in particular, is very cosy with Mr Kagame's regime. Rwanda may be asked to join the Commonwealth next year, cementing its place in English-speaking Africa. Britain has promised Rwanda $100m in aid a year over the next decade, with only "light conditionality" (in essence, an understanding Rwanda will not reinvade Congo). By contrast, relations with France remain glacial, with Rwandan officials accusing the French of complicity in—not just covering up—the genocide.

In late October, Rwanda is to host an East Africa International Business Forum in partnership with the Commonwealth Business Council, identifying itself as part of eastern rather than central Africa, under the slogan "One Market, One Destination" for east Africa's 120m people. But for all Mr Kagame's efforts at pitching Rwanda as a business hub, its economy is still tiny. Exports of high-quality coffee and tea have grown but, along with minerals, amount to only $120m a year. The mountainous countryside is visibly overpopulated, with even precipitous slopes planted with beans and other staples. Large sections of the population are outside the cash economy. Kigali has yet to reach its Dick Whittington moment, when the rural poor are lured to the city in the hope of a better life.

A minnow in a turbulent ocean

The shock waves earlier this year from the disputed Kenyan election, and the rising cost of fuel, cruelly exposed the fragility of Rwanda's landlocked economy. The price of bringing a container from the Kenyan port of Mombasa to Kigali has rocketed, pushing up the already inflated price of imports. Banking remains rudimentary for a country hoping to emulate Switzerland, with limited provision for credit cards and an unwillingness to lend money. A "one-stop shop" has helped draw in foreign investment, but the initial invitation is often followed by disappointment. The government says it is tackling businessmen's concerns by—among other things—easing taxation and recruiting commercial judges from abroad. But the great leap forward will rely on deeper changes in the country, as well as getting inputs such as fertiliser to farmers, irrigating their land and building power stations that burn methane drawn from the depths of Lake Kivu.

Rwanda’s development also depends on stability in next-door Congo. Congolese minerals and timber are exported through Rwanda. Some Congolese businessmen use Rwanda as a safe haven for their savings and families. Kenya’s biggest supermarket chain, Nakumatt, which recently opened a branch in Kigali, plans to set up a mall on the Congo-Rwanda border.

But the security there, in North and South Kivu, has deteriorated badly since August. The UN says the situation is “extremely volatile”, with some 100,000 Congolese displaced in the past few weeks. Peacekeepers and aid workers have been targeted by angry mobs, with UN vehicles stoned and hijacked, water supplies cut off and medicine looted.

Mr Kagame is plainly fed up with the Congolese. He wants Congo’s president, Joseph Kabila, to distance himself from Hutu militias, including remnants of Rwanda’s previous regime of Juvenal Habyarimana, and to rein in his own troops. Mr Kagame denies that a renegade Tutsi general, Laurent Nkunda, whose militias terrorise much of Kivu, has been armed by fellow Tutsis from Rwanda. If the situation in eastern Congo gets much worse, Rwanda, with its relatively strong army and aggressive security service, may be tempted to intervene directly yet again. But if Rwanda is to prosper as a regional trading hub, it must avoid any more cross-border wars.

Elephants in Congo

Big and helpless

Sep 25th 2008
From The Economist print edition

Bad news for the biggest land mammals in the most anarchic bit of Africa

AFRICA'S elephants are divided between the savannahs of eastern and southern Africa and the forests of central Africa. Some biologists reckon the forest ones—smaller, with shorter, straighter tusks—may even constitute a distinct species. But not for long, at the latest rate of poaching. The high price of ivory is increasing the incentive to kill elephants everywhere in Africa, and especially in places where there is virtually no law.

The latest reports suggest that the forest elephant population is collapsing on the back of rising Chinese demand for ivory. Some conservationists argue that a recent decision by the Convention on International Trade in Endangered Species (CITES) to auction 108 tonnes of stockpiled ivory from southern Africa may be prompting more poaching in central and eastern Africa, as criminals seek to mix illicit ivory in with the legitimate kind. But some economists maintain that the legitimate sale of ivory lowers prices, thus decreasing the incentive to poach. A study of a previous sale of ivory suggested it did not lead to more intensive poaching.

Either way, the Congo basin is "haemorrhaging elephants", says TRAFFIC, which monitors trade in wildlife. The head of the 790,000-hectare (1,952,000-acre) Virunga National Park in eastern Congo, Emmanuel de Merode, reports that 24 elephants have been poached in his park so far this year. The situation is dire: 2,900 elephants roamed Virunga when Congo became independent in 1964, 400 in 2006, and fewer than 200 today. Most have been poached by militias, particularly Hutu rebels from Rwanda who hack off the ivory and sell it to middlemen in Kinshasa, Congo's capital, who then smuggle it to China.

Once ivory has left its country of origin, and if it is seized by customs officials, it can be hard to identify its source and those responsible for acquiring it. But forensic help may be at hand. Scientists from the University of Washington are using genetic markers in elephant dung to identify exactly where ivory has been poached. This should help governments in countries such as Tanzania and Zambia, which are capable of catching poachers, but not in anarchic eastern Congo, where 120-odd rangers have been killed in Virunga in recent years trying to protect elephants and gorillas.

With an influx of businessmen and other officials from China engaged in infrastructure projects such as road building and logging, the slaughter is expected to accelerate. Forest elephants may survive in large numbers only in remote protected pockets of the Congo basin, such as the Odzala-Koukoua National Park in Congo-Brazzaville and Minkebe National Park in north-east Gabon.

Sudan

Saving the president

Sep 25th 2008
From The Economist print edition

Efforts to rescue Sudan's president from the International Criminal Court


Reuters

THE UN Security Council is under pressure to suspend the International Criminal Court's prosecution of Sudan's president, Omar al-Bashir, for alleged genocide and crimes against humanity. Many say that if the court agrees to the prosecutor's request for an arrest warrant against Mr Bashir, the strife in Sudan's warring region of Darfur could get a lot worse, and that the Sudanese president will simply cease all co-operation with the UN and foreign governments seeking to find an end to the conflict. Others argue equally forcefully that a possibly permanent deferral of justice would create a bad precedent, irreparably damaging the world's first permanent war-crimes court, with no guarantee that Mr Bashir would behave any better.

Under Article 16 of the court's statute, inserted at the insistence of the Security Council's five permanent members (three of whom—China, Russia and the United States—refused to sign up to the court), the council has the power to suspend ICC proceedings at any time for a period of up to 12 months (infinitely renewable) without needing to provide any justification; it is assumed that such a move would be taken only in the interests of peace and security.

In the five years since the ICC has been operating, Article 16 has never been invoked. But then the court has never before sought to indict a serving head of state. (Slobodan Milosevic, Serbia's late president, and Charles Taylor, Liberia's former one, were both tried by other ad hoc war-crimes tribunals.) Nor has the ICC ever before sought to bring a charge of genocide, the gravest of international crimes.

Unsurprisingly, Mr Bashir does not like the charge at all, and nor do the rest of his peers in the 53-member African Union (AU) and the 56-member Organisation of the Islamic Conference (OIC). Both groups have demanded that the Security Council suspend proceedings against Mr Bashir, quite a few of their members no doubt fearing that it could be their turn next.

In July, South Africa and Libya, both current members of the Security Council, tried, with backing from China and Russia, both veto-wielding permanent members, to tag an amendment to that effect onto a Security Council resolution renewing the hybrid UN-AU peacekeeping force in Darfur. It failed, for want of support. But since then, two other permanent members, Britain and France, seem to have been persuaded to back a deferral, though only on certain tough conditions.

As a quid pro quo, Mr Bashir would have to agree, at a minimum, to stop all attacks by his forces on civilians and aid workers in Darfur; hand over the two men already indicted by the court, Ahmad Harun, Sudan's humanitarian affairs minister, and Ali Kushayb, a leader of the government-backed *janjaweed* militia; and facilitate the deployment of peacekeepers in the region. Secret ministerial discussions are continuing in various capitals.

But the Sudanese president sounds increasingly defiant. Meanwhile the situation in Darfur, where an estimated 300,000 have already lost their lives and some 3m have been forced to flee their homes in the five-year conflict, continues to deteriorate.

Further increasing the pressure on the ICC if it does indict Mr Bashir (a decision is expected in November), several AU and OIC members, who together account for a third of the ICC's 108 states parties, have threatened to pull out of the court. With an eye on Sudan, Ban Ki-moon, the UN's secretary-general, recently declared that the search for a balance between peace and justice "should never be influenced by the threats and postures of those seeking to escape justice". This week Luis Moreno-Ocampo, the ICC's chief prosecutor, has been in New York urging world leaders, gathered for the 63rd session of the UN General Assembly, to let the court continue its prosecution without the Security Council's intervention. These are dangerous times for the fledgling court.

Chad

Breaking the bank

Sep 25th 2008
From The Economist print edition

A vaunted model development project goes awry

WHEN the World Bank agreed to help finance a controversial pipeline from oilfields in Chad to a port in Cameroon, it claimed to be raising the bar for transparency and good government in the extractive industries. It insisted that the government of Chad spend almost all its revenue from the project on development; to make sure it did so, the oil firms involved were to pay royalties into an escrow account monitored by an independent agency. Eight years later, the bar has fallen with a thud. Rather than comply with the bank's strictures, the government of Chad has repaid its loans in full. It will now do as it pleases with its oil money.

The project did not get off to an auspicious start: the government spent a chunk of its $25m signing bonus on arms. As local rebel movements grew stronger, and the conflict in neighbouring Darfur began to spill over into Chad, the government's urge to funnel cash to the army only grew. It bickered frequently with the bank and the oil firms about the terms of the deal. The lockbox for revenue proved insecure, since the government simply took the money disbursed for education and health care and diverted it to less worthy causes. "Ultimately," says a World Banker, "these projects depend on the political will of the governments involved."

Pressure groups say the bank should have known better. Robin Hodess of Transparency International, a Berlin-based anti-corruption lobby, says that setting up parallel administrative structures to ensure sound management of revenues never works; the incompetence and venality they are designed to bypass inevitably undermine them. Instead, she says, the bank should have concentrated on reforming Chad's bureaucracy until the government seemed fit to handle the bonanza.

Korinna Horta of Environmental Defence, an American NGO, believes that Chad, already one of the world's poorest countries before the oil began to flow, is now even worse off. She argues that the government's spending on arms has fuelled a civil war, as well as the conflict in Darfur. She also points to pollution and public-health problems around the oilfields as proof that Chad's natural resources, like those of so many other poor countries, have proved to be more of a curse than a blessing.

The World Bank, meanwhile, says it still stands ready to assist Chad's government with future development schemes.

Islam

Try to be nice about each other

Sep 25th 2008 | CAIRO
From The Economist print edition

A Sunni preacher upsets the Shias

BECAUSE there is no recognised supreme religious authority in Sunni Islam—no one such as the pope among Catholics, for instance—Sunni clerics often suffer the indignity of being challenged, or even ridiculed, by their flocks. Outraged lawyers in Morocco, for example, recently filed a lawsuit against one sheikh after he declared it legal for girls as young as nine to marry. And Muslims the world over poured scorn on Sheikh Muhammad Munjad, a puritanical Palestinian preacher, when he suggested earlier this month, on a Saudi television show, that since mice are abhorrent to God, Mickey Mouse deserved to die.

Yet it comes as a surprise that Yusuf Qaradawi, the star preacher on the popular al-Jazeera satellite channel, who is a widely respected moderate on most issues, should find himself at the heart of a far bigger storm. The 81-year-old cleric, Egyptian by birth but long based in the Gulf state of Qatar, strayed onto tendentious ground by telling an interviewer he considered Shia Islam a heretical branch of the faith, and warning of a Shia attempt to “invade” Sunni societies by stealth and gain converts.

As might be expected, the response from Shias has been furious. Sheikh Muhammad Hussein Fadlallah, Lebanon’s most popular ayatollah, demanded that Mr Qaradawi produce figures to back up his claim of a Shia missionary drive and that he explain what danger it would be to Islam if one Sunni decided to adopt Shiism. Shia activists in Saudi Arabia have threatened a lawsuit, charging Mr Qaradawi with fomenting sectarian schism and requesting that he be forcibly retired on grounds of senility. A news agency in Shia-majority Iran posted a story that blasted the sheikh as a front for “international Freemasonry and Jewish rabbis”.

Some leading Sunnis have also been discomfited. Fahmy Huwaidi, a widely syndicated columnist who champions Islamist causes, said that while he could not dispute Mr Qaradawi’s authority in jurisprudence, his timing was politically disastrous, since maintaining Muslim unity was paramount at this stage. “He should be the first to know that there are forces at present who seek to ready public opinion for a military strike against Iran, and for stripping Hizbullah of its arms,” Mr Huwaidi chided.

Mr Qaradawi has responded to his critics by stressing his support for Iran’s right to nuclear energy and his long history of backing Muslim unity and Muslim causes around the world. Unlike Sunni extremists who deny that Shias are Muslim at all, he accepts their membership in the faith, he said. But as a Sunni scholar he could not overlook doctrinal differences. Unfortunately for the state of Muslim unity, it appears that most Sunnis tend to agree.

Abu Dhabi

Family feeling behind the football

Sep 25th 2008 | ABU DHABI
From The Economist print edition

The purchase of a football club reveals sensitivities about family rivalries

AP

Mubarak the Mancunian with the money

IT MUST have been a bit of a culture clash. More used to the deep carpets of the boardroom than the din and grit of an English football stadium, Khaldoon al-Mubarak recently watched his first match as chairman-designate of Manchester City, the second club of England's second city. Elegantly suited and bespectacled, Mr Mubarak heads Mubadala, Abu Dhabi's sovereign private-equity fund. But the way he acquired his new job may illustrate rivalries within the emirate's ruling family.

Owning a big English football club is a new experience for Abu Dhabi, the capital and wealthiest of the seven United Arab Emirates (UAE). True, it has a stake in Ferrari and is due to host a Formula One race next year. It has also commissioned, amid much fanfare, a series of ultra-modern museums by some of the world's leading architects. But the bear pit that is the English premiership football league is a different proposition.

Abu Dhabi has sought to portray itself as above this kind of thing: elegant, restrained and a little bit aloof. In the person of Mr Mubarak, a man who has spearheaded deals with, among others, General Electric, an American conglomerate, the emirate still wants to seem less brash than its northern rival, Dubai.

And Abu Dhabi's purchase of Manchester City has set off awkward family vibrations. The deal was driven by Sheikh Muhammad, the crown prince, and his four brothers, the so-called Bani Fatima. Their mother was a favourite wife of Sheikh Zayed, who founded the UAE confederation and left 19 sons. Among the Bani Fatima are Sheikh Hazza, Abu Dhabi's security supremo, and Sheikh Abdullah, the UAE's foreign minister. The man behind the consortium, in whose name the Manchester City shares are held, is Sheikh Mansour, minister of presidential affairs and another of the famous five.

Back home, amid an often anguished debate about national identity, people are quietly asking where this leaves 60-year-old Sheikh Khalifa bin Zayed, Abu Dhabi's ruler since the death of his father in 2004. As the eldest son, Sheikh Khalifa duly succeeded his father. But he has no full brothers.

The official story of the purchase of the club has shifted. At first, the consortium seemed to be led by Sulaiman al-Fahim, a property man, but he was ditched. It was then said to have been an entirely private deal by Sheikh Mansour. Mr Mubarak, Abu Dhabi's smoothest fixer, was brought in as chairman. In any event, with their involvement in Formula One, Ferrari and the new museums, alongside architects such as Norman Foster and Zaha Hadid, the Bani Fatima seem to be calling the shots—in the emirate as well as in the foreign football club.

Europe's economies

Struggling to keep moving

Sep 25th 2008 | FRANKFURT AND PARIS
From The Economist print edition

The financial meltdown may be happening mainly in America, but Europe is starting to feel the heat

Illustration by David Simonds

THOSE who hoped Europe might escape Wall Street's woes were sorely disappointed this week. Not only did markets slide across the continent, with bank shares especially hard-hit, but also a purchasing managers' index for the euro area fell to its lowest since 2001, and three business-confidence indicators were unexpectedly weak. The figures suggest that a recession may even have begun already. The questions are how deep it will be, and how long it will last. And the answers will depend heavily on the two biggest economies: Germany and France.

Germans feel aggrieved. While others were living on easy credit and blowing bubbles, they practised virtue. The economy clawed back lost competitiveness via low wage rises. The public sector was in surplus last year. Exports and investment have done well, giving Germany its best spell of growth since the early 1990s. Yet one does not have to indulge in a vice to contract a disease. The entire euro area was boosted by house-price increases, notes Jörg Krämer, chief economist of Commerzbank. “Germany can't decouple.”

One reason is exports. Net exports accounted for over half of last year's growth of 2.5%. But foreign orders for German manufactures slumped by 3.4% in the year to July. With unemployment falling and wage rises picking up, consumers ought to be stepping into the breach, but look unlikely to do so. In 2007 the government snatched away their extra income in higher value-added tax. This year the culprits were higher oil and food prices. Indeed, private consumption may drop for a second year. And unemployment may soon rise. After growing at an annual rate of 5% in the first quarter, the economy shrank in the second quarter and, probably, in the third. Most forecasters expect little growth in 2009. Yet IG Metall, a trade union, has demanded an 8% pay increase. Rising wages may make the European Central Bank more reluctant to cut interest rates.

So was all that economic virtue pointless? Not quite. Labour-market reforms will dampen the rise in unemployment. Households and businesses are less indebted than elsewhere. Consumer debt stands at 101% of disposable income in Germany, compared with 140% in America and 172% in Britain. German firms finance investment out of profits more than debt, and so are less exposed to the credit crunch. Some German banks, especially in the public sector, binged on subprime American assets, and further losses may come to light. But bank lending to enterprises rose by 9% in the year to mid-2008.

With luck, Germany faces disappointment, not disaster. The government is expected to cut its growth forecast for next year from 1.2% to 0.5%. Those who expect recession, says Peer Steinbrück, the finance minister, have "sado-masochistic tendencies". Mr Steinbrück also rules out extra fiscal stimulus, which would endanger his goal of balancing the budget by 2011.

In France the impact of the credit crunch has taken many by surprise. As recently as May Christine Lagarde, the finance minister, was praising the "totally remarkable performance" of the economy, which grew by 0.6% in the first quarter over the previous one. She dismissed the "pessimistic analyses" of those (such as the IMF) who forecast a sharp downturn. Yet GDP shrank in the second quarter; and, as she prepared to unveil her budget for 2009 this week, she conceded that it would rise by only 1% this year and next. Some economists are gloomier.

Most French indicators have weakened. A September index of manufacturing slowed at its sharpest pace for seven years. Order books are thinning. Consumer spending, the motor of the economy in recent years, fell in August by 0.3% over a month earlier. Cafés and restaurants report a big drop in trade. The housing market may not collapse as America's has, because mortgages are highly regulated and banks tend to be cautious lenders to individuals. But prices are starting to fall, albeit more slowly than in Spain and Ireland.

Two knock-on effects from America's banking crisis directly touch the French economy. First, a credit squeeze is hurting the corporate sector. More than a third of banks tightened lending conditions to companies in the second quarter, says a Bank of France survey, and almost half said they would do so again in the third quarter. French firms rely on bank credit more than German ones; tighter credit feeds directly into less investment and job losses. The second knock-on is the exposure of French banks to America. Ms Lagarde insists there is "nothing to worry about over the solidity of French banks." But she still estimates that the banks will lose €20 billion this year.

Unlike Germany, France has little room for expansionary fiscal policy. The government made big tax cuts in 2007. The budget deficit next year could easily exceed the euro-area limit of 3% of GDP. "Even in Spain there is huge scope for counter-cyclical fiscal measures," says Carlos Caceres, an economist at Morgan Stanley. "But the French really have their hands tied, and it will be almost impossible for them not to break the 3% ceiling." France does not share Germany's keenness on fiscal austerity.

There are three broader reasons for worry about the euro area's prospects. One is the currency. In recent months, the euro has fallen against the dollar, offering hard-pressed exporters welcome relief. But the dramatic events of the past two weeks could easily spill over into renewed dollar weakness. Second, though European banks look healthier than American ones, they remain dangerously exposed, both to Lehman and to the American housing market (see article). Among the most vulnerable are some big banks that cross borders in Europe. The American authorities were able to assemble their bail-out plans fast. In Europe, it could be harder and take longer, as supervision is largely national and the role of the ECB in dealing with a troubled cross-border bank remains fuzzy.

Third are the well-known structural weaknesses of the biggest euro-area economies. America's economy is famously flexible, quick to lay off workers but also to hire them again. It may go into recession more suddenly, but it tends also to revive more speedily. In Europe, rigid product and labour markets inhibit such flexibility. So the risk is that the euro area will remain in the doldrums a lot longer.

Italy's economy

Creeping along

Sep 25th 2008 | ROME
From The Economist print edition

How Alitalia symbolises the ills of the euro-area's third economy

AFP

Flying at low altitude

THE Italian economy has been the euro-area's tortoise for so long that a broad slowdown makes it look better. Studies by the Bank of Italy and financial regulators all conclude that the exposure of Italy's financial system to Wall Street's crisis is modest. As Fabio Pammolli of CERM, a think-tank, puts it, "not having capital markets as developed as in some other countries is paradoxically an advantage in this situation. It is the other face of one of the historical problems of the Italian economy."

Yet that is not stopping some in Silvio Berlusconi's right-wing government, which includes the protectionist Northern League, from portraying recent developments as a revenge on the free-market economists who for years pilloried Italy for its old-fashioned, retail-oriented banks, excessive reliance on manufacturing and reluctance to embrace globalisation. The finance minister, Giulio Tremonti, this week put economists in a category with "bad teachers, exorcists, faith healers, shamans [and] witch doctors." But Francesco Giavazzi, an economics professor at Bocconi University, says that Mr Tremonti is drawing "completely wrong" conclusions from his analysis.

Although Italy may have escaped the worst direct effects of the crisis, it will be vulnerable to its indirect ones. A slowdown in America and Germany could do immense damage to an economy that is driven largely by exports. Because of this, Mr Giavazzi says, the crisis ought not to be seen as a reason for shrinking from globalisation, nor for failing to make more reforms. "If you cut Italy out from the demand of the rest of the world, which is what globalisation is all about, you are cutting out the main engine of growth", he argues.

Since trade is a matter for the European Commission, Italy is in no position to raise tariffs or take other protectionist measures. But it can discourage foreign investment—which is just what the government is doing over Alitalia. Mr Berlusconi vetoed a takeover by Air France-KLM earlier this year in favour of an all-Italian consortium of investors who were ready to buy the airline's profitable bits and merge them with its main domestic rival, Air One. But the consortium has pulled out of talks with the trade unions. Italy's civil-aviation authority has said that, without a credible rescue plan, it will withdraw Alitalia's licence to fly. Mr Berlusconi will do everything he can to stop the airline going under, not least because it would be a blow to his government's economic nationalism. But time is running out.

The Spanish civil war

Bones of contention

Sep 25th 2008 | MADRID
From The Economist print edition

Reopening graves of the past

A POET'S bones may offer no clues to his genius, but how they are treated can speak volumes about his country. The remains of Federico García Lorca, poet and playwright, at the centre of a row over Spain's violent past, are no exception. His is the most famous name on a list of 130,137 victims of the repression unleashed by Franco that was handed over to a Madrid court this week. The list is a first attempt to produce a comprehensive account of atrocities carried out in the generalissimo's name. It includes those condemned by kangaroo courts, as well as others taken from their homes, shot and buried in unmarked mass graves.

The list was produced after an investigation into the fate of those who disappeared during the civil war. That investigation, opened by a magistrate, Baltasar Garzón, may pull down the wall of silence over this painful subject. It may also lead to the opening of hundreds of mass graves so that bodies can be recovered, identified and handed to families for reburial.

The judge's investigation has provoked indignation on the right. Critics argue that the transition to democracy after Franco's death in 1975 included an agreement not to stir up the bitter divisions of the civil war. A 1977 amnesty ensures that nobody can be tried for abuses committed by Franco's regime. Mariano Rajoy, leader of the opposition People's Party, has said he is "against reopening old wounds".

Even the Socialist prime minister, José Luis Rodríguez Zapatero, whose grandfather was shot by a Francoist firing squad, has found it tricky to navigate the minefield of Spain's past. A "historical memory" law passed last year enraged the right but was denounced by campaigners as toothless. "The law is both lightweight and low cost," said Emilio Silva, founder of a volunteer group that has exhumed 1,200 victims. Judge Garzón, he added, has now opened the floodgates. "This takes the debate out of the political sphere," he noted. "Hundreds of people have written to us in the past weeks."

Relatives of Dióscoro Galindo, a teacher, were among those who delivered the names to Judge Garzón. Galindo is thought to have been shot and buried with Lorca and two anarchist bullfighters in a grave on a hillside above his home city, Granada. Galindo's relatives have spent five years campaigning for the grave to be dug up. They have always been opposed by Lorca's family. But now, in a sign of a change of direction, the family has said it will not fight a court order to open the grave.

Georgia and Russia

Tense times

Sep 25th 2008 | TBILISI
From The Economist print edition

Coping with the fraught aftermath of August's war

SEVEN weeks after the war between Russia and Georgia began, the situation remains edgy. On September 21st a Georgian policeman was shot dead at a checkpoint close to Abkhazia, the breakaway enclave in the north-west—the third policeman to be killed since fighting stopped last month. Two days later the Georgians claimed to have shot down a Russian drone over Gori, near South Ossetia, the other enclave.

Systematic destruction, looting and ethnic cleansing of Georgian villages continue, both in and beyond South Ossetia proper. Georgia is also struggling to cope with some 30,000 refugees from the two enclaves, plus another 30,000 from buffer zones round them. The tents housing them in Gori and elsewhere look pitifully inadequate for winter. Resettling them will take time. And Georgia is already home to more than 200,000 refugees left from the wars in the early 1990s.

The European Union has now sent 300 people to monitor the ceasefire brokered by France's Nicolas Sarkozy. This will cause further tension, as the EU (backed by the Georgians) insists they should work inside Abkhazia and South Ossetia. The Russians will not allow this. Although they are stuck with 28 observers from the Organisation of Security and Co-operation in Europe, they have blocked any new ones. If observers cannot get into the enclaves, they may end up patrolling their borders, which might seem to imply de facto recognition.

Yet Mikheil Saakashvili, Georgia's president, has few regrets—as he showed when he addressed the United Nations in New York this week. He is popular: one survey gives him a 76% approval rating. He insists that the economy is strong enough to ride out the war's impact. Some officials say GDP growth will fall from 10% to 5% this year, but others expect it to be near-zero. Yet reconstruction work and foreign aid should boost the economy next year.

Mr Saakashvili remains adamant that he did not start the war. The Georgians are handing out evidence, including telephone intercepts, to show that large numbers of Russian troops entered South Ossetia through the Roki tunnel on August 7th, long before the Georgians began bombarding the South Ossetian capital, Tskhinvali. Mr Saakashvili also insists that this bombardment was in retaliation for Ossetian shelling of Georgian villages after the Georgians had declared a ceasefire. He says he would welcome an inquiry into how the war began; indeed, he claims to have been the first to call for one.

Yet Western governments remain troubled by the Georgian president. Why were claims of Russian troops moving into South Ossetia not made earlier? Many believe that he walked into a trap, miscalculating that he could take South Ossetia before Russian forces arrived in strength. Although publicly they stick to their April commitment that Georgia (and Ukraine) should both one day join NATO, in private some are having second thoughts. It might take another case of Russian aggression, in Georgia or elsewhere, to win them round. Mr Saakashvili, for one, believes that is highly likely to happen.

Turkey and Armenia

Friends and neighbours

Sep 25th 2008 | ANKARA AND YEREVAN
From The Economist print edition

Rising hopes of better relations between two historic enemies

KEMAL ATATURK , father of modern Turkey, rescued hundreds of Armenian women and children from mass slaughter by Ottoman forces during and after the first world war. This untold story, which is sure to surprise many of today's Turks, is one of many collected by the Armenian genocide museum in Yerevan that "will soon be brought to light on our website," promises Hayk Demoyan, its director.

His project is one more example of shifting relations between Turkey and Armenia. On September 6th President Abdullah Gul became the first Turkish leader to visit Armenia when he attended a football match. Mr Gul's decision to accept an invitation from Armenia's president, Serzh Sarkisian, has raised expectations that Turkey may establish diplomatic ties and open the border it closed during the 1990s fighting between Armenia and Azerbaijan over Nagorno-Karabakh. The two foreign ministers were planning to meet in New York this week. Armenia promises to recognise Turkey's borders and to allow a commission of historians to investigate the fate of the Ottoman Armenians.

Reconciliation between Turkey and Armenia could tilt the balance of power in the Caucasus. Russia is Armenia's closest regional ally. It has two bases and around 2,000 troops there. The war in Georgia has forced Armenia to rethink its position. Some 70% of its supplies flow through Georgia, and these were disrupted by Russian bombing. Peace with Turkey would give Armenia a new outside link. Some think Russia would be happy too. "It would allow Russia to marginalise and lean harder on Georgia," argues Alexander Iskandaryan, director of the Caucasus Media Institute.

Mending fences with Armenia would bolster Turkey's regional clout. And it might also help to kill a resolution proposed by the American Congress to call the slaughter of the Armenians in 1915 genocide. That makes the Armenian diaspora, which is campaigning for genocide recognition, unhappy. Some speak of a "Turkish trap" aimed at rewriting history to absolve Turkey of wrongdoing. Indeed, hawks in Turkey are pressing Armenia to drop all talk of genocide.

Even more ambitiously, the hawks want better ties with Armenia to be tied anew to progress over Nagorno-Karabakh. But at least Mr Gul seems determined to press ahead. "If we allow the dynamics that were set in motion by the Yerevan match to slip away, we may have to wait another 15-20 years for a similar chance to arise," he has said.

Charlemagne

Transatlantic model wars

Sep 25th 2008
From The Economist print edition

What Wall Street's woes reveal about European and American views of markets

Illustration by Peter Schrank

THE world needs to rebuild financial capitalism, and that means more regulation, says France's Nicolas Sarkozy. It is time to make capitalism "moral" by directing it to its proper function: serving economic development and the forces of "production", not "speculation". Mr Sarkozy's rebuke was mild by some standards. Immense power, amounting to a "despotic economic dictatorship" has fallen into "the hands of a few", thundered another leader. He added that the over-mighty few are often not "owners" of assets "but only the trustees and managing directors of invested funds." A fallacy had spread: that the market does not need any "public authority" to restrain it, because "self-direction" will do the job better.

There is no faulting Europeans for consistency when it comes to distrusting financiers, liking businesses that make things you can touch and looking to regulators to keep markets in good moral order. Mr Sarkozy was speaking on September 23rd at the United Nations. The second leader cited was Pope Pius XI, speaking after the Wall Street crash of 1929. The quotes come from a 1931 encyclical calling for economic governance by guild-like "corporations" of industrialists, workers and the like, overseen by a "special magistracy" of high-minded officials.

Europe's long squeamishness about finance is more than a historical curiosity. It is also as good a guide as any to future policy responses that will appeal to European voters. And questions of instinct and theory matter for another reason: they show a big divide between Europeans and Americans. Capitalism is actually practised in similar ways on both sides of the Atlantic. But in much of Europe, it is still easy to win applause with speeches about America being run by "the law of the jungle".

In truth the American economy is both heavily regulated and irrigated by torrents of public money. Count the lobbyists in Washington, DC: you don't need lobbyists in a jungle. America also spends a lot on public goods such as education and health, albeit differently. A new French government paper on the European social model notes that, once you add in company health insurance, American net "social spending" lies in the same range as many EU countries, at about a quarter of GDP.

Globalisation is divisive in both America and Europe. In a 2007 survey of global attitudes by America's Pew Foundation, almost identical numbers of American and French respondents called foreign companies good for their country (just under half liked them). In Spain, Sweden, Britain and the ex-communist block, enthusiasm for foreign investors left America trailing. Nor are pinko Europeans cheering at the spectacle of America nationalising banks. Europe is a capitalist place. True, there has been some *Schadenfreude* about the humbling of the “Anglo-Saxon” or “ultra-liberal” model. But there is also much unease about the taxpayer paying billions to take control of wayward businesses. In the words of Joaquín Almunia, the European economics commissioner, action must be taken to prevent systemic risks, but “Socialists like me are against financial socialism.”

A question of attitudes

Yet when it comes to instincts, three big differences suggest themselves: attitudes to risk, attitudes to the state, and attitudes to profit as a motive. The French paper says that the European social model is “characterised by a high level of protection of people against the vagaries of life”. That is not a policy goal with much resonance in America, where winning and losing are part of life and society is tolerant of those who have done both—like successful entrepreneurs with a bankruptcy behind them. The paper reflects a western European view, too. Unemployment benefits are higher in western Europe than in America, and can last (much) longer. But in eastern Europe, welfare is often stingy.

Trust in the state is also greater in western Europe than in either America or the ex-communist block, where public services nearly collapsed in the early 1990s. Dutch government research found that eastern Europeans like the idea of private pensions. Western Europeans, in contrast, trusted the state to provide for their old age.

Language can be revealing. The European press has written much about America using the “state” to save AIG and other outfits. Americans talk instead of a “government” bail-out. There is a difference. In places like France, the state is the State, run by a bureaucratic elite with a special claim to disinterested wisdom. America’s government does not claim a monopoly on wisdom when it comes to bailing out markets; it is just that, in hard times, it is the only bit of the system with money.

Among officials in French-speaking countries, a favourite term is the hard-to-translate verb *maîtriser*, meaning to take something in hand. The list of activities in need of official mastery is long. Charlemagne recalls being informed that officials—not the market—should judge where to locate dairy farms (in France), where to plant new vineyards (in Luxembourg), and when shops should open (in Belgium). That said, European life is less minutely regulated than it was 20 years ago. Even France is changing under Mr Sarkozy.

Perhaps the biggest difference concerns the profit motive. Peer into European debates on privatisation, for instance, and many opponents argue that running a service for profit means pain for workers, consumers, or both. In short, many Europeans still instinctively believe that capitalism is a zero-sum game, in which a company making profits must be exploiting somebody. That is far less true of Americans. European leaders have no problem with profits as such, or even with those who make them. But many of the voters they answer to are uneasy about capitalism. Mr Sarkozy’s call to make high finance “moral” has deep roots. When crisis management turns to a debate on new regulation, Americans and Europeans will start from different places.

The Labour Party

Political alchemy

Sep 25th 2008 | MANCHESTER
From The Economist print edition

The prime minister tries to turn a faltering economy to his advantage

Reuters

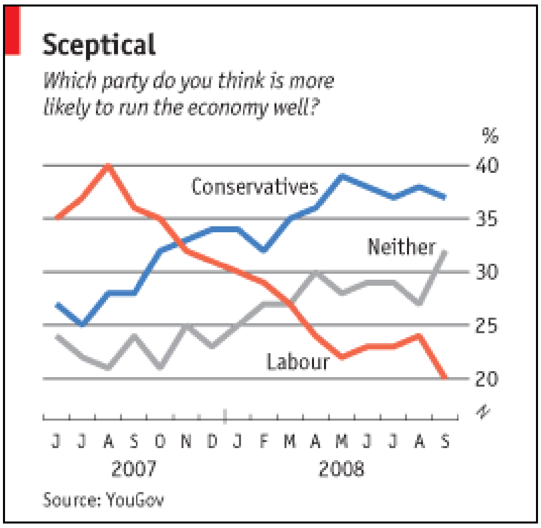
GORDON BROWN'S premiership, seemingly cast-iron a year ago, is now so vulnerable that even a good day at the office does no more than buy him a few weeks of respite from Labour Party rebels. By that criterion at least, his address to the party's annual conference in Manchester on September 23rd was a success.

Mr Brown did not eschew his infuriating tropes: the selective deployment of statistics, targets for an unfathomably distant future and attempts to claim for the government a near-monopoly of credit for the past decade or so of economic growth. But he did offer a clear sense of his priorities—social mobility at home and financial reform internationally—something that last year's speech had only promised. For once, thanks to the unsettling economic context in which he spoke, his stolid predictability seemed an asset.

A long-standing theory in Westminster has it that economic difficulties might actually work to Mr Brown's benefit, just as they did for the Conservative government in the 1992 general election. This has always seemed fanciful. After all, the electorate was still prepared to give the Tories the benefit of the doubt on economic policy then—until they lost it a few months later when the pound was slung out of the ERM. And Mr Brown, a decade-long chancellor of the exchequer, is implicated in economic performance as John Major, the then prime minister, who had served at the Treasury only briefly, never was.

Yet Labour's hope that the downturn can play the role of *deus ex machina* may not be entirely fantastic. Voters preferred the devil they knew in 1992 because Labour looked more like a punchy opposition than a credible government. On economic policy at least, the modern Tories may well inspire similar doubts. True, a poll by YouGov released on September 20th showed that the Conservatives were more trusted than Labour on economic management by a margin of 17 percentage points (see chart). But a third of all respondents had confidence in neither party, and a sharp dip in trust in Labour since August has not benefited the Tories at all.

The inexperience of their leaders is one likely reason for this; but Labour politicians are confident of undermining the Tories' economic credentials on two other fronts. One is class. Witless attacks on the gilded backgrounds of Tories such as David Cameron and George Osborne, their leader and shadow chancellor respectively, have flopped. But hinting that these privileged folk cannot grasp the struggles of ordinary voters, as the usually bludgeoning Mr Brown did in his conference speech, may work.



Another is the Tories' actual record. Blaming shadow cabinet members for distant recessions that took place before they entered Parliament is unreasonable. But shining a light on more recent failings, such as their contradictory statements during the crisis of Northern Rock, a bank that ran into trouble last year, is not.

Despite these glimmers of opportunity, the immediate future looks tough for Mr Brown. Even Labour's hefty post-conference bounce in the polls (see article) leaves the Tories leading by a wide margin, and that is before they begin their own conference in Birmingham on September 28th. Mr Brown's hopes for a solid recovery were hit by the announcement on September 24th that Ruth Kelly, the transport secretary, intends to leave the government for family reasons—which ensured that his speech hogged the headlines for only a matter of hours. Some speculate that the real motives for her departure were more incendiary: disaffection with Mr Brown's leadership and, as an observant Catholic, objection to the government's relaxation of the laws on embryo research.

Mr Brown was forced to adopt desperate measures in his conference speech, such as getting his publicity-shy wife to introduce him on stage and implying that Mr Cameron uses his children as political props. That leaves him with little in store for the next emergency. That could come as soon as November 6th, when a by-election in Glenrothes is likely to be held. As the constituency is next door to Mr Brown's own, defeat for Labour would be even more embarrassing than other by-election setbacks this year. And if that proves survivable, heavy losses at local and European elections next June may not be.

The remaining weapon that Mr Brown has at his disposal, a cabinet reshuffle, may be deployed before then—perhaps right after the Tories return from Birmingham. Mooted changes include promoting young ministers such as Jim Murphy and Liam Byrne, finally relieving the overburdened Des Browne of either his defence or his Scotland portfolio, and sending Mr Darling to the home office—though that would disrupt Mr Brown's narrative of economic competence, given that he appointed Mr Darling in the first place. Geoff Hoon, the chief whip, may lose his job only to be given a grander one next year—he is tipped to replace Peter Mandelson as Britain's European Union commissioner.

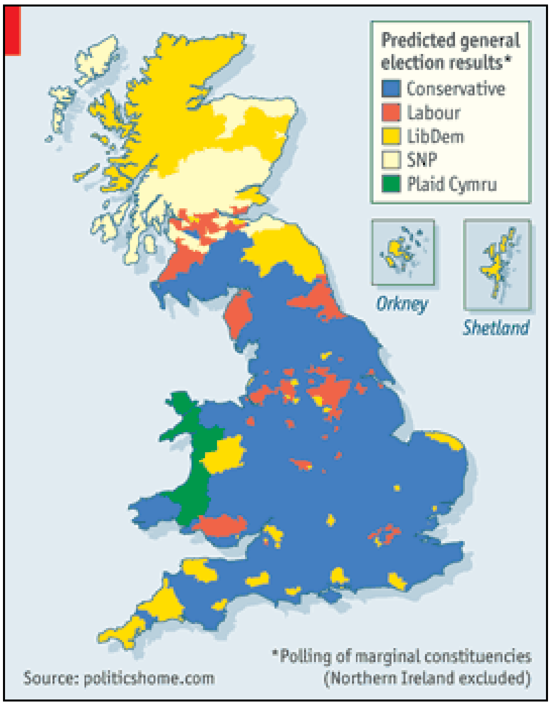
But even if a reshuffle as dramatic as this emerges (and, given Mr Brown's habitual caution, that is far from certain) it will, like his conference speech, give him only a transient fillip. If someone else looked capable of improving Labour's electoral prospects quickly, Mr Brown would already have packed his bags. To be sure, the Tories are more vulnerable than they realise on the economy. And it helps Mr Brown that his party lacks the Tories' cold-eyed, dagger-wielding pragmatism: the mood in Manchester was of gloom, not insurrection. But it is, more than anything, the lack of an obvious alternative to Mr Brown that keeps him in power.

Labour's electoral prospects

Dead-cat bounce

Sep 25th 2008
From The Economist print edition

Bets as well as polls signal defeat



GORDON BROWN may have won a reprieve from the critics within his party—and even a post-conference bounce in the electorate's esteem. But the prime minister needs more than a bounce to clamber out of the hole he and his party are in.

In the run-up to Labour's conference opinion polls put the Conservatives, on average, around 20 points ahead. A survey of marginal constituencies published on September 21st found so much support for the main opposition party that, were it to be repeated at the ballot box, the Tories would win a general election with a landslide majority of 146 MPs (see map). The Liberal Democrats, Britain's third-biggest party, would keep 44 of their 63 seats, and nationalists would make big gains in Scotland and Wales. But Labour would be wiped out in the south of England outside London and would also suffer big losses in the north, traditionally safe ground.

This dire prediction for the government is particularly striking given the electoral hurdles the Conservatives face. In particular, their supporters tend to cluster in true-blue constituencies, so under the first-past-the-post system many of their votes are wasted on whopping majorities. In 2005 Labour won 355 seats with 35.3% of the vote; with 32.3%, the Tories won just 198. Until recently the size of the national swing needed to overcome this stacked electoral arithmetic seemed out of the Tories' reach.

Mr Brown's woes are more than mid-term blues. As well as asking about voting intention, pollsters at Ipsos-MORI regularly ask which party has better leaders, which issues count and which party performs better on those issues. Worryingly for Labour, twice as many now think the Tories are well led as think Labour is. Only on health and education does Labour do better—and these now concern voters less than the economy.

YouGov, an online pollster, offers a little comfort for Mr Brown, in the shape of a pair of polls taken before and after his speech to the Labour conference on September 23rd. Between the two, support for Labour rose seven points from 24% to 31%, while support for the Tories fell from 44% to 41%. Parties commonly experience a conference-season bounce, but this is larger than normal and may buy Mr Brown more time to persuade the detractors within his own party that he is their best and only hope of victory in the next election.

Such a victory, though, is still a long shot. Punters are of the same mind as pollsters: the current odds on betfair, an online gambling exchange, translate into probabilities of 63% for a Conservative outright win and 77% for getting the most seats, against a mere 14% for a fourth Labour term in office. “If you’re dissatisfied with the government, you may tell a pollster you’ll vote for the opposition,” says Leighton Vaughan Williams of Nottingham Trent University’s Betting Research Unit. “But gamblers bet on what they think will happen, not to register a protest. After all, it’s their own money they stand to lose.”

EDF and British Energy

Nuclear renaissance?

Sep 25th 2008
From The Economist print edition

The government may have to offer some subsidies to get new plants built

FREE markets are not popular at the moment, and Britain is home to more than most. Known for its famous—or infamous—"light-touch" regulation of financial services, it is a pioneer in other areas too, with one of the most liberalised energy markets in the world. Supporters argue that this has allowed Britons to enjoy low energy prices for over a decade. Detractors say it has led to price swings, robbed the government of direct influence over energy policy and made grand plans for expanding nuclear power and renewable energy hostage to the hard-nosed decisions of profit-seeking private firms.

So there were sighs of relief in official circles at the announcement on September 24th that EDF, a French power giant, would pay £12.5 billion ($23.2 billion) to buy British Energy, the firm that runs most of Britain's remaining nuclear-power plants. The deal had stalled in July when two of British Energy's biggest shareholders argued that EDF's offer undervalued the firm in an era of high oil prices. But prices have fallen since those heady days, and EDF's new offer of 774p per share is only 9p higher than its old one. Centrica, a British energy firm, hopes to take a 25% stake in the newly-merged firm, in the hope of reducing its own exposure to fossil-fuel prices. That would also spare ministerial blushes by sticking a Union Jack-patterned fig-leaf over a deal that hands control of Britain's existing nuclear power plants to a firm that is 85% owned by the French government.

EDF has been among the most vocal lobbyists for a British nuclear renaissance; British Energy offers it a beachhead in what it hopes will be a growing market. It is less interested in British Energy's existing reactors (most of which are old and unreliable) than in building new ones on the sites they occupy, probably at Sizewell in Suffolk and Hinkley in Somerset.

The British government is keen too, in order to show that it is making tangible progress with an energy policy which has become steadily more pro-nuclear as carbon emissions have risen and worries over security of supply have grown. Ministers hope that EDF's trailblazing will encourage other companies to build reactors too. Indeed, one condition of the deal is that, once planning permission has been granted for new stations on the sites EDF has chosen for its own efforts, it will sell some remaining land to competitors. Sir Adrian Montague, British Energy's chairman, said the deal was "the linchpin of a new nuclear future".

Cynics look instead to Britain's chequered nuclear past. Sizewell B, its newest plant, was completed in 1987 after one of the longest planning inquiries ever. So painful was the process that ministers abandoned plans for other stations of the same design. New fast-track planning powers are intended to prevent such delays in future, but economic questions remain. Nuclear plants are expensive to build and must run constantly, so they are vulnerable to changes in electricity prices. Five years ago British Energy had to be rescued from bankruptcy by the government after a long period of cheap power.

Ministers insist that nuclear power will not be subsidised, meaning that investors must rely on power prices remaining high for decades. Not everyone believes the government will stick to its guns. John Hutton, the business secretary (whose department is responsible for energy), worried this week that unless the government ensured "the right climate for investment", firms might choose to put their money elsewhere. Put less politely, says Dieter Helm, an energy economist at Oxford University, the private sector has the government over a barrel: "It's a good investor's bet that the government will change its policy," he says, possibly by extending some form of carbon-free energy subsidy to nuclear power or perhaps even by guaranteeing a minimum electricity price.

Decommissioning plants and disposing of waste pose a particularly tricky question. The bill for dismantling existing reactors stands at around £74 billion over 130 years. Ministers insist that the private sector will pay the clean-up costs for the new plants it builds, but it is hard to see how—nuclear decommissioning is an infant industry, and the time span involved in waste disposal is beyond the likely lifetime of any private firm. Those literate in Whitehall-speak point out that official documents say only that firms must bear their “fair share” of costs—and that a “share” usually means less than 100%.

Energy supplies

A chill wind

Sep 25th 2008
From The Economist print edition

Britain’s dependence on gas imports will increase

ENERGY policy in Britain over the past half-decade has been a tale of despair and redemption. Nuclear power was ruled out in 2003 as too expensive; the Anglo-French deal announced this week suggests that a new nuclear age is dawning. In a climate-conscious age, coal, the dirtiest fossil fuel, is a pariah. Yet on September 22nd John Hutton, the secretary of state for business, proposed new coal plants to complement the new nuclear stations, in order to reduce Britain’s reliance on imported natural gas.

A sensible goal, but tricky—at least in the short run. North Sea production has been declining for almost a decade. Imported gas accounted for around two-fifths of British consumption last winter; it will be four-fifths by 2020. And as indigenous supplies fall, a looming shortfall in electricity generation (elderly nuclear plants and dirty coal-fired stations must soon be closed) will have to be met largely through more gas, which already provides 40% of Britain’s power.

Ian Fells, an energy consultant, believes that gaps between demand and supply may emerge as early as 2012, too soon for either new nuclear plants (which take around a decade to build) or coal stations (which take four or five years) to prevent. Gas plants, by contrast, can be built in a little over a year, and cheaply. In operation they can respond quickly to changes in power prices, which is useful in Britain’s cut-throat market. And they are cleaner than coal stations, a big advantage now that firms have to pay for emitting carbon. On government figures gas will account for 55% of British power generation by 2020.

Rising imports look inevitable, and the government has tried to ensure supplies by diversifying their sources. It has approved new pipelines to Norway and continental Europe as well as building terminals for landing liquefied natural gas (LNG) brought in by ship. But the experience of importing gas has not so far been reassuring: prices more than doubled in a few days in November 2005, as temperatures fell and European firms refused to send gas across the Channel. LNG terminals have been under-used because cargoes are attracted instead to places such as the Far East, where customers will pay higher prices.

These problems are exacerbated by a lack of storage. Britain has the capacity to store just 14 days-worth of gas, compared with Germany’s 70 days, for example. So British firms cannot buy foreign gas in summer, when it is cheap, and must pay spot prices in winter, when demand is highest. Forward prices for the coming cold season are already around 85p a therm, up from 60p this summer. Some new storage is being built, but much is tied up in the planning process. Mr Hutton could do worse than expedite it.

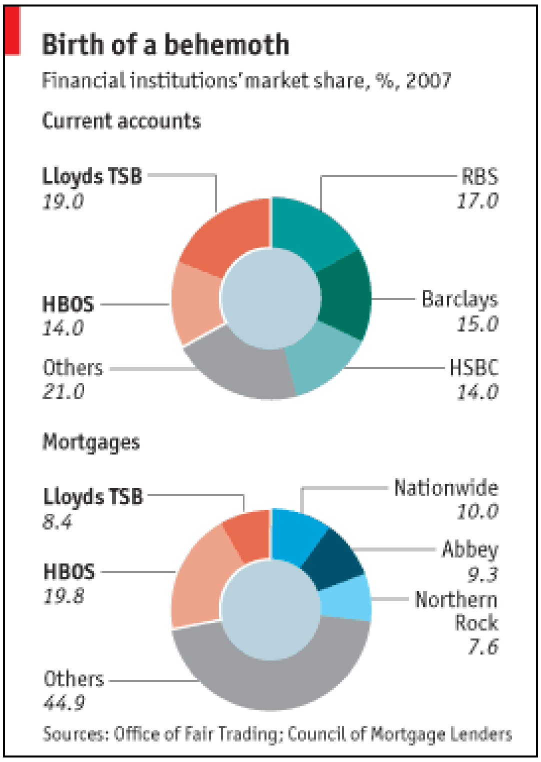
Economist.com
WORLD
BRITAIN

Lloyds TSB and HBOS

Monster mash

Sep 25th 2008
From The Economist print edition

Out of the turmoil came forth…what exactly?



SHOTGUN weddings rarely make for happy marriages. The relief at the news on September 18th that HBOS, Britain's fourth-biggest bank (by regulatory capital), had found safety in the arms of Lloyds TSB, the fifth biggest, has now given way to headache. Scotland is mourning the loss of a national champion (see article). Elsewhere too shareholders and financiers are asking questions. Was the merger necessary? Were market conditions really so bad? And, perhaps most pressingly, what exactly is this merger giving birth to?

Together, the banks have 142,000 employees, 2,800 branches and 38m customers. The merged super-bank would dominate the markets for retail banking and mortgages, with close to 30% of both. It would also be the biggest player in life insurance with around 18% of the market.

In normal times, creating such a monster would have been impossible; indeed, Lloyds TSB was turned down in 2001 when it sought to take over Abbey National, a bank. But the recent financial turbulence has been anything but normal, and ministers promised to use their powers to sidestep competition concerns. And so a final question: does that matter?

Thanks to the merger, around 1,000 branches are expected to disappear from high streets. That is reasonable, if the deal is to make economic sense. Eric Daniels, Lloyds TSB's chief executive, insists that there is "vibrant competition" in British banking which a merged firm would not stifle. He points to Switzerland and Scandinavia, where a relatively small number of banks compete vigorously for custom.

But British banking is not quite the competitive hotbed that Mr Daniels suggests. A report in July by the Office of Fair Trading (OFT), a competition watchdog, found that the four established high-street banks—Lloyds TSB, HSBC, Royal Bank of Scotland and Barclays—compete on quality but are slow to respond to price-cutting by other rivals. British depositors, for their part, are among the most reluctant in Europe (after the Finns, the Dutch and the Swedes) to switch institutions. HBOS is one of what the OFT calls the "challengers" who do compete primarily on cost; as part of Lloyds TSB, it might well abandon such competitive vigour for the more languid approach of its parent. And choice may be muffled within HBOS too as a result of the takeover. Lloyds TSB and its mortgage arm Cheltenham & Gloucester have homogenised their mortgage rates. HBOS's mortgage arms—Halifax, Intelligent Finance, Bank of Scotland and Birmingham Midshires—offer different rates, for now.

Yet the merger is not yet a done deal. The OFT has invited comments on the nascent leviathan and will present its findings before it goes through. Although the government is likely to trump the process, citing the national interest, the competition boffins could still make recommendations designed to mitigate the result—hiving off certain businesses (such as Scottish Widows, an insurance and asset-management firm), for example.

Shareholders in both banks will also have a chance to vote on the union, and plenty of them are riled. Standard Life, one of the biggest, is angered by how news of the deal was handled (though it says it will not oppose the merger). Other critics argue that had the authorities advanced the announcement of two decisions—extending the Bank of England's Special Liquidity Scheme designed to underpin the banking system, and suspending short-selling of financial shares—HBOS would not have needed to be rescued.

Short-sellers were not the only ones pushing down HBOS's share price in the days before the deal was announced; many existing shareholders had lost patience as the shares dipped far below the price of an expensive (and poorly subscribed) rights issue in July. But the liquidity problems of a stand-alone HBOS could have been solved by Bank of England funding, says Alex von Ungern-Sternberg, who runs Euro-IB, an investment-banking boutique, since its mortgage assets, he believes, are of good quality. He wants HBOS shareholders and managers to vote to reject the merger.

In reality that is improbable unless financial markets recover far faster than they now look likely to; HBOS has been struggling for months. Yet the shareholders of Lloyds TSB might do well to ponder the fine print too. JPMorgan Chase, a bank, reckons that cost savings may prove illusory because of the loss of revenue that will occur as the two loan books are put together and rationalised. More important, two generations of chief executives of Lloyds TSB have focused on the home market, making extraordinary profits but limiting the bank's horizons. With this merger, Lloyds TSB risks growing too big for that strategy: Sir Victor Blank, its chairman, has announced ambitions to be a world top-ten player. Buyer, beware.

HBOS and Scottish politics

Bye bonnie bank

Sep 25th 2008 | GLENROTHES
From The Economist print edition

How a takeover is fuelling a political battle

OUTSIDE the HBOS branch in the Kingdom shopping mall at Glenrothes in Fife this week, most customers professed themselves unworried that their bank is going to be bought by rival Lloyds TSB. But across the river Forth in Edinburgh a political row is brewing about the takeover. That storm will engulf Glenrothes when a parliamentary by-election in the previous Labour stronghold is held, probably on November 6th. The outcome may yet determine Gordon Brown's chances of remaining prime minister despite his rallying conference speech this week.

Until Labour's extraordinary defeat at the hands of the Scottish Nationalists in the Glasgow East by-election in late July, Glenrothes would have been regarded as a shoo-in for Labour and the man who leads it. But now it is Gordon Brown, MP for the adjoining seat of Kirkcaldy, who looks the underdog, whereas Alex Salmond, Scotland's Nationalist first minister, is in the ascendant. The row over HBOS encapsulates their battle for Scotland's soul.

The controversy arises because the Bank of Scotland (as it called itself before merging with the Halifax, a Yorkshire-based mortgage lender, in 2001) is more than just a bank. It was Europe's first joint-stock bank, founded in 1695 while Scotland was still independent. It has remained proudly Scottish, jealously protecting its right to issue banknotes. Its long-term corporate lending is seen by many Scottish businessmen—such as Brian Souter, founder and chairman of Stagecoach, a big bus company—as vital to their success.

So Mr Salmond, who has made boosting the Scottish economy a priority, is appalled at the prospect that those decisions will migrate south to London. He fears the merger may also deal a blow to Scotland's financial-services sector, the fastest-growing part of the Scottish economy. The potential loss of jobs (4,000-5,000, some estimate) is another bone of contention. On September 22nd Mr Salmond won united backing from opposition parties and business leaders for a demand that Lloyds TSB, assuming the takeover goes ahead, must pledge to keep as many executive functions and jobs in Edinburgh as possible.

Mr Salmond also rages at the "spivs and speculators" who shorted the bank's shares. He has rounded on the Financial Services Authority (FSA), which supervises banks, for not doing more to back its September 17th statement reassuring depositors that the bank was soundly capitalised. He fumes that the suspension of short-selling on September 18th came too late to save the bank. And he storms that Alistair Darling, the chancellor, stood idly by when a bail-out loan from the Bank of England might have saved it.

Mr Darling, equally angry, points out that HBOS did not seek such a loan but asked only that the government clear away regulatory hurdles obstructing a merger. This, he says, was an "infinitely better" solution than leaving the bank to struggle and probably end up nationalised.

There may be a good deal of political posturing in all this, but Mr Salmond's version is catching attention among HBOS customers at Glenrothes. "I think the FSA should have kept a better eye on the stockmarket. They could have stopped this," says one. "City whizz kids have brought it down, they shouldn't have the power to do that," says another. Mr Salmond hopes that, by polling day, enough will share his view to turn an expected Labour defeat in the by-election into a rout.

Stalemate in Northern Ireland

A tongue-twister of a dispute

Sep 25th 2008
From The Economist print edition

A demand to make Irish an official language is causing ructions

Illustration by Claudio Munoz

SINCE June Northern Ireland's power-sharing arrangement between the Protestant Democratic Unionist Party (DUP) and the Catholic Sinn Fein, the political wing of the now disbanded IRA, has been in abeyance. The stalemate has arisen for several weighty reasons, including a disagreement over when control of policing and the courts should be handed back from Westminster. But a more intractable issue is the status of "Irish", the Gaelic language respected by many but spoken fluently by only a small proportion of Catholics. Although the linguistic dispute may appear trivial, the row compacts ancient hatreds and modern resentments into a toxic compound.

Most northern place names originate in Irish, including the term "Ulster" (Uladh) for Northern Ireland, which is preferred by hardline unionists. By contrast streets, public buildings, bridges and even the new town of Craigavon usually bear the stamp of previous unionist dominance.

Sinn Fein—"We Ourselves"—the biggest party representing Northern Ireland's Catholics—now wants Irish to be given official status, with support for the language in schools and translation of much official business. Some of the party's high command could do with lessons themselves. Gerry Adams, Sinn Fein's president, inexpertly chunters through opening remarks in the language and spatters his conversation with Irish sayings. Martin McGuinness, the deputy first minister at Stormont, has taken classes but settles for the introductory "*A dhaoine uaisle*...ladies and gentlemen" used for decades by politicians in Dublin similarly challenged by the Irish state's first official tongue.

Sinn Fein's enthusiasm for Irish is partly a response to a revival in the language. Around 167,000 people, a tenth of the population, claim some knowledge of it and more than 4,000 children are being educated through it. More important, Irish gives Sinn Fein a popular issue to cover its climbdown from traditional demands for Irish unity.

The party's linguistic aspirations are difficult for the DUP to swallow on top of its other worries. Peter Robinson, who took over the party leadership from Ian Paisley, would probably like to reach a compromise on policing and justice, but he is reluctant to confront colleagues who take a harder line. He is also worried about the possible appeal to DUP voters of Jim Allister, who founded "Traditional Unionist Voice" after leaving the party in protest against power-sharing.

Gordon Brown's assertion on a recent trip to Belfast that it was time to devolve policing and justice pleased Sinn Fein, who were promised the move by Tony Blair. But it angered the DUP and, if anything, made movement less likely. The anxious Mr Robinson could not be seen to bow to what he called the prime minister's "ill-conceived, unbalanced and ill-advised" remarks.

Today's DUP likes to believe it is in power at Stormont purely because of its electoral strength. Its members downplay Mr Paisley's agreement with Mr Blair's government and deny any with Sinn Fein. Yet before Mr Brown's visit negotiators for the two parties had agreed that neither should initially take the post of minister for policing and justice. A deal on the devolution of these powers and the period over which it should happen is possible.

In contrast, giving Irish an official place in Northern Ireland may be beyond Mr Robinson's DUP. It would mean admitting that the place is not as British as Finchley. Mr Paisley had the charisma to carry his party into a deal it does not like. Mr Robinson lacks it.

Bagehot

Gordon Brown's 1,001 hours

Sep 25th 2008
From The Economist print edition

The prime minister's speech bought him some time—but perhaps not much

Illustration by Steve O'Brien

IN THE *1,001 Nights*, the princess Scheherazade faces execution at dawn. She keeps herself alive, night by night, by telling the murderous king stories, sustaining his interest and thus her life by beginning a fresh one each evening. Gordon Brown's premiership has likewise been surviving, day by day, on a succession of tantalising fables; the endings have mostly been disappointing, but each has been quickly succeeded by another, so that the time has never seemed right for the Labour ministers who want to depose him to do so. There was the story of how the wise vizier of Downing Street would help his subjects with their housing problems, and then one about the bounty that would ameliorate rising fuel costs. There is the unfinished story of the imminent cabinet reshuffle; the mysterious resignation of Ruth Kelly, the transport secretary, was its prologue.

And, for much of the summer, there was the story of a story—of the gripping tale Mr Brown was to tell at the gathering of his Labour tribe in Manchester on September 23rd; of a speech whose magnificence might force the conspirators to sheathe their daggers. Marvellous to relate, this one turned out to be true.

The speech was terrific. Borrowing from America, Mr Brown was introduced and embraced by his normally discreet wife. After the smooching came the uncharacteristic schmaltz: reminiscences of his youth, and anecdotes of hardship eased and lives saved though Labour's beneficence. There was half an apology (though more in the manner of "I am sorry you feel that way" than outright contrition) over the botched tax reform earlier this year. There were one-and-a-half jokes. Most important, the speech itself contained two further, exciting stories.

The first was about the Conservatives. Hitherto, Mr Brown's assorted criticisms of them and David Cameron, their leader, have flopped. This time he tried a new line of attack, part of his general strategy to turn the ongoing financial mayhem to his advantage: this was, he said, "no time for a novice". The charge of callowness may stick. And the barb also struck David Miliband, the young foreign secretary, who had assiduously, if mostly decorously, used the conference and his own calculated speech to advance his claim to Mr Brown's job.

The second, related story in Mr Brown's address was about Labour. It was actually an old legend, though one not recounted so heartily for a while. Mr Brown depicted Labour as the party of the activist state, whose resources it could and would mobilise to protect the little man from the perils of degenerate capitalism.

The conference hissed with talk about "speculators" and "spivs", short-selling and other sibilant enemies of the people. That is standard chat among Labour's unreconstructed Left: the difference this year was that the sub-Stalinist vocabulary was echoed by cabinet members too. Ed Balls, the schools secretary and the prime minister's right-hand man, claimed that advocates of "light-touch regulation" had been "routed". Normally centrist ministers talked privately about squeezing the rich. While describing Labour as "a pro-market" party, Mr Brown himself denounced "the dogma of unbridled free-market forces".

Manchester nights

This evolving tale of state activism is also, of course, a parable of hypocrisy: these foes of light regulation were until very recently its champions; the ministers who in Manchester extolled the nationalisation of Northern Rock, a failed bank, as an example of decisive intervention spent months dithering over whether to do it. All the same, this new-old story is clever politics. Rising prices and economic uncertainty now head voters' concerns. The electorate may indeed be ready to embrace a party that promises to protect it from the fallout of the financial cataclysm—and only Labour can plausibly offer itself as that bulwark. That is Mr Brown's new narrative—a beguiling one for the Labour supporters who heard it, and potentially others too.

It has a serious political flaw, however: not what Labour has done in the past, but what it proposes to do now. Neither Mr Brown nor any other senior minister has made clear exactly (or even inexactly) how the redemptive power of the state is to be unleashed. The opportunity for Labour is plain enough—but where are the grand neo-Keynesian policies with which the prime minister plans to seize it? Whether because of political timidity or fiscal limitations, there don't seem to be any.

Just as the modest measures on housing and fuel costs announced earlier this month fell short of the expectations raised by the Downing Street fabulators, so the ideas mooted at Labour's conference do not match Mr Brown's year-zero rhetoric. Perhaps the prime minister will help to engineer a new and safer global architecture for financial institutions, something he has long advocated and which he pledged to do in New York this week. But, in domestic policy, his temporary ban on the short-selling of shares, and hot air about restricting City bonuses, do not amount to the "new settlement" his speech promised. (There were other worthwhile initiatives, such as expanding nursery provision and remedial teaching, but none was epoch-making.) The left-wingers who have rallied behind him, partly in the hope of keeping Mr Miliband out, may soon feel disappointed.

For that reason, Mr Brown's big speech, rousing as it was for the audience in the hall, seems unlikely to revive Labour's ratings or prospects for long. He and his party may anyway have sunk too low to come back. And so the plots to oust him that rumbled on beneath the hypocritical conference smiles and photo-op handshakes will probably erupt in the end (though Mr Miliband now looks less likely to be their beneficiary). Even some of Mr Brown's closest allies talk only about deferring a leadership struggle until next summer, not avoiding one altogether. His speech and his stories have bought him some time, but perhaps only a few months: 1,001 hours, maybe, rather than 1,001 nights.

Economist.com WORLD INTERNATIONAL

Data mining

Know-alls

Sep 25th 2008
From The Economist print edition

Electronic snooping by the state may safeguard liberty—and also threaten it

Kobal Collection

IF A Muslim chemistry graduate takes an ill-paid job at a farm-supplies store what does it signify? Is he just earning extra cash, or getting close to a supply of potassium nitrate (used in fertiliser, and explosives)? What if apparent strangers with Arabic names have wired him money? What if he has taken air flights with one of those men, with separate reservations and different seats, paid in cash? What if his credit-card records show purchases of gadgets such as timing devices?

If the authorities can and do collect such bits of data, piecing them together offers the tantalising prospect of foiling terrorist conspiracies. It also raises the spectre of criminalising or constraining innocent people's eccentric but legal behaviour.

In November 2002 news reports revealed the existence of a big, secret Pentagon programme called Total Information Awareness. This aimed to identify suspicious patterns of behaviour by "data mining" (also known as "pattern recognition"): computer-driven searches of large quantities of electronic information. After a public outcry it was dubbed, perhaps more palatably, Terrorism Information Awareness. But protests continued, and in September 2003 Congress blocked its funding.

That, many people may have assumed, was that. But six of TIA's seven components survived as secret stand-alone projects with classified funding. A report in February by America's Department of Homeland Security named three programmes it operates to sniff out suspicious patterns in the transport of goods. Similar projects have mushroomed in, among other countries, Britain, China, France, Germany and Israel.

Civil-liberties defenders are trying hard to stop data-mining becoming a routine tool for the FBI to spy on ordinary Americans. They say that the administration is racing in its final months to formalise in law programmes that have run solely under authorisation from the White House that bypasses Congress. One pending change would authorise more intelligence sharing between federal and local officials. In a federal court filing made public on September 20th, America's attorney-general, Michael Mukasey, sought legal immunity for telecoms firms which have provided details on international phone calls. What happens in practice, and what the law permits, is a hot and unresolved issue.

Last month, after a briefing by the Department of Justice about a secret data-mining plan for the FBI, a group of American lawmakers wrote to Mr Mukasey complaining that the plan would allow the FBI to spy on Americans "without any basis for suspicion". The proposed project could be made public in coming weeks.

No similar pan-European data-mining programme is operating, at least to public knowledge. Yet under an agreement signed in July last year airlines flying from the European Union to America have had to provide the authorities there with reservations data, as well as information obtained by airport-security screeners. This can include passengers' race, religion, occupation, relatives, hotel reservations and credit card details. Internet service providers and telecoms firms in the EU must now keep for up to two years, though not automatically hand over, data on websites visited and phone calls made and received (but not the content of conversations).

Fast company

FAST, a Norwegian company bought by Microsoft this year for $1.3 billion, collects data from more than 300 sources (including the web) for national data-mining programmes in a dozen countries in Asia, Europe and North America. In April British members of Parliament learned that almost a year earlier the home secretary, Jacqui Smith, had secretly authorised the transfer of licence-plate data recorded by roadside cameras to foreign intelligence agencies. In June the Swedish Parliament voted into law a data-mining programme strongly backed by the defence ministry. From January 1st it will provide sweeping powers to monitor international electronic messages and telephone traffic.

The staggering, and fast-growing, information-crunching capabilities of data-mining technology broaden the definition of what is considered suspicious. In June America's Departments of Justice and Homeland Security and a grouping of American police chiefs released the "Suspicious Activity Report—Support and Implementation Project". Inspired in part by the approach of the Los Angeles Police Department, it urges police to question people who, among other things, use binoculars, count footsteps, take notes, draw diagrams, change appearance, speak with security staff, and photograph objects "with no apparent aesthetic value".

Companies, and especially credit-reporting firms, generally enjoy more latitude than government bodies do in making personal information available to third parties. They find intelligence agencies are eager clients. Chris Westphal, head of Visual Analytics, a firm in Poolesville, Maryland that operates data-mining software for security and intelligence agencies, says the data provided by such firms is "very significant". Narayanan Kulathuramaiyer, an expert in data mining at UNIMAS, a Malaysian university, says companies are selling database access to intelligence and law-enforcement agencies "at a level you would not even imagine".

Legal challenges to governments' use of personal information held by companies have reached high courts in many countries, including America's Supreme Court. Rulings, however, have for the most part frustrated privacy advocates. Suzanne Spaulding, a former legal adviser to the Senate and House intelligence committees, says improvements in data-mining technology have enabled intelligence agencies to milk favourable court rulings in ways that exceed judicial intent. For example, such cases typically concern permission to use data from a single source, such as a phone company's billing records. When different databases are mined simultaneously, the value of information increases exponentially.

Spies are increasingly snooping on private internet use. Katharina von Knop, a data-mining expert at the University of German Federal Armed Forces in Munich, says many systems remotely analyse the content of web pages people visit. A man who has travelled to, say, Peshawar, a stronghold of Islamist extremism in Pakistan, is considered more dangerous if he also reads the blog of an extremist Muslim cleric. If the cleric lives in Peshawar, the man's suspicion score rises further. Data-mining software develops profiles by taking into account all web pages visited by a computer user; if a suspect visits a stamp-collecting website, the suspicion score is lowered.

Such profiling increasingly relies on "sentiment analysis". Hsinchun Chen, head of the Artificial Intelligence Lab at the University of Arizona says this technique, which he performs for American and international intelligence agencies, is an emerging and booming field. The goal is to identify changes in the behaviour and language of internet users that could indicate that angry young men are becoming potential suicide-bombers. For example, a person who exhibits curiosity by visiting many Islamist websites and asking numerous questions in online forums might be flagged by sentiment-analysis software if he shows signs of resentment and eventually turns to "radicalising" others by, say, justifying violence and providing links to militant videos. Mr Chen says intelligence agencies in the United States, Canada, China, Germany, Israel, Singapore and Taiwan are customers for this technique.

Does it work?

Donald Tighe, vice-president for public affairs at In-Q-Tel, a non-profit investment outfit that helps the CIA stay abreast of advances in computing, says that data mining is now so powerful it has become “essential to our national security”. But campaigners for privacy have many worries. One fear, prevalent in Britain after incidents in which officials lost huge quantities of confidential personal information, is that the state may be even more careless with data than private firms are. Another is that innocents are flagged for further investigation or added to “watch-lists” that may impede air travel, banking and gaining jobs in places where radioactive materials are used, such as hospitals. The American Civil Liberties Union (ACLU), a lobby, says the list maintained by the Terrorist Screening Centre at the FBI now has more than 900,000 names, with 20,000 more every month. Being removed is tricky.

Data-mining may be bad for national security as well as for civil liberties. The software is often modelled on the fraud-detection applications used by financial institutions. But terrorism is much rarer. So spotting conditions that may precede attacks is harder. Mike German, a former FBI agent who now advises the ACLU, says intelligence agencies too readily believe in the “snake oil” of total information awareness, which drains effort from more useful activities such as using informers and infiltrators.

AFP

Explosive data

Abdul Bakier, a former official in Jordan’s General Intelligence Department, says that tips to foil data-mining systems are discussed at length on some extremist online forums. Tricks such as calling phone-sex hotlines can help make a profile less suspicious. “The new generation of al-Qaeda is practising all that,” he says.

Last year two pattern-detection programmes, ADVISE and TALON, run respectively by America’s Department of Homeland Security and the Pentagon, were shut down following privacy concerns and irregularities. Privacy advocates, however, say that other programmes continue—and many are operated, with minimal oversight, by the National Security Agency. The NSA insists that it does keep Congress informed. It also vigorously defends data mining, saying that if today’s systems were in place before the terrorist attacks of September 11th 2001, some of the hijackers would have been identified.

In July, after fierce debate, Congress imposed new limitations on government wiretapping when it renewed the expiring Foreign Intelligence Surveillance Act (FISA) sought by President George Bush after September 11th. The main law governing data mining, this has provided the administration with broad and unprecedented electronic-spying powers. But civil-liberties lobbies such as Amnesty International and Human Rights Watch say the renewed, restricted law leaves largely untouched far-reaching secret “black” programmes, run by the NSA, which crunch data on great numbers of people, including millions of Americans. Much of that is personal financial information collected by the Treasury.

Mr Bush says that FISA helps protect citizens’ liberties “while maintaining the vital flow of intelligence”. Several hours after the president signed the bill into law, the ACLU filed a federal lawsuit, on the grounds that the executive branch’s expanded wiretapping powers violated the constitution.

In 2001 American-led forces routed the Taliban in Afghanistan, destroying al-Qaeda training camps there. Berndt Thamm, who advises Germany’s armed forces on terrorism, says that in retreat the Islamists left valuable clues about their online communications and electronic plotting. It is in following up these leads that data mining and pattern analysis can, and should, be used. Such techniques, says Mr Thamm, are “the only answer” to jihadist extremists. That is the argument which the strenuous objections of civil libertarians need to overcome.

The odd couple

Sep 25th 2008
From The Economist print edition

AP

Koreans want their international standing to match the south's economic success. They may have to wait until the peninsula is unified, says Dominic Ziegler (interviewed here)

AT THE heart of North-East Asia sits a failed state with the worst human-rights record on Earth. The regime maintains its grip by putting one in 20 of its population in military uniform. One in 40 has spent time in the gulag. Mobile phones and the internet are forbidden, except for the elite, and radio and television sets are made to tune only to government stations. Unauthorised travel within the country is banned, at least in principle. Food shortages are chronic, and a decade ago the regime's malign neglect created a famine that killed between 600,000 and 1m people. The famine still casts a long shadow, and not just through malnutrition and stunted growth; recent studies of refugees have pieced together a picture of a population that, in wide swathes, remains traumatised—and there are fears that famine conditions might be returning.

Now fresh uncertainties have arisen with reports that North Korea's dictator, Kim Jong Il, may be seriously ill. That has underlined how little the outside world knows about North Korea. What to do about this failed state, which happens also to possess the material for nuclear bombs, is likely to be the region's single biggest challenge over the coming years.

Slap next to all this sits the epitome of globalisation's success, whose men on average are three inches (7cm) taller than their poorer neighbours. Half a century ago South Korea's economy was on a par with Upper Volta's. Today its citizens have an average income per person of $20,000. They enjoy the highest penetration of broadband internet on Earth, along with a popular culture of television shows and music that has become a highly bankable Asian export known as the "Korean wave".

South Korea's success is often called the "miracle on the Han", after the river that runs through the 23m-strong capital, Seoul. Yet a more obvious explanation is the sweat and the tears of a people with a passion for work and self-improvement, coupled with generally enlightened economic policies since the 1960s—often in the face of what is now known as the "Washington consensus". As well as a modern economy, this impassioned people has also fashioned a constitutional democracy out of a military dictatorship, again with sweat and tears and not a little blood.

The regime in the north tries hard to keep its citizens in the dark about the south's success, and in South Korea six decades of separation have done much to weaken the blood ties which, in both states' official rhetoric, are supposedly unbreakable. Reunification of the peninsula remains a hallowed goal on either side. Yet for most people in the south, North Korea is not just another country but another planet. Some 10,000 North Korean defectors now live in the south, but despite efforts by the government and others they live mostly on the fringes, despised by many South Koreans and ill-qualified for decent jobs. "The Crossing", a film with a star cast released in Seoul this summer, authentically recreates everyday life in the north and explores why its citizens are driven to leave their homeland. Yet it was quickly eased out at the box office. South Korea is ill-prepared, psychologically, politically and economically, for the unification presumed to follow the eventual collapse of the north.

The cost of such a collapse scarcely bears thinking about—and South Koreans for the most part are trying their best not to do so. The task would make West Germany's absorption of East Germany look like a doddle. South Korea is merely a middle-income country, with only a minimal social safety net to offer its own people, let alone abject North Koreans, who are perhaps 15 times poorer than their southern counterparts (whereas East Germans were two or three times poorer than West Germans at the time of unification).

So unification, if and when it comes, will require South Korea to field huge resources, however much help it might get from international institutions. That is a good reason to start building them up now. Yet there are also plenty of pressing home-grown reasons for more economic growth. The most important of these is a dramatic plunge in fertility. Today's birth rate is extraordinarily low, and heading lower. This is an Asia-wide trend, but South Korea's has fallen more than most. The total fertility rate of South Korean women (ie, the average number of births they can expect) has dropped to just 1.26 (see chart 1), down from 4.5 in 1970 and 1.5 in 2000. That is roughly half the rate at which a population replaces itself. In other words, the child-bearing generation 25 years from now will be roughly half the size of the current one. Even Japan, famous for its dearth of children, has a higher fertility rate, at 1.3.

For South Korean women, as for those elsewhere in Asia, this appears to be a good thing, offering them greater security and more autonomy than ever before within a Confucian family structure that has historically been hierarchical and male-dominated. Even better, South Korea's mortality rate has also fallen steeply, and people can now expect to live 30 years longer than they did at the start of the country's modernisation in 1960.

Yet the fall in the fertility rate may reflect dissatisfactions too: notably, over the difficulties faced by women who want both to work and to raise a family. Almost everyone still gets married in South Korea. In other words, the fertility rate is falling because more women are postponing marriage to nearer the end of their reproductive lives. That is partly because the burden of raising children still falls heavily on women, whereas men are consumed with work, which in South Korea, as in Japan, entails long hours and drinking sessions late into the night.

Also as in Japan, companies, despite some improvement, still discriminate heavily against women, especially those with children. Just one-third of South Korean women go back to work after having children, half the OECD average. The World Economic Forum's ranking of sex equality puts South Korea 97th out of 128 countries. This represents a huge economic and social waste, and not only because South Korean women are better educated, on average, than their men.

Either way, the profound consequences for the economy, the government's finances and the nation's social structure have barely begun to sink in; nor has the impact on families. Nicholas Eberstadt, a demographer at the American Enterprise Institute, puts it with only mild exaggeration: changing fertility patterns mean that "2,500 years of East Asian family tradition stand to come to an end with the region's rising generation." What will it do to people if many, perhaps most, of them will no longer have brothers, sisters, uncles, aunts or even cousins? As Mr Eberstadt points out, when family structures atrophy—even in a country such as South Korea where children are treated as fondly as they are in Italy—sturdy institutional alternatives will quickly need to be found to take on the role now played by family networks.

As the South Korean population ages, the country's high savings rate is almost bound to decline, which will have an effect on both what the economy can invest and what the government can raise in taxes. As it is, the country's national pension scheme and a long-term-care scheme for the old are only two decades old, and their funding structure is not geared to South Korea's expected demographic transformation over the coming quarter-century, which will involve a rapidly ageing society, a shrinking workforce and a population in absolute decline.

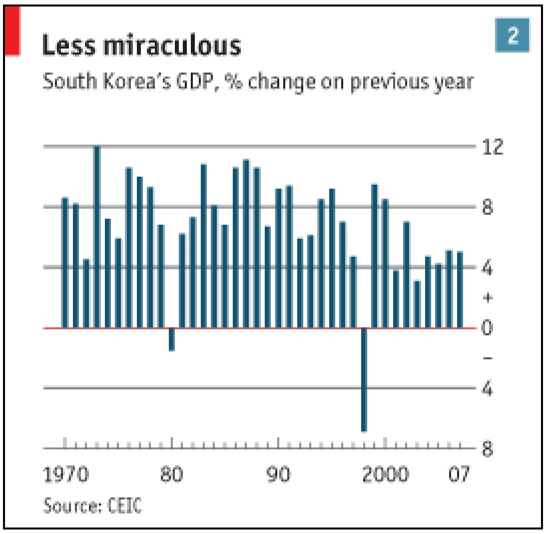
In search of a miracle

Until now most of the debate about such matters has concentrated on Japan, where the working-age population has already begun to fall. Yet Japan is a prosperous place, which will help it deal with the consequences. In South Korea the average income per person is only half Japan's. If the country does not find new sources of economic growth, it will grow old before it grows rich. Throw in the prospect of paying for the integration of 23m North Koreans to the mix, and the case for a radical approach to growth—in essence, another miracle on the Han—starts to press itself forward. The only problem is the country's dismal politics.

The Bulldozer

Sep 25th 2008
From The Economist print edition

Enters stage right; trips head-over-heels



THE president since February, Lee Myung-bak, swept to office with a simple message: he would electrify the economy. For the past five years South Korea has averaged an annual growth rate of about 4.4% (see chart 2): below potential, most economists reckon, and anaemic by the standards of a country that had one of the world's highest growth rates in the 1970s and 1980s.

South Korea had made extraordinary progress immediately after the devastation of the Asian financial crisis of 1997-98 that had led to a $57 billion bail-out by the International Monetary Fund—a humiliation for a country that had recently joined the OECD club of developed economies—and a brutal drop in output of 15% or so. The left-leaning government of President Kim Dae-jung turned radical, going well beyond even what the IMF demanded of it. It swiftly took over the banking system before selling much of it to foreigners: nine of the 14 commercial banks are now foreign-owned. It forced a number of indebted *chaebol* (the family-owned conglomerates that have long dominated the South Korean economy) into bankruptcy, and pushed others to dump loss-making businesses.

Exports quickly revived and domestic demand also surged, thanks to brief booms in housing and consumer credit. By 2003 South Korea was a favourite among international portfolio investors. Yet now the air seems to be going out of a once pumped-up model. For instance, South Korean graduates are having trouble finding decent jobs, if they can find any at all. And it is not just Koreans who feel flat. Foreigners have left the stockmarket in droves.

South Koreans argue over what is wrong. One camp blames the owners of capital, in particular the *chaebol*, for keeping wages low by threatening to send jobs overseas, and for suffocating the nation's myriad small and medium-sized enterprises (SMEs). The second camp blames the unions for illegal strikes and rigid work practices. For economists, the problem is a lopsided economy that has long given priority to manufacturing exports over services and domestic demand. The country's export sector is remarkably robust (see article), but an American-led global slowdown will emphasise this imbalance. Since the export sector is already highly productive, new sources of growth will have to come from these two underperforming areas.

In theory that should not be too hard. Productivity in the service sector is only two-thirds that in manufacturing, the largest gap in the OECD. Turnover per employee is just one-third of the American average in areas such as law and accounting. Low productivity matters, since services employ three times more people than does manufacturing, and SMEs account for nine-tenths of that employment.

Start here

The OECD lists the problems succinctly. First, industrial and tax policies have long favoured manufacturers. Second, barriers to entry into service industries remain high, with foreign investment excluded from nearly every business except finance. Much has been made of a ground-breaking free-trade agreement (FTA) signed last year between South Korea and the United States, but the deal excludes American firms from education and health care. The benefits of foreign investment in services are clear: when the South Korean banking sector was opened after the financial crisis, post-tax profits nearly trebled in the four years to 2005, and the return on assets grew by almost two-thirds. Foreigners brought in know-how and transformed banks' risk management.

AFP

Beefing about beef

Lastly, low labour productivity in services is a consequence of a skewed employment structure. As in Japan, companies in South Korea tend to reward employees less on merit than on seniority, and dismissals are rare. So rather than be burdened with too many expensive older workers, companies impose a low mandatory retirement age. Employees tend to leave firms at around 50, and three-quarters of them become self-employed, mainly in services.

Economists agree about other shortcomings too. During decades of military dictatorship, growth at all costs took precedence over the interests of workers. Since then, successive democratic governments have attempted to strengthen workers' rights. For instance, the previous president, Roh Moo-hyun, attempted to protect temporary workers by obliging companies to offer them equal rights to those enjoyed by permanent employees after two years.

The unfortunate consequence has been an increase in sackings just before the two years are up and a big rise in the number of temporary workers, who now make up one-third of the entire workforce. This hurts not only the individuals concerned but also the economy as a whole: temporary workers are denied the kind of training which in the long run boosts economic performance.

Economists also point to a vast accretion of regulations, interventions, subsidies, special taxes or special tax exemptions, loan guarantees and countless other measures distorting or ensnaring nearly every economic activity in South Korea. This is a legacy of decades when the government—central and local—was directing development and economic growth.

It affects not just business but consumers too. The experience of a former Seoul correspondent of *The Economist* is just one example. Recently her house of over 30 years was seized by the Seoul metropolitan government under a compulsory purchase order to make way for a development of luxury condominiums. Without being offered a choice she was allocated a new flat elsewhere, which she estimates to be worth at least a third less than her former home. To rub salt into the wound, she had to complete dozens of separate sets of forms and make 15 visits to various government offices. Little surprise, perhaps, that the property market is moribund.

With doubts about the economy's vigour widespread, Lee Myung-bak looked to many to be a saviour. Presidential campaigns in South Korea are rambunctious affairs where political rallies include raucous singalongs and crowds perform synchronised dances. They are also highly competitive, yet Mr Lee, representing the conservative camp, swept the field of ten candidates with over 48% of the vote, beating his "progressive" opponent, Chung Dong-young, by a record 5m votes out of 24m cast. When he moved into the presidential Blue House after his February inauguration, he ended a ten-year run for the progressives.

What sort of mandate?

In business, Mr Lee, a trim-looking 66-year-old Christian, had won the approving nickname "the Bulldozer" for getting things done. Born to a poor family in Japan during the second world war, Mr Lee had risen to run the giant construction arm of Hyundai, then the country's largest and most powerful *chaebol*. He promised that growth would be his priority during his five-year presidential term, whereas his predecessor, Mr Roh, had sought to rein in the country's biggest businesses and spread prosperity from Seoul to less developed regions. Practical-minded and market-friendly, Mr Lee proposed a package of changes to the economy that would, he said, deliver annual growth of 7% and double South Koreans' income per person over the next ten years.

The package was radical—but then Mr Lee appeared to have a popular mandate, thanks not only to his presidential victory but to elections for the National Assembly in April which the conservatives also won convincingly. The public appeared in the mood for the president's pro-business message. Nostalgia for South Korea's glory days was running high: one television advertisement showed Hyundai's late founder, Chung Ju-yung, describing how in the early 1960s he had launched Korea's shipbuilding industry, now the world's biggest, on a rough field.

The new president proposed to sell a slew of powerful public entities, such as the Korea Land Corporation, that had resisted privatisation before; cut through swathes of regulations constraining the operation of businesses; reduce corporate taxes; encourage the family-run *chaebol* to go on an investment binge by lifting restrictions imposed by previous administrations; ease planning rules on land; deregulate capital markets; call for foreign direct investment; and streamline the government in a way that would make all these tasks easier yet still cut the annual budget by one-tenth. In addition, Mr Lee promised to pursue FTAs around the globe, starting with the one with the United States, which though signed has as yet been ratified by neither side. He made the system of higher education the target for a shake-up and he promoted national construction projects, including an ambitious if not self-evidently useful "Grand Canal" linking the country from north to south.

But then things started to go wrong for the Bulldozer in spectacular and unpredicted fashion. Least surprising, perhaps, was a dismal lack of unity among the conservatives following the National Assembly elections. For the presidential nomination the previous autumn, Mr Lee's chief rival in the Grand National Party (GNP) had been Park Geun-hye, daughter of Park Chung-hee, the military dictator who had seized power in 1961 and ruled until his assassination in 1979. The contest for the nomination had been a bitter one and no one, least of all Mr Lee, had done much to deal with the rancour that persisted in the rival factions. The opposition took full advantage of the GNP's in-fighting. The National Assembly did not convene until July and got properly down to business only in September.

All this underlines the immaturity of the country's young democracy. With politicians more beholden to local interests than to their parties, discipline along party lines is weak and the level of policy debate is woeful. The parliament too often comes across as a circus for charlatans and third-raters. A good number of the National Assembly's members have convictions or are under investigation for wrongdoings.

Even more damaging for Mr Lee were street protests that started in Seoul on May 2nd, just after he had returned from a visit to the United States. At the time the trip had seemed a triumphant success. Mr Lee's administration had just signed an agreement with America to resume imports of beef that had been suspended since 2003, following a single case of mad-cow disease in Washington state. Congress had made it clear that without the resumption of beef imports the FTA between the two countries was dead. With the beef issue resolved, Mr Lee had been feted by President George Bush at Camp David. Yet the demonstrators claimed that the beef agreement was exposing Koreans to unacceptable health risks. The protests became a regular event, generally starting as a candlelit parade and ending in bloody attacks on police.

Fall from grace

The effect on Mr Lee's administration was just short of catastrophic. The president's stellar popularity ratings crashed to earth. He was forced to apologise publicly for failing to take South Koreans' views into account. His first team of senior advisers in the Blue House was sent packing and his cabinet resigned en masse to allow him to make a fresh start. Calls grew for his own resignation. The beef deal was hastily renegotiated and Mr Lee's idea for a Grand Canal was dropped.

So has Mr Lee learnt his lesson? On August 15th South Korea celebrated the 60th anniversary of its founding. In the Confucian world 60 is a revered number, signifying a human life coming full circle. Mr Lee used the occasion to relaunch his agenda, albeit with more humility. Ambitious quantities of bills are now being introduced into the National Assembly, in the hope that most of the legislation required for the proposed reforms will be passed by the end of this year. But doubts persist. The government distracted itself with a paranoid campaign to punish the television stations and internet sites that broadcast distortions and plain lies over the beef issue. It should have learnt a lesson about the importance of communication: it should be running a permanent campaign.

The deeper question has to do with the character of the president himself. Those who deal with him every day say he is remarkably resilient, and his belief in his programme is undiminished. But they also point out that he has a habit, carried over from his business days, of getting too involved with the minutiae of his reform plans, keeping staff running around endlessly to produce fresh details for him.

If he is too much of an action man to delegate to technocrats, Mr Lee also dislikes doing many of the things political leaders need to do: schmoozing with local politicians, stroking egos in the National Assembly and keeping up a dialogue with the public. No technocrat can do that for him, and if he does not soon begin to do it himself, his programme will get nowhere.

The export juggernaut

Sep 25th 2008
From The Economist print edition

Heavy industry is South Korea's sweet spot

JUST as South Korea, in historical terms, sees itself as a little thing among overbearing powers, so many of its businessmen and policymakers now feel that the country's export machine, the thumping heart of the economy, is being squeezed by two giants. On one side is Japan, whose high technology and sophisticated production give it an edge in exports. On the other is China, whose low wages allow it to compete ruthlessly on cost, even as it learns to make ever more complex products. What, South Koreans wonder, is their economy's place in Asia's future?

They may be overreacting. Certainly, China's rise up the production chain has been swift and, in some cases, ferocious; and the South Korean won has been the strongest of the region's currencies since Asian growth took off earlier this decade, even if it has softened somewhat this year. Yet South Korea has responded admirably to increased competition and a stronger currency, notching up double-digit export growth for the past five years. It is now the world's tenth-biggest exporter, and apart from a cyclical slump in Asian export growth that appears to be caused by America's and Europe's sharply slowing economies, there is plenty of reason to think that its success can continue for a while.

To date, China has proved a boon for South Korea's exports. Having overtaken America in 2003 to become South Korea's largest trade partner, it runs a bilateral trade deficit thanks to large imports of capital equipment and parts from South Korea. This growing bilateral trade reflects the knitting-together of production networks all over Asia, centred on China. China's share of South Korea's total exports of unfinished goods—that is, parts—rose from just 1% in 1992 to 27% in 2004, according to the IMF. Now China's bilateral deficit is narrowing as South Korea imports more intermediate goods from there. Yet much of this is the result of South Korean investment in China.

South Korean manufacturers are still improving their own competitiveness. Partly thanks to modest wage growth, labour productivity in manufacturing has grown by an average of 10% a year since 2002. Indeed, the stronger won appears merely to be the flip side of that productivity growth. Currency strength, certainly, is squeezing profits in some areas, notably for small- and medium-sized businesses that are less efficient than larger firms, as well as for the big carmakers.

South Korean exports have not only grown but become more sophisticated as production has shifted out of low-value-added goods such as textiles that rely mainly on cheap labour. Korea's spending on research and development is equivalent to nearly 3% of GDP a year, one of the highest rates among developed economies. According to the IMF, high-value-added products—things like cars, consumer electronics and top-of-the-range ships—now make up half of Korea's exports, up from a quarter in 1990.

South Korea today is more of a whale than a shrimp in several global industries. In memory chips it is home to the world's biggest maker of flash memory (Samsung Electronics) and the two biggest makers of DRAM chips (Samsung and Hynix). It has the third-largest steelmaker (POSCO), the fifth-largest carmaker (Hyundai Motor), and the world's three biggest shipbuilders (Hyundai Heavy Industries, Samsung Heavy Industries and Daewoo Shipbuilding & Marine Engineering, or DSME). It is a leading producer of mobile handsets and of LCD screens for televisions, computers and much more.

Heavy industry, as Shaun Cochran of CLSA, a brokerage, puts it, is the country's "sweet spot". Take shipbuilding. As Hyundai's founder, Chong Ju-yung, was boasting posthumously in those television advertisements this summer, there was no shipbuilding industry in South Korea until the 1960s. When the country's dictator, Park Chung-hee, summoned Chong and told him to produce oil tankers, for which there was a sudden demand, Chong went straight to Greece and scooped up two contracts to build 260,000-tonne tankers, promising his customers delivery within two years, sooner than anyone else. He had neglected to mention that at that moment he lacked even a shipyard. He then waved the order in front of Barclays Bank, which lent him enough money to build a modern yard. No one in South Korea knew how to do that, so Chong dispatched 60 engineers to Scotland to learn. The ships were delivered before the deadline. This famous story, concedes Bruce Cumings of the University of Chicago in a refreshingly revisionist modern history, “Korea’s Place in the Sun”, may be apocryphal in its details, yet it has a strong whiff of truth about it.

The shipping forecast

Korea’s three big shipbuilders are thriving. Competing fiercely against each other, though by unwritten agreement not for staff, their order books are nearly full up to 2013. South Korea has two-fifths of the world market in new ships (which account for 8% of its exports), whereas China and Japan have to make do with a quarter-share each.

Seen from a helicopter, the vast DSME yard at Okpo Kojé island, near the south-eastern industrial port of Busan, looks impressive: great walls of steel rise up from the dry docks as enormous gantries offer up bows and other hull sections to assemble the world’s biggest container ships, liquefied natural gas (LNG) carriers and giant floating depots for storing and processing offshore oil and gas. On the ground, all notions of human scale are lost.

OnAsia

The stuff of legends

DSME’s chief executive, Nam Sang-tae, says that China is not a chief competitor, despite the state aid from which its shipbuilding industry has benefited. It cannot match South Korea for prompt delivery, and although Chinese shipyards offer low costs, they turn out relatively low-tech vessels, such as bulk carriers and run-of-the-mill oil tankers. South Korean yards are more interested in building, say, high-tech LNG carriers, which keep their cargo at -163ºC. A new type which Daewoo Shipbuilding was the first to build regasifies the methane before it is piped ashore. The design and manufacture of deep-sea rigs, much in demand now that many oil and gasfields on the world’s continental shelves have been exploited, is even more challenging than building advanced ships, and offers higher profit margins; indeed DSME wants to operate as well as build specialised offshore oil rigs because oil companies pay such lucrative fees.

All the South Korean shipbuilders throw a lot of money at research and development. Each has a large design institute, and they generously support university engineering faculties.

Mr Nam is also sanguine about the effect of shipping’s notorious boom-and-bust cycles on his business. Patterns of global logistics are changing, he says, spurred by a growth in world trade and a China-led hunger for resources, so more ships are needed overall, not just new kinds. Climate change, Mr Nam says, offers further opportunities. The potential viability of Arctic sea routes in future is prompting a demand for vessels strengthened to withstand ice. Another growth area is “winterising” oil rigs to cope with drilling in cold climates. Pressure for cleaner transport also helps (bunker fuel used by most of the world’s shipping is filthy).

Okpo is a company town where DSME has its own hospital, cinemas and international school for the families of overseas clients who come to keep an eye on their ships under construction. There are dormitories for single young men and women respectively, one on each side of the bay. Internet forums host thriving dating and matchmaking services, and newly married couples get to move out of the dormitories into their own flats. The town has an income per person of over $30,000, the second-highest in the country.

Iron constitution

Daewoo Shipbuilding was nationalised when the Daewoo *chaebol* of which it formed a part continued to pile up debts even when the financial crisis was over, entering new businesses with what turned out to be criminal insouciance. Kim Woo-choong, the *chaebol*'s founder, eventually admitted to accounting fraud and embezzlement worth over $30 billion, and in 2006 was sentenced to ten years in jail before being pardoned. Yet the company's shipbuilding arm has thrived.

The government has floated a minority of DSME's shares on the stockmarket. Later this year it is due to sell the controlling stake to one of four prospective buyers. Among the bidders is POSCO, the shipbuilder's main steel supplier, which itself was started from scratch by the state in the late 1960s, using $120m of war reparations paid after Japan and South Korea normalised their relations. Foreign investors and development experts in Washington, DC, had given warning that a dirt-poor country like South Korea should not aim for self-sufficiency in steel. Yet the company, which was privatised after the 1997 financial crisis, has become a symbol of national pride. POSCO fed the country's industrial beast and is now, by several measures, the world's most efficient steel producer.

South Korea's industrial structure is unusual, says POSCO's boss, Lee Ku-taek. Its steel consumption per person is the fourth-highest in the world, yet most of the steel eventually goes overseas: nearly 100% in the case of POSCO's shipbuilding clients, and 60% in the case of Korean carmakers. The steelmaker also serves South Korean construction companies abroad, for example in Dubai. Its customers' eagerness to conquer fiercely competitive markets overseas may have kept POSCO lean. "Steel's competitiveness here has made South Korea what it is," says Mr Lee, "and I'm hugely proud of that."

Now that he is hoping to buy DSME he sees the chance to double the shipbuilder's value, which the stockmarket currently puts at $6 billion, by concentrating on complex products such as oil rigs. In shipbuilding, Mr Lee points out, the less you need to weld, the more you save. POSCO, he says, can tailor plates to specific ships, making the product much cheaper.

After two decades of building up its domestic market, says Mr Lee, POSCO will spend the next two decades establishing a powerful presence overseas, through greenfield sites and acquisitions, including in mines that can secure the company's supply of ore. It will be following the example of South Korea's consumer-electronics companies, which sometimes used almost military methods for their push overseas. At LG Electronics (LGE) they tell a story of a country manager who was dropped into Algeria during the civil war when other multinationals kept away, put off by the risk. When he emerged several years later, he had built up a multimillion dollar franchise.

The country's biggest successes in consumer electronics are LGE and Samsung Electronics. Only a decade ago consumers abroad hardly knew them, and if they did it was as makers of cheap knock-offs of classier brands, notably Sony. Today they have annual sales of $43 billion and $92 billion respectively, along with a reputation for making hip and sophisticated mobile handsets, MP3 players, televisions, digital cameras and more. LGE, for instance, is the world's largest maker of plasma televisions; Samsung has recently overtaken Motorola to become the second-biggest maker of mobile phones. Samsung's stockmarket capitalisation, at over $80 billion, has raced past Sony's and is second only to Apple among consumer-electronics companies. Samsung Electronics now makes the televisions on which Sony sticks its name badge.

All we need is love

Dermot Boden, LGE's new chief marketing officer, explains that much still needs to be done to realise the company's global ambitions, but his appointment, as a non-Korean, indicates the direction in which the best South Korean companies are going. South Korean companies, like Japanese ones, tend to recruit managers internally, rewarding length of service and often putting generalists into positions calling for special expertise. Exceptionally, LGE this year brought five overseas specialists to form part of the 20-

strong top team of executives, among them Mr Boden, an Irishman who had earned a reputation for building consumer-goods brands.

Branding, says Mr Boden, is what LGE needs now. The company has superb products and offers excellent service. (It needs to in South Korea, where impatient customers put down the phone if it is not answered within ten seconds.) Yet emotional attachment to LGE's products, Mr Boden points out, remains low. Products come and go: a new mobile-phone model, for instance, is typically on sale for only about six months. It is a brand that encourages the customer to keep coming back—and if he likes LG mobile phones, he might consider buying, say, an LG television. Samsung has already gone down this road, raising its profile by sponsoring the Olympics and Chelsea football team.

Reformed characters

Sep 25th 2008
From The Economist print edition

The chaebol have mostly learnt their lesson, but some lapses continue

THE rapid international rise of companies such as Samsung Electronics and LGE underlines a sea change in South Korea's *chaebol* in just a decade. Before the Asian financial crisis the leading 50-odd *chaebol* were heavily indebted. With the help of cheap credit they had been able to get into any business that took their—or the government's—fancy. After the crisis, about half the *chaebol* went to the wall; at the time, Daewoo's collapse was the biggest corporate bankruptcy in history. The remainder were forced to shed hundreds of businesses or divisions in order to keep afloat and concentrate on what they did best. Those that learnt the lesson have done very, very well.

Many of the changes have gone deep. After the crisis, foreign investors were welcomed, and now around half of the shares of Samsung Electronics and LGE are foreign-owned. South Korea made a vigorous attempt to improve corporate governance, increasing the rights of minority shareholders, boosting the role of outside directors, punishing improper disclosure and requiring the *chaebol* to publish consolidated financial statements. Shareholders may now, at least in theory, pursue class-action suits against the country's biggest companies.

Alamy

Now with added transparency

The previous two progressive administrations, less enamoured of big business than the current one, also took aim at the dominance of the biggest *chaebol* and their controlling families. By putting a ceiling on shareholdings in other companies held by *chaebol*-related firms, the Korea Fair Trade Commission (KFTC) hoped to cut through the rat's nest of cross-shareholdings through which the founding families typically exercise control. The KFTC argued that the complex structures discouraged transparency, disadvantaged minority shareholders and raised the risk that bankruptcy in an affiliate might bring down the whole group.

In practice the new rules were hardly draconian. Exemptions were made for *chaebol* that had good internal monitoring systems or that formed a holding-company structure. Moreover, no South Korean government appears able to resist the temptation to use the *chaebol* for policy ends. Some of the biggest ones were exempted from the ceilings on outside shareholdings because they were giving support to Roh Moo-hyun's favourite initiatives, such as investing in sectors designated as "growth engines", promising to help build the "enterprise cities" that Mr Roh hoped would spread growth to the regions, or even attempting to do business with North Korea. As a result, the founding families of large business groups, using circular chains of shareholdings, continue to exercise control even though, says the OECD, they hold an average of only 6% of their group's shares.

In almost any other OECD country this would be a scandal. In South Korea such foibles are too easily tolerated. Moreover, the *chaebol*'s ruling class displays an extraordinary degree of delinquent behaviour, and only rarely does it suffer the consequences, as it did in the case of Kim Woo-choong and Daewoo's collapse.

Still behaving badly

A roster of recent misdemeanours illustrates the point. Last year Kim Seung-youn, the chairman of Hanwha, an explosives, construction and insurance group, confessed to going to a bar and, helped by his goons, beating up the staff. He said it was in retaliation for his own son having been hurt in a scuffle. Last year, too, the chairman of Hyundai Motor (and son of Hyundai's founder), the world's fifth-biggest carmaker, was convicted of embezzling $90m from his company. In 2003 the head of SK Group, a telecoms, oil-refining and construction conglomerate, was convicted of illegal share swaps designed to keep the group in family control. All three men were pardoned by President Lee Myung-bak on South Korea's national day in August. Only Mr Kim served any time in jail.

The biggest case concerns the Samsung Group, South Korea's largest, and its recent chairman, 66-year-old Lee Gun-hee. Samsung has long been accused of corrupt practices: Mr Lee was convicted of political bribery in the 1990s, though escaped without penalties. In April he was charged with tax evasion and breach of trust. But more serious allegations of bribery were dropped—even though he had been fingered by Samsung's former chief lawyer, who spoke of a huge slush fund.

Mr Lee has also been charged with transferring control to his 40-year-old son and heir, Jay Y. Lee, by arranging for Samsung affiliates to sell shares to the younger Mr Lee at artificially low prices. After the charges he resigned, on live television, "to take legal and moral responsibility". Yet though Mr Lee technically faces a life sentence, few believe he will spend much, if any, time in jail. Nine other Samsung officials have been charged, but none has been detained—partly, the government says, out of concern that the economy might be harmed. Although Mr Lee is no longer chairman, Samsung executives in private talk as though he were still running the group.

How do the *chaebol* families get away with it? Many of them grew from black markets, smuggling and other rackets that thrived after the Korean war in the early 1950s, thanks to vast amounts of American aid and military spending, and to the policies of import substitution favoured by South Korea's strongman, Syngman Rhee. When Park Chung-hee seized power in 1961, the junta marched many of the racketeers through Seoul wearing dunce caps and placards with slogans such as "I am a corrupt swine". As Mr Cumings recounts, it was Lee Gun-hee's father, Lee Byung-chol, who proposed to Park that the swine seek foreign capital and equipment to launch the South Korean economy. Park called in ten of the leading businessmen and agreed not to jail them if they invested their "fines" in new industries that would sell to foreign markets.

The rest is history. To this day *chaebol* families are more admired for their economic contribution than reviled for their criminal propensities, which are often viewed as the foibles of a ruling aristocracy. The *chaebol* families are the closest thing South Koreans have to royalty. The clans intermarry and their shenanigans fill the gossip pages, as well as providing much of the inspiration for the television soap operas of the "Korean wave"—yet another South Korean export hit.

Survival of the fittest

Sep 25th 2008
From The Economist print edition

North Korean society is turbulent and in flux

Reuters

Cucumbers get on-the-spot guidance

WHAT with North Korea being a cold-war state and a nuclear one to boot, the fixation on its missiles is perhaps not surprising. Around the world that fixation has spawned a veritable industry of think-tankers, journalists and officials past and present, many with an axe to grind, who make a living from parsing the intentions of the regime and second-guessing the leader's health and even thoughts. Yet much Pyongyangology is futile, because no outsider has a line into the ruling elite. Almost certainly the upper levels of the regime have never been infiltrated by Western or South Korean spy agencies. The most recent high-level North Korean defection was in 1997.

The keenest insights into Kim Jong Il and his court have come from more surreal angles. For instance, a well-known Italian chef, brought in to pamper the dictator, later wrote about the experience. And there is Shin Sang-ok, a legendary South Korean film director whom Mr Kim, a film buff, kidnapped and held with his actress wife, hoping to improve the North's film industry. "All our movies are filled with crying and sobbing," an indignant Mr Kim told the pair, hauled out of prison to attend a cocktail party in their honour. "I didn't order them to portray that kind of thing."

A fixation on North Korea's missiles can "end up obscuring a great deal of other things worth knowing," as Christian Caryl, a journalist based in Asia, put it in the *New York Review of Books*. Most worthwhile of all is knowing just how the mass of ordinary North Koreans act, think and feel. It is still too widely assumed that such things are unknowable. After all, foreigners, and especially reporters, have always found it hard to get into North Korea, and those who do are assigned minders. Only the minders offer the chance to learn about life and leaders—which is why they are often supplied in pairs, to mind each other.

So a visit to North Korea—which usually means only to Pyongyang, with its empty boulevards, its traffic policewomen in skirts and boots, pirouetting with fixed smiles, and its old-fashioned communist propaganda—leads many to the conclusion that the North is set in amber. A reconsideration of this view is overdue. For a new picture is emerging that shows a protean society in flux, one that in the face of harsh realities is adopting an improvisatory approach to survival, and some people are thriving.

The uses of famine

The roots of this change lie with the famine of 1995-98 that killed up to 1m people, or over 4% of the population, and brought outsiders—aid agencies and non-governmental organisations (NGOs)—to North Korea. The regime made it hard for these groups to get aid to those who needed it, and kicked some of them out after the famine was over, notably the UN's World Food Programme (WFP). Other NGOs, however, continue to work there in inconspicuous ways. Aid groups have filled big gaps in outsiders' knowledge about life and death in the provinces. Good Friends, a South Korean Buddhist outfit, publishes regular reports on food supplies across North Korea, the latest government campaigns and evidence of popular discontent. Not every detail can be substantiated. But the latest bulletin reports some dozens of deaths from hunger and the ill-effects of eating grass among farming families in the southern part of the country. Earlier this year Good Friends reported the public execution in North Hamgyong province of 15 North Koreans, mainly women, for having attempted to cross into China.

The risks of crossing the border illegally are high, but during the famine the rewards easily outweighed them. That was particularly so for those from the north-eastern provinces near China where food shortages were most severe because of a breakdown in the public food-distribution system in industrial areas: uniquely, North Korea's was as much an urban famine as a rural one.

Thus for the first time the famine brought North Koreans to the outside world. At the peak, perhaps 80,000 North Koreans were hiding in north-east China looking for food, work or a clandestine route to South Korea. These crossings bred a habit: whereas leaving North Korea was unthinkable before, since the mid-1990s more than 500,000 North Koreans have crossed into China, legally or illegally. Most have eventually returned (indeed, many make multiple trips), with startling evidence of a very different world outside.

Surveys among these North Koreans in China's border provinces offer the best insights to date about ordinary life in North Korea. Ground-breaking work by three scholars, Yoonok Chang, Stephan Haggard and Marcus Noland, published this year by the Peterson Institute for International Economics (IIE), offers a psychological as much as a material portrait of North Korea. It is clear that the famine and the government's brutal mismanagement of it (both in denying food to those who most needed it and in criminalising people's response to hunger) cast a long shadow.

In their survey of 1,300 North Koreans, the authors draw a harrowing picture. Some 23% of men and 37% of women say family members died of hunger. More than a quarter report being arrested, and of those who were held in political detention (about a tenth of the survey sample), 90% witnessed forced starvation, 60% saw deaths due to beating or torture and 27% said they had witnessed executions.

The findings underscore earlier clinical reports of psychological distress akin to post-traumatic stress disorder: doctors working with North Korean refugees put rates of distress at 30-45%. Clearly, some of the stress is associated simply with getting to China. But beyond that, the IIE authors find that certain groups of refugees are particularly disturbed. These include those imprisoned by the regime, and those who lost family members to hunger or illness.

Strikingly, the psychological effect is as great or greater among the group of interviewees who were aware of international aid programmes for the starving but who did not believe that they themselves had been beneficiaries. At its peak, the humanitarian programme was supposedly feeding more than a third of the population, yet a large minority of those interviewed had never heard of the programme. Of the majority who had, 96% believed they had not benefited from it; they assumed that the armed forces had appropriated the aid. This group, the authors find, was "profoundly embittered". Modelling conservatively, they estimate that 35% of the North Korean population were in a famine area, knew of the aid but thought they were not receiving any of it. That makes it hard to argue that Mr Kim, even as his public appearances are greeted with mass displays of emotion, still commands the people's loyalty. It seems that the regime itself does not think so: it has long classified more than half the population as hostile or at best wavering in their loyalties. Possibly this assessment is no longer paranoid.

Non-identical twins 4

The two Koreas, latest figures available

	North Korea	South Korea	North as % of south
Population, m	22.9	48.5	47.2
GDP, $bn	25.6	957.1	2.7
GDP per person, $	1,118	19,751	5.7
Trade, $bn			
total	5.2	719.9	0.7
imports	1.7	363.2	0.5
exports	3.5	356.7	1.0
Power generation, kWh, 100m	225	3,646	6.2
Production, tonnes, m			
steel	1.2	47.7	2.5
grains	4.5	5.5	81.8
fertiliser	0.5	1.5	33.3
Life expectancy, years	67.3	78.6	85.6
Total fertility rate, %	1.85	1.26	146.8
Average male height, cm	165.6	172.5	96.0

Sources: Ministry of Unification; OECD; IMF; UN Population Division

Holding up more than half the sky

Border surveys also cast light on life in North Korea since the famine, with a proliferation of informal markets and an increase in unofficial movements subverting people's relationship with the state. The factories of the command economy have ground to a halt: fuel and other inputs are too expensive to run them, and workers often go unpaid. Frequently, it is not just a factory's output that its managers have sold on the black market but all its plant and equipment too, leaving a shell.

Yet most men in the state system still sign on each day, even if they sit about. In the countryside the men have the backbreaking work of farming without mechanisation: again, fuel is dear, and many powered irrigation systems have broken down. In the main, it is women who have been responsible for the explosion of markets and other entrepreneurial activity.

The degree of marketisation of this socialist paradise, although noted by foreign observers, seems to have been underestimated. One young defector recently disparaged Seoul's famous street market of Dongdaemun, sniffing that it was not a patch on markets up north. (As for the feral orphans, or *kotjebi*—literally, "flower swallows"—who were a post-war feature of Dongdaemun, they now flitter around North Korea's black markets, scavenging or stealing what they can.)

In the IIE survey four-fifths of interviewees agreed that anything in North Korea can be bought for money, something they say has been true since at least the mid-1990s. This corrects another widely held misconception. Marketisation was not a consequence of a set of economic liberalisations trumpeted by the regime in 2002, leading some to wonder whether North Korea would at last go down the Chinese path of reform. Rather, these policies were the state's belated acknowledgment of an unstoppable force set off by the famine, described by Messrs Haggard and Noland (in a separate work, "Famine in North Korea") as "coping mechanisms": foraging, barter and petty trade.

In North Korea, then, everything, as the Korean expression goes, is for sale except cats' horns: household belongings, vegetables from private plots, grain that is supposed to be distributed by the state, consumer electronics, designer brands, Mercedes cars and any kind of official paperwork you care to name (a passport is $60; what is known as a "VIP defection" to South Korea, with every detail taken care of, costs $1,500 and can be arranged within a month). North Korea's elite has always been relatively well off, and some of its members have dived into business. And people are making money on the Chinese border, where both official trade and smuggling have boomed.

As well as humans for work or sex (another area of competitive advantage for women entrepreneurs), the Chinese pay for medicinal herbs foraged in North Korea's hills, furs and drugs (methamphetamines). In addition, Chinese businesses are investing in the northern part of the country, buying underworked mines and factories on the cheap. They are hated for it, but their money is now starting to splash around the North Korean economy.

North Korean traders returning from China stock up on clothes, secondhand sewing machines and consumer goods. Paradoxically, those social groups that in the past have borne the brunt of the regime's persecution have gained most from this growth in private trade. Japanese-Koreans have used remittances from relatives overseas as start-up capital for new trading businesses. North Koreans of Chinese origin and those with Korean-Chinese relatives across the border take advantage of their relative freedom to travel.

The daily grind

As much as the economic impact, the cultural effect of this cross-border exchange is already huge and still unfolding. Andrei Lankov of the Australian National University, an astute observer of North Korea, describes how a relatively minor technological revolution in China changed the lives of many North Koreans. Earlier this decade DVD players fell dramatically in price, so South Korean households quickly dumped their old VCRs in favour of the new players. Smugglers picked up the old units for next to nothing and sold them in North Korea for $40 or so apiece—a price that plenty of urban North Korean families could afford if they saved up.

The consequence was what Mr Lankov calls a "video revolution": a flood of South Korean soap operas, melodramas and music videos entering North Korea by the same route and delighting new audiences. The impact of the astounding affluence on display—the stars' clothes and cars, Seoul's glittering skyline—

exposes the central lie on which the regime bases its claim to rule: that South Korea is backward, impoverished and exploited. Korean-language programming from abroad on radio sets imported from China (and thus not tuned permanently to state radio) reinforces this discovery. Thus, disillusion and anger with the regime only mounts. In the IIE surveys nine-tenths of the interviewees disagreed that either the regime or the economy were getting better.

On the border

In the face of what Mr Caryl, the journalist, calls the “profound epistemological shock” of North Koreans who have glimpsed another world, the regime has adopted an ambivalent attitude. Although those caught crossing the border can face harsh punishments, the regime, if it was minded to, could be much more brutal. The penal code was revised in 2004 to differentiate between “economic” refugees and “political” ones (though refugees say judicial proceedings under the new code are often skipped and torture is still used). Border-crossers can buy a degree of protection by bribing local authorities; border guards are even rotated every six months so that more of them can get a share of the spoils. The border with China is, as Peter Beck, a scholar of North Korea, describes it, both the regime’s safety valve, providing an alternative living to the dysfunctional state economy, and its Achilles heel.

In daily life, the regime appears to be re-establishing its grip in some areas but losing it more often in others. Since 2005, after a decent enough harvest, the regime sought to take control of burgeoning markets, redirect grain supplies through the public distribution system and get people back to their work units. First men were banned from selling in the markets, and more recently women under 50 too. The attempt at control has been only partly successful.

The state manufacturing economy has officially stayed aloof from the new market economy, though parts of the regime have proved opportunistic. For instance, railways are the major conduits for the new trade, and railway stations often serve as lively markets. Rather than clamp down on them, railway staff and police take a cut. The armed forces, too, have leapt into the black market: after all, they have the transport, the personnel and the weaponry to enforce a protection racket. This may be profitable for the state’s agents, but it hardly reinforces their moral authority. A Western diplomat recounts seeing a group taking a sofa up a subway escalator in Pyongyang to sell on the street. Guards were bawling at them to get out of the way, but nobody paid the slightest attention.

It all adds up, reckons Mr Lankov (whose life in the former Soviet Union informs his view of changes in North Korea), to something of consequence: North Korea is no longer the ruthless Stalinist state it was, but a shoddy, corrupt little tyranny. And now the people know it.

Jaw-jaw

Sep 25th 2008
From The Economist print edition

The international consequences of North Korea, and all the talk about it

THE divided peninsula is the biggest and nearly the last manifestation of a cold war that ended almost two decades ago. The division, with huge armies facing each other across the border, was not entirely or even mainly of Koreans' own making. Until the modern era Korea, the Hermit Kingdom, had kept to itself, its isolation underwritten by the ruggedness of its coast and its land border with China. But starting in the late 19th century Korea became the contesting ground of great powers. The Japanese fought to deny influence first to China and then to Russia, annexing the country outright in 1910. Japan's colonisation until defeat in 1945 was a brutal one, even if it helped lay an industrial base. Hundreds of thousands of Koreans were forcibly conscripted into the Japanese army or sent to work as slave labour in Japanese mines.

AP

Token of good intent

Before the end of the second world war, the United States and the Soviet Union had, without troubling to consult Koreans, agreed to partition Korea into respective spheres of influence and military occupation. In 1945, on the day of Japan's surrender, the line was drawn along the 38th parallel. The Republic of Korea (that is, South Korea) declared independence on August 15th 1948, with the approval of its American godfather. On September 9th the Democratic People's Republic of Korea (North Korea) emerged out of the Soviet occupation. Both states have just celebrated their 60th anniversary.

In June 1950 North Korea invaded and overran much of the southern part of the peninsula. An American-led United Nations force pushed it back across the border, making gains deep inside North Korea. That led Mao Zedong to order China into the war. By 1953, after immense physical destruction and the deaths of 3m soldiers and civilians, the two sides had fought themselves to a standstill along the original border. An armistice was signed and a buffer established: today the "demilitarised zone" (DMZ) is the most heavily militarised border in the world.

Technically the combatants remain at war, but the north has lost nearly all outside military help. When the Soviet Union collapsed in 1991, Russia dropped its material support for North Korea. China, for its part, has made clear it no longer feels bound to come to its defence. Though the north's armed forces are huge, swallowing up a third of the national budget, they are also backward. By way of compensation, North Korea has amassed stockpiles of chemical and biological weapons as well as a handful of plutonium bombs, and its missile technology to deliver its warheads is improving. At least rhetorically, the regime of Kim Jong Il keeps the country on a near-permanent war footing, forever giving warning of imminent imperialist attack by America or, on occasion, Japan.

It does so mainly to boost its own legitimacy at home, yet there is little doubt that North Korea feels beleaguered, even if its own behaviour is chiefly to blame. About 30,000 American forces are stationed in the south, many of them in a huge base in downtown Seoul. Until 2012 the United States will remain in overall command in case of a war or the collapse of the north. Those numbers will fall (and the base will be closed) as part of plans both to reconfigure America's military presence in the Pacific and to hand back command of South Korean forces.

Even so, President Lee Myung-bak has reasserted South Korea's alliance with America as the cornerstone of its foreign and defence policy, and his country has American nuclear guarantees. The United States is racing to equip South Korea (as well as Japan) with destroyer-based missile-defence systems to counter the nuclear threat. South Korea's military spending has risen by more than 70% since 1999, and though troop numbers are to be cut, the savings will be spent on ship-to-air missiles, unmanned spy planes and new fighter planes. North Korea is hopelessly outclassed, and any war would result in its utter destruction. That is why more than anything its regime wants security guarantees from America—especially after George Bush named North Korea as part of his "axis of evil" in 2002.

Knocking heads together

Though the chief burden of making the peninsula whole will fall to South Korea, historical responsibility and strategic necessity have brought together China, America, Russia, Japan and the two Koreas in the so-called "six-party process", which since 2003 has been aiming, step by reciprocal step, to persuade Mr Kim to abandon his nuclear weapons and programmes in return for material aid, security guarantees and American diplomatic recognition.

American hawks condemn the exercise for allowing a monster regime to blackmail the outside world. The talks' defenders, none of whom has illusions, point to progress, however glacial—for North Korea never passes up the chance to miss a deadline. Alexander Vershbow, America's outgoing ambassador to South Korea, says that the latest round of talks, which began in March 2007, has produced few unpleasant surprises. The north has allowed international inspectors into the Yongbyon nuclear facility and shut down the main, Soviet-era reactor there. This summer it blew up the cooling tower that is the most visible mark of its nuclear-weapons programme. America sent the first instalment of 500,000 promised tonnes of grain. Others have provided oil.

Now the sticking-point is North Korea's promise to produce a full list of its nuclear programmes. America has complained that the means of verifying what North Korea has declared to date fall short of what is required—not least because the declaration makes no mention of existing nuclear bombs, a suspected programme for enriching uranium or proliferation in the Middle East. Piqued, the north threatened in late August to suspend the dismantling of the Yongbyon facility. As *The Economist* went to press, the two sides appeared to be stalled. But any deal would probably entail Mr Bush accepting less than cast-iron assurances on verification if he wants the prize of a commitment to freeze North Korea's plutonium programme before the end of his term. In return, America would, at long last, remove North Korea from its blacklist of state sponsors of terrorism. That would pave the way for the country to join multilateral institutions such as the World Bank and embark on reforms.

The hawks will scream. But Yu Myung-hwan, South Korea's foreign minister, says verification is the key issue, and without agreement "the six-party talks will collapse." That, he worries, will deprive the world of the best means for "coaxing North Korea into our sphere".

Even if agreement is reached, the next phase of the talks—persuading North Korea to give up its existing weapons—will be far harder. Mr Vershbow argues that whatever the doubts about Mr Kim's intention to give up his weapons, the six-party process offers the only means of "getting him to change his cost-benefit analysis".

AFP

Six-part dance

So the question-mark over the six-party process is whether giving up nuclear weapons and coming out of his shell are compatible with the survival of Mr Kim's regime. Mr Vershbow says coyly that the collapse of North Korea's regime is not his government's policy. China dreads such a collapse, which would risk releasing a flood of refugees and causing chaos along its border. South Korea's "sunshine policy" vis-à-vis the north, launched by Kim Dae-jung a decade ago and continued by Roh Moo-hyun, aimed for engagement not in order to hasten collapse but rather to postpone it for as long as possible, using money and material aid—$500m in bribes alone, it turned out, for Mr Kim's historic summit in 2000 with Kim Jong Il, and unconditional food aid under Mr Roh.

Mr Lee's line is tougher. He came to office saying that aid should depend on progress in the six-party talks and even on human rights. That caused North Korea to throw a hissy fit and cut all communication with the south. Matters worsened in July, when a North Korean soldier shot dead a South Korean tourist at the Mount Kumgang resort, where the north earns much-needed hard currency. Still, government officials in the south expect North Korea to come back to the negotiating table. They too stress a policy of engagement and even predict that Mr Lee will hold a summit with Kim Jong Il before his term is out. Mr Lee is just as wary as his predecessors of a sudden implosion of the north.

Nightmare scenarios

Forecasting collapse of the north has been unfashionable ever since a flood of false predictions after the death in 1994 of Kim Il Sung, the country's political and spiritual father since 1948. At the time most Western experts argued that Kim Jong Il utterly lacked his father's legitimacy and could not last. Loyalty to Kim Il Sung had been forged by a guerrilla war against Japanese imperialists waged in Manchuria. In creating a state cult around himself, Kim blended communism with something that, with rich irony, most closely resembled Japan's emperor system between the wars: he became a neo-Confucian sun king, the nation's moral as well as political father.

In predicting that Kim Jong Il could not pull off the dynastic succession, the experts were wrong not just because the state retained its grip on all the instruments of repression to keep the masses in line; they also underestimated the moral authority of the Kim family among the ruling elite. The band of Manchurian guerrillas who had attended the state's birth appeared bound by almost chivalric oaths of fealty, trust and reciprocal obligation. These oaths passed to a second generation, and the families of that early band of brothers now occupy nearly every significant position in the state.

No one can claim to know whether the regime is capable of surviving succession to a third generation, but the odds are surely longer. Though the state retains its monopoly of force, people at the bottom are now less frightened. At the top, chivalric ties are presumably getting weaker.

If Mr Kim has a succession plan, he has not announced it. His children do not appear to be the stuff of leadership. In 2001 his eldest son was caught entering Japan on a false passport in the hope of visiting Tokyo Disneyland; he later moved to Macau, China's casino enclave. Of the two younger sons, still in their 20s, all that is known is that one is obsessed by Eric Clapton. Perhaps Mr Kim, an ardent family man, does not want a family successor. After all, the consequences of giving up power are certainly not a comfortable retirement in Monte Carlo. The North Korean gulag and the regime's willingness to let 1m people die of hunger rather than loosen its grip on power amount to crimes against humanity.

Speculation has its bounds. Yet if collapse came, it could come quickly, posing a huge challenge for the region's powers. It is assumed that South Korean troops would rush in to provide humanitarian help and restore law and order, but it is not clear how they would deal with factional fighting, or with floods of North Koreans heading south. American special forces would presumably be dropped in to secure weapons of mass destruction, but where would they look for them? Meanwhile, faced with refugees pouring over its own border, China might send in its own army. As Bill Emmott, a former editor of *The Economist*, puts it in his latest book, "Rivals": "There would be little time to think, to discuss, to calculate. It is at such moments that a move by one country can be misinterpreted, or that a country might decide that it has to move quickly if it is to move at all and by doing so could miscalculate and bring the great powers into conflict. It is all an extremely risky thought." Particularly so since, as Chinese, American and South Korean officials admit in private, so far they have drawn up only the sketchiest contingency plans among themselves.

Contested grounds

Sep 25th 2008
From The Economist print edition

Of history wars and peace parks

DISPLAYED in nearly every government office in South Korea is one of two stunning landscapes, sometimes both of them. One is a volcanic mountain, with a turquoise lake in the caldera and forests on its flanks. The other is a pair of rocky islets, black-tailed gulls wheeling around the crags. These are the front lines of South Korea's history wars.

Emotions ran high this summer over the rocks, known as Dokdo in South Korea and Takeshima in Japan, when the Japanese education ministry reminded textbook writers that they were formally incorporated into Japan in 1905, when Korea was forced to cede the conduct of its foreign policy to Japan. Outraged Koreans claim historical rights to the islets going back more than a millennium.

FLPA

Good for gorals

The South Koreans are not laying claim to the volcano, Mount Paektu, which is divided in two by China's border with North Korea, as is the lake. This was the area of one of Korea's three founding kingdoms, Koguryo, which flourished between 37BC and 668AD. Koreans have an unshakable belief in their bloodlines, and most insist that holy Mount Paektu is the fount of their culture and myth. Tangun, Korea's mythical founder, was born on its slopes, and Kim Jong Il, in his official biography, made sure he followed suit.

The problem is a Chinese state history project claiming that Koguryo's ancestry and culture was Chinese, not Korean. China wants to hold the 2018 winter Olympic games on Paektu and list it as a UNESCO world heritage site. Koreans think China is stealing their mountain and may one day even claim parts of North Korea.

History wars are bad news for wildlife. China's notion of conservation is to build golf courses and theme parks. Hordes of politicians, soldiers and tourists from South Korea now stumble around windswept Dokdo. The government has even planted trees, because the law on maritime claims suggests that trees differentiate an island from a mere islet.

Another heavily contested piece of ground could set a conservation example. The demilitarised zone (DMZ) between North and South Korea, 4km wide on average, is all that keeps two awesome lines of firepower and hair-trigger soldiery apart. But for any lover of wilderness the view through binoculars from the Seungri mountain observatory is breathtaking. Far below are willow flats and watermeadows, and the meanders of a stream that has not seen a rod in 60 years.

In the DMZ, the wilderness has smothered the human past. Below the observatory, a town and rail terminus that was thriving under Japanese occupation is now a dense wood. The zone is rich with a fauna that has disappeared from most of the rest of north-east Asia: the black-faced spoonbill, of which a total population of only about 2,000 remains; the solitary Manchurian goral (a goat-antelope); and the eagle-owl. An admirable outfit, the DMZ Peace Forum, wants to keep the wilderness from voracious developers when north and south are reconciled. If only the nationalists left all contested ground to those species with the oldest claims.

Half-finished

Sep 25th 2008
From The Economist print edition

What Lee Myung-bak still needs to do

SOUTH KOREA'S story to date has in big part been the story of what is sometimes called a "developmental state"—that is, one that uses formidable powers to direct and regulate the economy to achieve growth above all else. The first "Miracle on the Han" worked because the developmental state, after 1961, mostly got things right. Or, rather, it got them right until it got them very wrong, resulting in the 1997 financial crisis. By then, the economy and the way it was financed had become far too complex for traditional guidance, and the state's sense of omnipotence had blinded it to the need for structural reform. The recovery from crisis accomplished only half the structural reforms South Korea needs. There will be no second miracle unless Mr Lee accomplishes the other half.

Now that he has recovered his poise after the beef fiasco, his supporters argue that Mr Lee is just the man for the job. Under him, says Sakong Il, chairman of the president's National Competitiveness Council, restrictions will be lifted to augment the country's low stock of foreign investment. Small businesses will be boosted when the government cuts through red tape and lowers the minimum capital requirement for start-ups to just 100 won, from 50m won now. And rules for investment will be eased in the Seoul metropolitan area, which businesses much prefer to the investment zones in the middle of nowhere promoted by Roh Moo-hyun, the previous president. The council plans to submit 147 laws to the National Assembly this autumn, with the aim, Mr Sakong says, of raising South Korea's standing in the World Bank's comparisons of national competitiveness from 30th to 15th.

AP

President Lee says he's back on track

All this is welcome, but it is not enough. Mr Lee, as a former *chaebol* executive, will need to prove that he is friendly to markets, not simply to business. "When critics say the *chaebol* are too big, I don't know what they mean," says Mr Sakong. "Bigness itself is not badness; what matters more is whether the actions companies take are legitimate or not." That is fine as far as it goes. One test for Mr Lee will be whether he and the courts continue to treat the misdemeanours of *chaebol* bosses lightly. An even more telling one will be whether minority shareholders will be able to seek redress against *chaebol* trampling on their rights.

Old habits die hard

Traces of the developmental state persist. Although Kang Man-soo, the finance minister, blames heavy taxes, subsidies and regulation for a decline in South Korea's investment rate, he also promises "a very ambitious plan" of subsidies and incentives for boosting internet businesses such as computer gaming. Known as "e-sports", this has emerged out of nowhere and become a huge spectator sport, employing 25,000 people in Seoul and spawning nearly 100 game-engineering "academies". It is an example of Korean entrepreneurial energies let loose. The government's proposals seem to represent an old-fashioned instinct to back winners.

Both the country's patterns of energy use and its attitude towards the environment point more towards the past than the future. Randall Jones, an economist at the OECD, notes that South Korea uses 1.5 times as much energy for every unit of GDP as does Japan. For a country that imports all its hydrocarbons, energy efficiency will, the government says, be pushed to the top of the agenda. As well as promoting a more efficient industry, that will mean weaning Koreans off their gas-guzzlers and improving mass transit.

Seoul’s air, once famously noxious, is much improved, but South Korea lags at conservation. The developmental state is also a construction state, and too often the government seems to feel that nature untrammelled is a chance wasted. Two-fifths of the country’s rich mudflats, or about 1,600 square kilometres, mainly on the peninsula’s west coast, have been “reclaimed”. That has dire consequences not only for fishermen but for seabirds and rare waders too. Almost invariably the government and the construction companies trump environmental interests.

Just as South Korea’s economy is something of a half-way house, so is its democracy. The beef protests seemed to reflect this. Only a short time after Mr Lee had been voted into office, the protesters bringing downtown Seoul to a halt argued that theirs was a more representative kind of politics. That was clearly nonsense. Yet the nation’s political establishment hardly helped its case when the National Assembly was incapable of convening.

South Korea’s labour disputes can also be ascribed to an immature democracy. Workers’ rights were suppressed during years of military dictatorship. Unions have since made up for lost time, and even illegal strikes are tolerated at some of the big *chaebol*. Yet the strikes do not reflect an unbridgeable divide between capital and labour: rather, nearly all South Koreans are capitalists, and many of the strikers had voted for Mr Lee. Clear leadership from him could do much to put the country’s labour relations on a more stable footing.

The sense of something half-finished colours South Korea’s diplomacy too. Mr Lee has reiterated that foreign policy rests on his country’s military alliance with the United States, which he now calls a “strategic alliance”. South Korea has already sent troops to Iraq and Afghanistan in support of American-led reconstruction, and Mr Lee says that in future it will spend more on aid and contribute more to peacekeeping and antiterrorism operations. This reinvigorated alliance, the president’s foreign-policy advisers explain, will not only boost South Korea’s global standing but also provide leverage with tricky neighbours, notably Japan and China, where relations are bedevilled by land and history.

That is probably wishful thinking. For no matter what efforts South Korea makes on the global stage, it is still a shrimp among whales in its own region, and even there the power of its American godfather may decline in relative terms. Only the unification of a divided peninsula might bring South Korea the standing it craves. And given the fearsome problems North Korea would carry with it, even that is far from guaranteed.

Sources and acknowledgments

Sep 25th 2008
From The Economist print edition

The author wants to thank all those who gave generously of their time and expertise in the preparation of this report. In addition to those named in the text, they include Stephen Bosworth, Choi Kang, Yoichi Funabashi, Jim Hoare, Hur Kyung-wook, Hyun Jung-taik, Jung Ku-hyun, Erica Kang, Ki Won-kang, J.R. Kim, Minyoung Kim, Kim Tae-hyo, Kim Young-sun, Catherine Lee, C.S. Lee, Lee Hye-min, Jay Y. Lee, Park Yong-man, Tomohiko Taniguchi, Roland Villinger, David Wolff and Shigeo Yamada.

Sources

"Famine in North Korea", by Stephan Haggard and Marcus Noland.

"Korea's Place in the Sun", by Bruce Cumings.

"North of the DMZ", by Andrei Lankov.

The OECD's "Economic Survey of Korea 2007" is very useful. The next survey is due out soon.

Two reports by the IMF were also helpful: "Republic of Korea: Selected Issues" and "Republic of Korea: 2007 Article IV Consultation".

Two papers by Yoonok Chang, Stephan Haggard and Marcus Noland cited in the special report are "Exit Polls: Refugee Assessments of North Korea's Transition" and "Migration Experiences of North Korean Refugees: Survey Evidence from China".

"The Other North Korea", by Christian Caryl in the *New York Review of Books*, August 2008.

The Nautilus Institute for Security and Sustainability has extremely helpful online resources on North Korea-related security issues.

Japan Focus, an online journal on Asia-Pacific issues, is also highly recommended.

Country-wide reports on economic and social conditions in North Korea are published regularly by Good Friends, a South Korean Buddhist organisation.

Offer to readers

Sep 25th 2008
From The Economist print edition

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

The Economist can supply standard or customised reprints of special reports. For more information and to place an order online, please visit our Rights and Syndication website.

Economist.com BUSINESS

Management consulting

Giving advice in adversity

Sep 25th 2008 | SAN FRANCISCO
From The Economist print edition

Wall Street's woes are yet another headache for the consulting industry

Illustration by Claudio Munoz

WHEN even consultants suggest that companies might want to spend less on consultancy, you know the industry is in for a difficult time. A recent article in the *McKinsey Quarterly* argues that Wall Street's ailing banks could slash up to $2 billion each from their bloated overheads without damaging employee morale. The authors, who work for McKinsey, a leading strategy-consultancy, highlight several areas that bankers could cut—including fees paid to consulting firms. Presumably this includes McKinsey, which has advised most of America's once-mighty investment banks at one time or another.

Convulsions on Wall Street and elsewhere are grim news for the global consulting industry, which boasted $309 billion in revenues last year, according to Kennedy Information, a research firm. Financial institutions are some of the industry's biggest customers. But revenues are also under pressure in other areas. The credit crunch has cut the number and size of deals by private-equity firms, which are also big consumers of consulting services. And a decline in mergers and acquisitions means there is less demand for the nitty-gritty work of combining computer systems, a mainstay of some consultancies.

Consultants say they have fared pretty well in the first half of 2008. But consulting revenues are not immune to a downturn (see chart). The impact may simply be delayed because firms such as Accenture (which was due to unveil its latest results as *The Economist* went to press) and IBM (which earned 55% of its $98.8 billion of revenue in 2007 from consulting-related services) have multi-year contracts that protect them from sudden slumps. But consultants will feel the pinch next year, as clients cancel or delay projects.

Some consultancies are already sounding cautious about the rest of this year. "I would expect the second half of 2008 to be slow," says Shumeet Banerji, the head of Booz & Company, a strategy consultancy. Industry observers agree. "Consulting firms will be anaemic for a while," reckons Christopher McKenna of Oxford University's Saïd Business School, who is the author of a history of consulting.

This month Monitor, based in Cambridge, Massachusetts, cut almost 20% of its staff. It laid off consultants in its main business, shut a unit that produced customised software and closed down another that provided consulting to start-ups. It also spun off e-learning and merger-advisory activities, in which it is keeping a small stake. And it closed several small offices, including one in Milan.

Joe Fuller, a co-founder of Monitor, says revenue is up on the previous year, but that it is “anticipating a demanding and tough market in the short term”. In response, Monitor plans to invest some savings in promising regions such as the Middle East, and in new areas such as its defence practice. Other consulting firms are coy about plans to reduce costs, but in the past the industry has dealt with slowdowns by recruiting fewer new staff and encouraging surplus consultants to seek jobs elsewhere.

Might tougher times lead to consolidation? Rumours of link-ups abound. One company that has considered a merger in the past year is the Trinsum Group, which is itself the product of a union in early 2007 between Marakon, a strategy consultancy, and Integrated Finance, a financial- and risk-consulting company that includes Robert Merton, a Nobel prize-winning economist, among its founders. Jim McTaggart, a co-chairman of Trinsum, says neither of the firms that it talked to about a combination was an ideal fit. In the meantime, Trinsum has shelved a plan to create a private-equity-style fund because of the chaos in financial markets. “It’s been a challenging year,” says Mr McTaggart.

One consultancy that has been on an acquisition spree is Oliver Wyman, part of Marsh & McLennan Companies, an American conglomerate that also has insurance-broking and human-resources businesses. The consulting firm, which has a huge financial-services practice, has seen revenue growth slow this year, but its advice on financial restructuring and regulation is in demand. John Drzik, Oliver Wyman’s chief executive, says the five purchases it has made in the past eight months have bolstered its presence in fast-growing areas. In August, for example, it snapped up ChapterHouse, a health-care consultancy.

As some consultants have tied the knot, others have divorced. In July, Booz Allen Hamilton (BAH) split into two separate companies—one focused on defence and government consulting and the other, Booz & Company, focused on corporate clients. Rivals claim that the split was inspired by BAH’s government partners, who were bringing in most of the money at the combined firm, and that the split disrupted Booz & Company. But Booz’s Mr Banerji argues that the commercial arm is better off now because the split freed it from legal strictures associated with BAH’s government work. He says the separation was fairly smooth because the two sides were already operating independently.

All consultants agree that emerging markets such as China, India and the Middle East offer the best opportunities for the future. But they accept that most of their business will come from the developed world for a while yet. So the industry badly needs a “Big New Idea” that it can sell to clients there. Previous consulting booms were built on ideas such as “total quality management” and re-engineering. But at the moment consultants have no successor to such money-spinners.

Even so, one corner of the industry is thriving. Companies such as FTI Consulting and Huron Consulting, which advise firms and boards on litigation, forensic accounting and many other issues, have never had it so good. FTI Consulting has been busy helping firms caught up in the financial crisis; its revenues shot up 41% last year to just over $1 billion. On September 18th it was appointed by Lehman Brothers’ unsecured creditors to defend their interests. Demand for FTI’s crisis- and risk-management services is soaring too. To cope with demand, the firm hired 50 new staff in August. “Unlike strategy consultants, we’re very tactical,” says Dennis Shaughnessy, the firm’s chairman, who jokes that firms such as FTI are “bad-news bulls”. Given the troubles in the banking world—and the deluge of hearings, investigations and lawsuits it has triggered—he and his colleagues have plenty to be bullish about.

Economist.com BUSINESS

Mobile phones

The un-iPhone

Sep 25th 2008 | SAN FRANCISCO
From The Economist print edition

What Apple did for smartphones, Google may do for all the rest

NOT since the launch of Apple's iPhone last year has the unveiling of a handset caused such a stir. On September 23rd T-Mobile, a mobile operator owned by Germany's Deutsche Telekom, presented its new phone, the G1, which is made by HTC, a Taiwanese manufacturer. The reason for the buzz is that the device is the first to be based on software called Android, made by Google, the largest internet company.

The phone naturally invites comparisons to the iPhone, still the most elegant "smartphone" on the market today. But that is to focus on the wrong thing. It is not the features or design that matter, since the two phones aim at different users. Rather, it is what each phone is likely to do for the industry as a whole. The iPhone, for its part, has demonstrated that consumers do and will use mobile phones to search, browse and otherwise use the internet. Vendors of other smartphones, such as RIM, the maker of the BlackBerry, are now racing to match the iPhone in usability. As they do so, mobile-internet usage is rising steeply.

Yet fancy smartphones account for less than 15% of the handset market, says Kevin Burden at ABI Research, a consultancy. Most consumers, using simpler phones that the industry confusingly calls "feature phones", are not going online while on the move. These are the people that Google is targeting.

Android-based phones will be cheaper than existing smartphones. But the more fundamental difference hearkens back to the mid-1980s, when the PC era was dawning and two rival operating systems—from Apple and Microsoft—competed to become the dominant platform for which software companies would write programs. Something similar is now happening with phones, all of which will become "smart".

Most mobile operators and handset-makers are searching for a platform for their mass-market phones of the future. Many have warmed to Linux, a free, open-source operating system which can be customised. Some are tweaking Linux to make their own flavours. Google's Android is also a variant of Linux.

Google hopes that other operators and handset-makers—South Korea's Samsung and LG appear to be next—will adopt Android to save themselves the expense of developing their own software. It also hopes that programmers will write fun software for Android, making it as ubiquitous as Microsoft Windows became in the PC era (but has failed to become on phones). Its aim is not to challenge Apple or Microsoft. Instead Google, which makes money from online advertising, will be happy as long as nobody locks up the market and people do ever more Google searches, on all their devices.

Economist.com BUSINESS

Social networking

Facebook for suits

Sep 25th 2008 | HAMBURG AND MOUNTAIN VIEW
From The Economist print edition

Websites that encourage business networking are thriving

Illustration by David Simonds

AMONG the few firms benefiting from the upheaval in the financial markets are professional social networks—websites that help with business networking and job-hunting. On LinkedIn, the market leader, members have been updating their profiles in record numbers in recent weeks, apparently to position themselves in case they lose their jobs. The two most popular sites, LinkedIn and Xing, have been growing at breakneck speed and boast 29m and 6.5m members respectively. And, in contrast to mass-market social networks such as Facebook and MySpace, both firms have worked out how to make money.

LinkedIn and Xing are similar in many ways. Both cater to youngish professionals with above-average income, and allow people to connect, keep track of each other's activities and create groups of common interest. Both are also profitable: since they help members find jobs or build their businesses, many users are willing to pay.

Yet the firms come from very different worlds. LinkedIn, a typical Silicon Valley start-up, was founded in 2002 by Reid Hoffman, a serial entrepreneur, to manage his own network of business contacts. Funded by venture capitalists, it recently secured $53m of funding in a deal that gave it a valuation of over $1 billion. Xing, for its part, hails from Hamburg, in Germany, and was founded in 2003 by Lars Hinrichs, another serial entrepreneur. It has relied on subscription fees since its launch, and it went public in 2006.

LinkedIn is culturally American, not just because English is the dominant language (there is also a Spanish version), but because it is still chiefly about advancing its members' careers, even if many other things get a look in. The company does not release numbers, but a big chunk of its estimated annual revenues of $100m in 2008 is said to come from headhunters and companies, which pay to search LinkedIn's database and contact its members.

Xing, by contrast, has a distinctly Germanic feel, despite being available in 16 languages, including Mandarin. Although recruiting also plays an important role, the site is more about networking. Members often meet offline. They also generate 80% of the firm's revenue, which amounted to €16m ($24m) in the first half of this year. Half a million users pay a monthly fee of €6 ($9) to use the site: Xing's profit margin was 37% in the most recent quarter.

LinkedIn is well on its way to becoming the networking site of choice for English-speaking businesspeople with global connections. But this does not mean that Xing will get squeezed out. If it plays its cards right, it could become the European alternative that takes more account of cultural differences in the way business is done.

Things could change, however, if Facebook grows up and becomes a place to do serious business, says Jeremiah Owyang of Forrester Research, a market-research firm. There are other potential rivals, too. American newspapers such as the *New York Times* and the *Wall Street Journal* are adding networking features to their websites. These are mainly meant to get readers to stick around, but they could grow into alternatives to professional social networks. And then there are the professional associations for which moving online would be only natural, but which have been a surprising no-show in social networking so far, according to a recent study by Outsell, another market-research firm.

Whatever the outcome, it seems certain that professional social networks are here to stay as independent entities—something that cannot be said of their mass-market counterparts. As Mr Hoffman, LinkedIn's founder, puts it: "Most users of social networks have a lot of disposable time, but not much disposable income. With professionals it is the other way around.”

Economist.com BUSINESS

French companies in China

Francophobia

Sep 25th 2008 | PARIS
From The Economist print edition

Politicians' pro-Tibet stance has harmed prospects for French firms in China

ON SEPTEMBER 18th at the Elysée Palace in Paris, France's president, Nicolas Sarkozy, hosted Jin Jing, the handicapped Chinese Olympic torchbearer who had been accosted by pro-Tibet protesters in the French capital in April. On the same day the Bank of China announced it would take a 20% stake in the French arm of LCF Rothschild, a private bank, its first investment in a euro-zone bank. The timing was probably coincidental, but French businesspeople are hoping that these events signal an improvement in relations with China, which deteriorated sharply this year over French support for Tibet.

Many French executives who do business with China are furious with their politicians for poisoning the relationship. As well as Mr Sarkozy's threat to boycott the opening ceremony of the Olympic games, the mayor of Paris infuriated China by making the Dalai Lama, spiritual leader of Tibet, an honorary citizen. "It has been shocking for the French business community here to see that their whole industry can be penalised for what happens on the streets of Paris," says Joerg Wuttke, president of the European Union Chamber of Commerce in China, based in Beijing.

Chinese protesters targeted Carrefour, a French retail giant, and internet activists called for boycotts against Louis Vuitton, a luxury-goods brand, and L'Oréal, a cosmetics group. French companies also faced discrimination from government officials: an investment banker's routine application to open a banking business was unexpectedly turned down, for example, and another firm found that guidelines on labelling which it had previously been able to ignore suddenly became rigid laws.

Some of this is likely to continue, says an executive at a company listed on the CAC 40, France's index of leading firms. "The Chinese have a long memory and they will make us pay for a long time," he says. Industries that rely on government contracts, such as transport and infrastructure, are likely to feel the most impact.

Even before this year's difficulties, France was not doing terribly well in China. It lags behind Germany, which exports more than three times as much to China, though it does slightly better than Italy. According to Bruno Valersteinas, an economist who looked into the issue for France's finance ministry, there are two main reasons for this. Although France has several multinationals doing well in Asia and plenty of tiny firms, it lacks medium-sized manufacturers. And the products France offers in China, mainly in areas such as luxury goods and cosmetics, are not as suited to China's needs as German products such as machinery and heavy equipment.

Another reason why French companies in aggregate have not done so well in China, says Wang Jiann-Yuh, director-general of the France-China Committee, part of MEDEF, the French employer's union, is that French businesspeople can be impatient, sometimes arrogant, and overly focused on short-term results. They often pay too little attention to local officialdom in China, he says. A French department-store chain, for instance, bought a building in Shanghai from its owner in 2006, but did not bother to get approval from the local authorities. It is still waiting for permission to open.

Food regulation in China

The poison spreads

Sep 25th 2008 | HONG KONG
From The Economist print edition

Tainted milk kills children—and harms China's image abroad

WITH each passing day the news about China's tainted-milk scandal gets worse. It started with reports in the Chinese press on September 10th about tainted baby-formula produced by Sanlu, a large diary firm, but has since spread to 21 other producers, including the three Chinese giants, Mengniu, Yili, and Bright. Four children have died, 53,000 have been taken ill and there is no end in sight.

The range of products found to have been tainted with melamine (an industrial chemical used to hide the fact that milk has been watered down) now includes milk, yogurt, sweets and cake. Private testing laboratories, which have sprung up like mushrooms in China recently, are working overtime testing food. Several countries in Asia and Africa have banned imports of Chinese dairy products, and testing has been stepped up in Europe and America. Even if no more problems emerge, damage has been done. A survey by Interbrand, a consultancy, shows that the post-Olympics improvement in the perception of the "Made in China" brand has been wiped out by the scandal.

Fonterra, a New Zealand co-operative that owns 43% of Sanlu, has been praised for working with New Zealand's government to push Sanlu and the Chinese government to disclose information about contaminated products and get them off the shelves and out of homes. But it has also been slammed for not doing more—in particular, for not going public earlier (it first learnt of problems in early August). Several of China's big internet portals have also been accused of filtering out information about tainted milk from as long ago as December, in order to protect China's reputation during the run-up to the Olympics.

The government's response has changed, seemingly overnight, from suppression to intervention. The chairwoman of Sanlu has been detained. Four milk dealers have been arrested and 22 others held for questioning. The mayor of the city where Sanlu is based has resigned, along with the local Communist Party leader and the head of China's national department of quality supervision.

Whether all of this will address the problems with China's food-production system is questionable. The boss of one big food company says that at a local level, regulation is the responsibility of the Communist Party officials. Companies close to the party get an easy ride, until there is a breakdown, at which point punishment is draconian. Until the regulatory and judicial systems become independent, there will always be an incentive to ignore problems until they explode.

Foreign companies have been concerned about the possibility of such a scandal for some time. Unilever dumped its joint ventures years ago, to ensure it had full control of all domestic Chinese operations. McDonald's has created its own closed supply chain, spanning beef, fries, bread and pickles. Coca-Cola imposes stringent rules on suppliers of sugar, water and carbon dioxide.

This approach is being greeted with increasing approval within China. In monitoring consumer opinions, Coke says it initially found its recent effort to acquire Huiyuan, a large juice company, generated complaints on websites from nationalists opposed in principle to foreign brands. But support for the deal has since grown as a result of the company's reputation for safety and quality. Chinese firms are just beginning to build up their own brands and have yet to establish the kind of trust that persuades people that it is worth paying more for a better product, says Tom Doctoroff, chief executive in China of JWT, an advertising agency. Never has there been more reason for that to change.

Companies and human rights

Not the usual suspects

Sep 25th 2008 | OTTAWA
From The Economist print edition

A new report on corporate complicity takes a broad-brush approach

IMAGINE a company accused of human-rights abuses and you will probably conjure up an image of a mining group or an oil firm operating in some unstable, tropical place where governance is weak and corruption rampant. But a report from the International Commission of Jurists (ICJ), a body made up of 60 leading judges, lawyers and legal scholars from around the world, wants to demolish the idea that only extractive industries need to worry about human-rights violations.

The report, compiled by eight experts from North and South America, Africa, Asia and Europe, and released on September 19th, is meant to clarify what criminal and civil laws say about corporate complicity. It offers a surprisingly broad interpretation of how such laws could be applied. The examples it gives range from a hypothetical software firm that modified generic software to allow a government to track and target a minority group for discrimination, to the loan of earthmoving equipment to a government that used it to demolish homes, to paying taxes to a regime with an unsavoury reputation.

Defining corporate complicity in law is becoming more important as a growing number of companies are accused of involvement in gross human-rights abuses. But although a state's responsibility to protect the rights of its citizens is clear-cut in international law and there are courts where such cases can be heard, it is unclear whether laws designed with sovereign states in mind can be brought to bear on companies, or where to hear such cases. The most frequently used venue is America, where over 40 cases involving companies have been filed under the Alien Tort Claims statute in the past two decades.

The ICJ report set out to answer these murky questions. But the breadth of the panel's interpretation—and the experts' failure to state unequivocally what companies should and should not do to avoid being held liable for such abuses—drew criticism from business. "If everything is complicity, then you are not really giving any guidance," says Adam Greene of the United States Council for International Business. The way the report is written, says Mr Greene, suggests that even supplying a box of pencils could get a company into trouble if they are used to write down which government opponents attended a meeting. Nor did the report please activists seeking a clear explanation of how they might hold firms to account. "That's the void," says Seema Joshi of Global Witness, a British group that successfully campaigned against blood diamonds.

Was such clarity ever possible? Not according to Ralph Steinhardt of George Washington University Law School, one of the eight legal experts. "We couldn't possibly have offered a bright-line rule," he says. What the experts tried to do instead, he says, was suggest areas in which firms might want to manage their risk of liability, which they called the "zone of legal risk". This has raised eyebrows because it is not a legal term. But companies will recognise it, says Mr Steinhardt, because they already think in such terms when assessing product liability, employment law or raising capital. Indeed, a new effort announced on September 23rd by three groups, including the United Nations Global Compact, is intended to help companies see human rights as a business issue that they need to incorporate into their thinking.

So the panel's report is far from being the final word. Meanwhile, the legal landscape is changing. National governments are being pressed to dust off old laws, or pass new ones, aimed at corporations. The world is inching toward a definition of corporate complicity, but it is not there yet.

Face value

Virgin rebirth

Sep 25th 2008
From The Economist print edition

Two books give very different views of Sir Richard Branson, Britain's best-known businessman

eyevine

HE HAS just said that he would like to buy London's Gatwick Airport when it comes on the market next year, and by the end of October he aims to break the transatlantic monohull sailing record. There is no escaping Sir Richard Branson, the chairman of Virgin Group, who goes to extraordinary lengths to put himself on the front pages. Not even a near-disastrous abseil down a building in Las Vegas last year could deter him. His brand is not just Virgin—it is also Branson. His ambition is boundless: lately he has been holding meetings on his private Caribbean island with a group of experts, to work out how to save the world from global warming and its people from disease.

The name Branson means two things to British people. To most he is the country's best-known businessman, hoist to stardom by his derring-do ballooning stunts and photo-ops with busty blondes, an anti-establishment "cheeky chappy" whose plucky airline has battled the mighty "monopoly" of British Airways (BA) and whose Virgin brand has spawned a business empire. The other, lesser-known Branson is a ruthless, wily entrepreneur who is always trying to get one over his rivals. The former thinks he walks on water; the latter skates on thin ice.

Two books published this month sum up these conflicting portraits. "Business Stripped Bare", billed as the "adventures of a global entrepreneur", is Sir Richard's take on how to succeed in business, peppered with self-justifying anecdotes from across his empire, from Virgin Atlantic to Virgin Trains to Virgin Mobile. It is an interesting read, marred by boasting and embellishment. The management lessons range from the homespun to the banal: "find good people and set them free"; "it's attention to details that really defines great business delivery". In fact, Mr Branson's real talents are his winning way with people and his ability to inspire loyalty—both hard to distil into business-book maxims.

The new edition of "Branson", by Tom Bower, treads the same ground but takes a very different view. Mr Bower is a former documentary-maker who has carved out a career as a biographer of business figures (he is being sued by Conrad Black, a disgraced media tycoon). Sir Richard described Mr Bower's original work, published eight years ago, as "a foul, foul piece of work—really rotten, nasty stuff". Mr Bower retells the story of the "dirty tricks" war with BA in the early 1990s, which ended with Sir Richard winning a libel action against BA's chairman Lord King. In fact, that legal victory was a side issue (BA's house journal falsely accused Sir Richard of lying). As Mr Bower describes, Virgin was fighting a propaganda war with BA. It revelled in the sympathy it attracted as the alleged victim of dirty tricks, in the process benefiting from plenty of free publicity.

Mr Bower delights in detailing Sir Richard's antics—avoiding sales tax in his first record-retail business, for example—and in outlining his group's brushes with insolvency. In March 1992 he managed to extricate himself from losses and debt by selling his music division to EMI for £560m ($983m). In 1998 he raised cash by selling half of Virgin Rail to Stagecoach, a bus group. And in March 2000, weighed down again with losses, notably in music retailing, he freed himself by selling 49% of Virgin Atlantic to Singapore Airlines. He was soon at loggerheads with his new partners, however, over Virgin Blue, a start-up budget airline in Australia. As Sir Richard tells it, this was a brilliant launch, capturing about a third of the Australian market with a slick operation that challenged its stodgy competitors, Qantas and Ansett. Sir Richard leaves the story with the new airline on a high after floating on the Australian exchange. Mr Bower, by contrast, writes of the rows with Singapore Airlines, which had to close down its Ansett subsidiary after trying to buy out Virgin Blue, and leaves the tale with Virgin Blue's listed shares having slumped and Sir Richard's Australian partner trying unsuccessfully to sell his stake.

Coming to America

After a series of rebuffs at the hands of the British government—most recently, the dismissal of his bid to rescue Northern Rock, a troubled bank—Sir Richard is no longer resident in Britain, but spends much of his time in the Caribbean while trying to reinvent himself and expand in America, with Virgin America, a new airline, and Virgin Galactic, a space-tourism business. These efforts may have been helped by a gushing profile in the *New Yorker* magazine last year, which drooled over his efforts to make his hideaway, Necker Island, carbon neutral, which sounds faintly ridiculous from a man who owns several airlines and travels in a Falcon 900 executive jet. One American admirer even likened his environmental effort to the work of Rachel Carson, the author of "Silent Spring". Sir Richard's recent enthusiasm for all things green led him to announce that he would pour $3 billion in profits from his empire into making the world cleaner. To Mr Bower and other sceptics, this is just another way of saying that Virgin thinks it can make money by investing in biofuels. When a Virgin jumbo flew from London to Amsterdam, with one engine running on a mix containing 20% biofuel, Sir Richard called it a "an historic day", but environmentalists dismissed it as a stunt.

Mr Bower's relentless assault fails to paint Sir Richard as anything worse than a terrible show-off, capable of utter ruthlessness and with a talent for separating bankers from their money. The British took Sir Richard to their hearts originally for his rebellious image, but many have grown weary of his self-publicising. Maybe Americans will applaud his chutzpah. For all the hype, Virgin does not make much money. The most recent accounts, says Mr Bower, show the holding company losing £3.9m, even as its mainstay air-travel subsidiary made a profit of £123m. Sir Richard argues that he pursues growth, not profits, building companies up in order to sell stakes in them. But with aviation in crisis as a result of high oil prices, his empire's dependence on profits from his airlines must be cause for concern.

Economist.com FINANCE & ECONOMICS

America’s bail-out plan

The doctors' bill

Sep 25th 2008 | WASHINGTON, DC
From The Economist print edition

The chairman of the Federal Reserve and the treasury secretary give Congress a gloomy prognosis for the economy, and propose a drastic remedy

AP

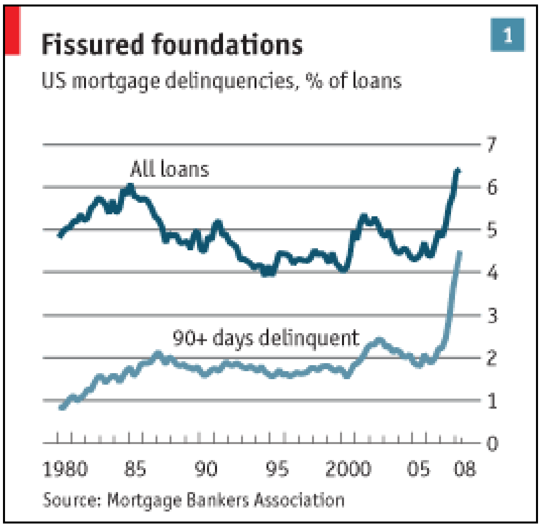
AMERICAN congressmen are used to hyperbole, but they were left speechless by the dire scenario Ben Bernanke, the chairman of the Federal Reserve, painted for them on the night of September 18th. He “told us that our American economy’s arteries, our financial system, is clogged, and if we don’t act, the patient will surely suffer a heart attack, maybe next week, maybe in six months, but it will happen,” according to Charles Schumer, a Democratic senator from New York. Mr Schumer’s interpretation: failure to act would cause “a depression”.

Mr Bernanke and Hank Paulson, the treasury secretary, had met congressional leaders to argue that ad hoc responses to the continuing financial crisis like that week’s bail-out of American International Group (AIG), a huge insurer, were no longer sufficient. By the weekend Mr Paulson had asked for authority to own up to $700 billion in mortgage-related assets. By the time *The Economist* went to press, Congress and Mr Paulson appeared to have agreed on the broad outlines of what is being called the Troubled Asset Relief Programme, or TARP.

However, passage was not assured as rank-and-file congressmen, in particular Republicans, balked. Uncertainty over the outcome rattled credit markets: three-month interbank rates jumped and Treasury yields fell on September 24th. In a prime-time address that evening to rally support, George Bush warned of bank failures, plummeting house values and millions of lost jobs if Congress did not act.

Both the crisis and the authorities’ response have been called the most sweeping since the Depression. Yet the differences from that era are more notable than the similarities to it. From the stockmarket crash of 1929 to the federally declared bank holiday that marked its bottom, three and a half years elapsed, and unemployment reached 25%. This crisis has been under way for a little over a year and unemployment is just over 6%, lower even than in the wake of the last, mild recession. More than 4% of mortgages are now seriously delinquent (see chart 1), but the figure topped 40% in 1934.

The scale of the American authorities’ response reflects both the violence with which this crisis has spread, and the determination of the American authorities, most importantly Mr Bernanke, to learn from the mistakes that made the Depression so deep and long.



In responding with such speed and vigour, they run several risks. One is that they overdo it, paying far too much for assets, sending the deficit into the stratosphere and triggering a run on the dollar. The risk of underdoing it may be even greater. Politicians, determined not to be seen as doing favours for Wall Street, might blunt the programme's effect in the name of protecting the taxpayer. Then there's the logistical nightmare of fixing a market whose very complexity is central to the crisis.

Experience, at home and abroad, is a poor guide. In past episodes authorities have typically not committed public money to their financial systems until bank failures and insolvency have become widespread. The first wave of savings-and-loan failures came in the early 1980s; the Resolution Trust Corporation was not created to dispose of their assets until 1989. Japan's banks began to fail in 1991, but a mechanism for taking over large, insolvent banks was not set up until 1998. Mr Paulson and Mr Bernanke are attempting to prevent the crisis from reaching that stage. "The firms we're dealing with now are not necessarily failing, but they are contracting, they are deleveraging," Mr Bernanke told Congress. They are unable to raise capital and are refusing to lend, and that, he said, is squeezing the economy.

One risk with such a pre-emptive bail-out is that to congressmen the benefits are hypothetical whereas the fiscal and political costs, five weeks before an election, are all too real. In polls voters waver between opposition and support depending on how the question is asked.

In spite of these risks, the odds seem to be in favour of both political passage and success. America has owned up to its mistakes with exceptional speed, and pulled out the stops to correct them.

After the crisis first broke in August last year, the Fed pursued a two-pronged strategy. The first element was to lower interest rates to cushion the economy. The second was to use its balance sheet to help commercial and investment banks finance their holdings of hard-to-value securities and avoid fire-sales of assets. Behind this approach lay the belief that the economy and the financial system were basically solid. Yes, too many houses had been built and prices were too high, but a return to more normal levels would be manageable if stretched over a few years. And banks in aggregate had entered the crisis in good shape, with much more capital this June than in 1990. The Fed saw their problem essentially as illiquidity, not insolvency. The Bush administration broadly shared this diagnosis—and an aversion to using public money to help overextended borrowers.

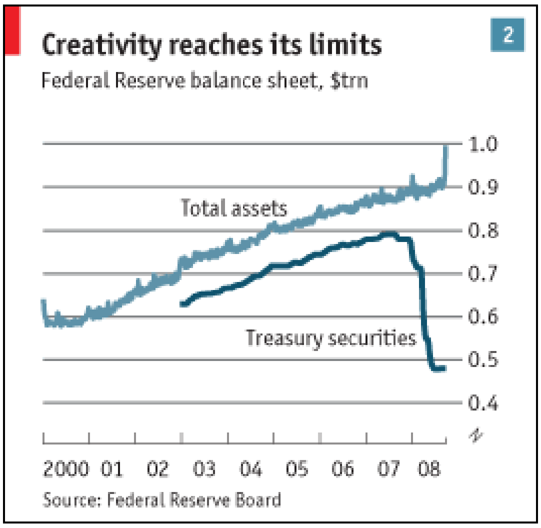
The intensification of the crisis came not from the banks but the "shadow banking system": the finance companies, investment banks, off-balance-sheet vehicles, government-sponsored enterprises and hedge funds that fuelled the credit boom, aided by less regulation and more leverage than commercial banks. As home prices fell and loan losses mounted, more of the shadow system became insolvent.

Insolvency cannot be cured with more loans, no matter how easy the terms. It requires more capital, which in deep crises only the government can provide. Mr Bernanke's groundbreaking paper on the Depression, published in 1983, noted that recovery began in 1933 with large infusions of federal cash into institutions, through the Reconstruction Finance Corporation, and households, through the Home Owners' Loan Corporation. They were, he wrote, "the only major New Deal programme which successfully promoted economic recovery."

A month ago Mr Bernanke and his closest aides began to think something similar might now be needed. The Fed and the Treasury had already drawn up contingency plans, thinking it would be months before a need arose. Then the financial hurricane blew up over the weekend of September 13th and 14th. That is when Mr Paulson, Mr Bernanke and Tim Geithner, president of the Federal Reserve Bank of New York, decided not to commit any public money to a bail-out of Lehman Brothers. They reasoned, wrongly, that the financial system was adequately prepared. The company's failure, coupled with the near-bankruptcy of AIG, threw the safety of all financial institutions into doubt, causing their stocks to plunge and borrowing costs to soar.

Several money-market funds that held Lehman debt reported negative returns, sparking a flight of cash to the safety of Treasury bills that briefly pushed their yields close to zero. On September 18th companies could no longer issue commercial paper. Banks, anticipating huge demands from companies seeking funds, began hoarding cash, sending the federal funds rate as high as 6%. That week, no investment-grade bonds were issued, for the first time (holidays aside) since 1981.

Conceivably, the Fed could have contained the damage by supplying lots of cash. But that would have meant ever greater and more creative use of its balance sheet. By September 17th it had grown to $1 trillion, up by 10% in a fortnight, with most of it tied up in loans to banks, investment banks, foreign central banks, AIG and Bear Stearns (see chart 2). It was becoming the lender of first resort, not last.



Such steps were also courting political risk. After the rescue of AIG, Nancy Pelosi, speaker of the House of Representatives, demanded, “Why does one person have the right to grant $85 billion in a bail-out [to AIG] without the scrutiny and transparency the American people deserve?” Mr Bernanke later acknowledged that the Fed wanted to get out of crisis management, for which it lacked authority and broad support. “We prefer to get back to monetary policy, which is our function, our key mission,” he told Congress this week.

The Fed chairman told Mr Paulson on September 17th that the time had come to call for a big injection of public money. By the next day Mr Paulson was in agreement and the two men, after getting Mr Bush’s approval, approached Capitol Hill.

Mr Paulson’s first proposal left Democrats cold: it would give the Treasury virtually unchecked authority for two years to spend up to $700 billion on mortgage assets or anything else necessary to stabilise the system. It looked like a power-grab. Democrats countered with several conditions: troubled mortgages would be modified where possible to keep homeowners in their homes; an oversight board would watch over the programme; taxpayers would share any gains for participating companies via shares or warrants; and executives’ compensation would be capped. By September 24th, Mr Paulson seemed to be bending to all these conditions. For its part, the finance industry is ready to yield to all of these conditions in order to get something done. “It was a gargantuan abyss that we faced last week,” says Steve Bartlett, chairman of the Financial Services Roundtable, which represents about 100 big financial firms.

Assuming it comes into existence, there are still numerous risks surrounding the TARP. The first is that it does too much. At $700 billion, the amount allocated to it easily exceeds the Federal Deposit Insurance Corporation’s (FDIC) estimate of roughly $500 billion of residential mortgages seriously delinquent in June, out of a total of $10.6 trillion, though that figure will rise. The Treasury has sought broad authority to buy not just mortgage securities but anything related to them, such as credit derivatives, and if necessary equity in companies weakened by their bad loans.

The arithmetic of crisis

When the loans to AIG and Bear Stearns assets are added in, the gross public backing so far approaches 6% of GDP, well above the 3.7% of the savings-and-loan bail-out in the late 1980s and early 1990s (see chart 3). That would still be much less than the average cost of resolving banking crises around the world in the past three decades, which a study by Luc Laeven and Fabian Valencia, of the IMF, puts at 16%. One reason why bail-outs, especially in emerging markets, have been so costly is inadequate safeguards against abuse, says Gerard Caprio, an economist at Williams College. “There was a lot of outright looting going on.”

The price of safety 3

Cost of bail-outs

Country	Start of crisis	Gross fiscal cost ,% of GDP
United States	1988	3.7
Finland	1991	12.8
Sweden	1991	3.6
Mexico	1994	19.3
Japan	1997	24.0
South Korea	1997	31.2
United States	2007	5.8*

*Includes $700bn to the Troubled Asset Relief Programme, $85bn to AIG, $29bn to Bear Stearns. Excludes capital investment in GSEs

Source: IMF, Luc Laeven and Fabian Valencia

The Congressional Budget Office had pegged next year’s federal budget deficit at more than $400 billion, or 3% of GDP. Private estimates top $600 billion. Tack on $700 billion and various other crisis-related outlays and the total could reach 10% of GDP, notes JPMorgan Chase, a level last seen in the second world war. On September 22nd the euro made its largest-ever advance against the dollar on worries that America might one day inflate its way out of those debts. Such fears are compounded by the expansion of the Fed's balance sheet. Some even think that the burden of repairing a broken financial system could place the dollar's status as the world's leading reserve currency in jeopardy.

The consequences will probably not be so far-reaching. The true cost to taxpayers is unlikely to be anywhere near $700 billion, because many of the acquired mortgages will be repaid. The expansion of the Fed's balance sheet reflects a fear-induced demand for cash, which drove the federal funds rate above the 2% target.

It is more likely that the programme will not go far enough. Conscious of the public's deep antipathy to anything that smacks of favours for Wall Street, politicians from both parties have insisted that the protection of the taxpayer be paramount. Yet the point of bail-outs is to socialise losses that are clogging the financial system. If taxpayers are completely insulated from losses, the bail-out will probably be ineffective. "The ultimate taxpayer protection will be the market stability provided," Mr Paulson argues.

This is especially critical in deciding how the government will set the price for the assets it purchases. An impaired mortgage security might yield 65 cents on the dollar if held to maturity. But because the market is so illiquid and suspicion about mortgage values so high, it might fetch just 35 cents in the market today. Recapitalising banks would mean paying as close to 65 cents as possible. Those that valued them at less on their books could mark them up, boosting their capital. On the other hand, minimising taxpayer losses would dictate that the government seek to pay only 35 cents. But this would provide little benefit to the selling banks, and those that carried them at higher values on their books could see their capital further impaired.

To some, that would be fine. "If they choose to fail rather than sell their debt at its real market value and record the loss on the books, they should be free to take that option," said Michael Enzi, a Republican senator from Wyoming. The failure of smaller regional banks may be tolerable. The FDIC offers a proven system for coping with failed entities (although it too may need a loan from the taxpayer) and other banks are keen to snap up their deposits. But the final result of big-bank failures would be a deeper crisis and a bigger cost in lost economic output.

Similarly, requiring participating banks to give the government warrants or cap their executives' salaries might make them less willing to take part. Veterans of the emerging-markets crises of the 1990s say their effectiveness would have been crippled had their ability instantly to deploy cash as they saw fit been compromised. "There is far more risk that the authorities will have too little flexibility…than there is risk that they will have too much authority," says Lawrence Summers, a former treasury secretary.

A more serious criticism is that buying assets is an inefficient way to recapitalise the banking system. Better, many argue, to inject cash directly into weakened banks. A dollar of new equity could support $10 in assets, reducing the pressure to deleverage. Moreover, since the price of banks' shares are less arbitrary and more homogeneous than those of illiquid mortgage securities, the process would be far more transparent, says Doug Elmendorf of the Brookings Institution. But banks might not volunteer to sell equity to the government before they reach death's door; and the prospect of share dilution could discourage private investors. In any event, the Treasury plan could be flexible enough to permit such capital injections.

But will it work?

Reuters

There have been several false dawns since the crisis began in August of last year. This could be another. The TARP may address the root cause, namely house prices and mortgage defaults, but the crisis has long since mutated. "The same underlying phenomenon that we saw in housing we're seeing in auto loans, in credit-card loans and student loans," says Eric Mindich, head of Eton Park Capital Management, a hedge fund. The crisis could claim another institution before the TARP's effect is felt.

The TARP could conceivably slow the resolution of the crisis by stopping property prices and home ownership falling to sustainable levels. Some homeowners who are up-to-date with payments but whose home is worth less than their mortgage may stop paying, betting the federal government will be a more forgiving creditor. The Treasury is considering using the TARP to write down mortgages to levels that squeezed homeowners can afford. But in the meantime, buyers might be reluctant to step in while a big inventory of government-owned property hangs over the market. That's one reason Japan's many efforts to bail out its banks failed to revitalise its economy: the institutions that took over the loans were hesitant to dispose of them for fear of pushing insolvent borrowers into bankruptcy, says Takeo Hoshi of the University of California at San Diego.

Time to mend the market

All the same, the TARP is likely to mark a turning-point. "It promises to break the vicious circle of deleveraging in the mortgage market," predicts Jan Hatzius, an economist at Goldman Sachs. This does not mean the economy will soon rebound, but it does suggest the worst scenarios will be averted. If the TARP helps banks and investors establish reliable prices for mortgage securities, it could restart lending and help bring the housing crisis to an end.

This will not come without a price. The unprecedented intrusion of the federal government into the capital markets seems certain to be accompanied by a heavier regulatory hand, something on which both Barack Obama and John McCain now agree.

Even without new rules, more of the system will be regulated because so much of it has been absorbed by banks, which are closely overseen. Sheila Bair, chairman of the FDIC, thinks this is a good thing. Banks were relative pillars of stability because of their insured deposits and the regulation that accompanied it. Although some banks have failed, she notes that other banks, not taxpayers, will pay the clean-up costs. Now that institutions like money-market funds are caught by the federal safety net even though that was never intended, they can expect to pay for it.

Yet predictions of a sea change towards more invasive government are premature. The Depression witnessed a pervasive expansion of the federal government into numerous walks of life, from trucking and railways to farming, out of a broadly shared belief that capitalism had failed utterly. If Mr Paulson and Mr Bernanke have prevented a Depression-like collapse in economic output with their actions these past two weeks, then they may also have prevented a Depression-like backlash against the free market.

American finance

And then there were none

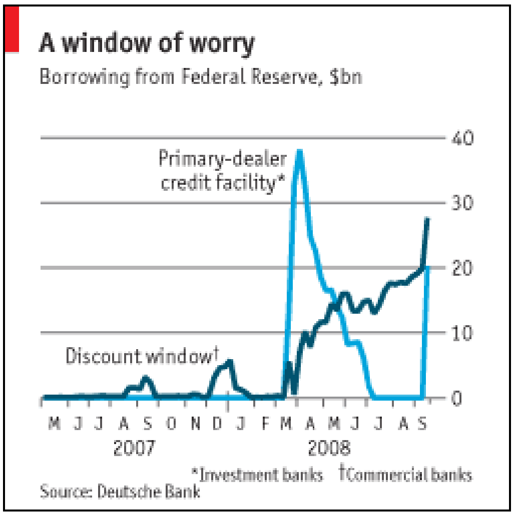
Sep 25th 2008 | NEW YORK
From The Economist print edition

What the death of the investment bank means for Wall Street

Illustration by S. Kambayashi

THE radical overhaul of the City of London in 1986 was dubbed the Big Bang. The brutal reshaping of Wall Street might be better described as the Big Implosion. The “bulge-bracket” brokerage model—the envy of moneymen everywhere before the crunch—has collapsed in on itself. Even more humiliating for the Green Berets of the markets, the new force in finance is the government.

The last remaining investment banks, Goldman Sachs and Morgan Stanley, sought safety by becoming bank holding companies after last week’s run on the industry, which sent Wall Street scrambling for loans from the central bank (see chart). After Lehman Brothers collapsed, the markets could no longer stomach their mix of illiquid assets and unstable wholesale liabilities. Both will now start gathering deposits, a more stable form of funding. Signing up strong partners should also help. Mitsubishi UFJ Financial Group (MUFG), a giant Japanese bank, will buy up to 20% of Morgan (see article). Goldman has gone one better, coaxing $5 billion from Warren Buffett (see article).



Mr Buffett, no idle flatterer, describes Goldman as “exceptional”. But some doubt that it will be able to adapt and thrive. As a bank, it faces more supervision from the Federal Reserve, tougher capital requirements and restrictions on investing. Universal banks, such as Citigroup and Bank of America, long dismissed as stodgy, argue that their vast balance sheets and wide range of businesses, from credit cards to capital markets, give them an edge in trying times. The head of one bank suggests that the golden years of risk-taking enjoyed by investment banks in 2003-06 were an “aberration”, fuelled by the global liquidity glut.

Private-equity firms and hedge funds spy opportunity, too. Blackstone’s Stephen Schwarzman is keen to take advantage of Wall Street’s disarray. Kohlberg Kravis Roberts, a rival, has ambitions to create a financial “ecosystem”. The buy-out barons got good news this week, when the Fed relaxed its rules on their ownership of banks. One of them, Christopher Flowers, bought a small lender in Missouri, which he may use to hoover up other troubled financial firms. Citadel, a hedge-fund group that is already an options marketmaker, is reportedly mulling a move into the advisory business. Hedge funds have stepped up their financing of mid-tier firms that cannot get loans from Wall Street.

These investors are also going after the “talent” in investment banks. Morale there is not high. One executive admits that becoming a bank “does little for our cachet”. Hedge funds will be particularly keen to get their hands on cutting-edge risk-takers, particularly the Goldman crowd who used to thrive on leverage.

Power may shift in two other directions: abroad and, to a lesser extent, to boutique investment banks. MUFG will be joined by others. After a brief wrangle in the bankruptcy courts, Britain’s Barclays has taken over Lehman’s American operations and quickly put its logo on the fallen firm’s headquarters. “Global financial power is becoming more diffuse,” says Andrew Schwedel of Bain & Company, a consultancy. Merger boutiques, such as Lazard and Greenhill, will emphasise their stability to pick up business. Their shares have done relatively well this year.

But all is not lost for the former investment banks. For one thing, they may not have to cut leverage by as much as feared. Though their overall leverage ratios are high, their risk-adjusted capital ratios under the Basel 2 rules are stronger than those of most commercial banks. They acknowledge, however, that they may have to raise these even higher for a while to assuage market concerns about hard-to-sell assets.

Brad Hintz of Sanford Bernstein, an asset manager and research firm, reckons regulatory shackles will cut Goldman’s return on equity by four percentage points over the cycle. The bank disputes this. Either way, even if it is forced to tone down its in-house proprietary trading it can make up for this by, for instance, launching more hedge funds. And it faces no immediate pressure to sell its large private-equity or commodities holdings. It will continue to co-invest in projects alongside clients, a key Goldman strategy.

Moreover, there are some advantages to becoming a bank. Goldman and Morgan should be able to amass deposits cheaply and easily, because dozens of regional lenders are expected to fail. Almost one-fifth have less capital than regulators consider a safe minimum. However, the new banks will be under scrutiny to ensure they do not put those deposits at great risk.

As sharp distressed-debt investors, they will also be looking to buy assets from the government’s giant loan-buying entity when it gets going. This is likely to be more helpful to them than to commercial banks, which have marked down their mortgage assets less and will not benefit as much when clearing prices are set.

Given the acute stress that remains in money markets, however, the accent for the time being is still on survival. Morgan Stanley’s debt with a maturity of four months was trading to yield as much as 37.5%. Maybe it should consider using credit cards instead.

Financial firms fear further fallout from the recent, potentially catastrophic run on money-market funds, after several of the supposedly ultra-safe vehicles saw their net asset values slip below the sacrosanct $1 level at which investors break even. Only when the government stepped in to guarantee that no more funds would “break the buck” did a semblance of calm return. But “prime” money funds, which are big buyers of corporate debt, are still pulling away from anything deemed risky. This is a big problem for banks, since some $1.3 trillion of their short-term debt is held by such funds, and they may have to turn to longer-term (and dearer) sources.

You might just miss us

Once markets stabilise, Wall Street will start to wonder if it is better or worse off without its stand-alone investment banks. Some think they were no more worth saving than Detroit, another once-iconic industry caught up in its own battle for a public rescue. Perhaps even less so: the securities Wall Street packaged were the financial equivalent of slick-looking cars with no brakes. But they may leave a hole. As broker-dealers, regulated more lightly by the Securities and Exchange Commission, they were free to put large dollops of capital to work, providing liquidity, making markets and assuming risk. As banks, they may find the Fed takes a more restrictive view.

It seems implausible that the investment bank will make a comeback, given the speed with which it has unravelled. Yet, 75 years after the legal separation of commercial and investment banking, America has made a full return to the one-stop-shop model practised by John Pierpont Morgan. Another black swan in 2083, and who knows?

Warren Buffett and Goldman Sachs

Tucking in

Sep 25th 2008 | NEW YORK
From The Economist print edition

Warren Buffett's return to Wall Street raises hopes

AP

Buffett lunch

IN 1998 Goldman Sachs was looking for help in bailing out Long-Term Capital Management, a sickly hedge fund to which it was exposed. It sought a contribution from Warren Buffett. But the Oracle of Omaha was on holiday (with Bill Gates, of course) and as the deadline approached his boat drifted out of mobile-phone range. This time there were no communication problems. Mr Buffett has answered Goldman's latest call with a $5 billion infusion from his cash pile.

Goldman could not have wished for a more credible vote of confidence, albeit at a steep price: Mr Buffett's holding company will receive $500m a year in dividend payments on its preferred stock. Mr Buffett knows from experience that it pays to negotiate hard with investment bankers. His only previous foray on Wall Street, a $700m bet on Salomon Brothers, went badly awry, though it eventually turned a profit.

He is, he says, betting "on brains"—and, implicitly, that Goldman's profits will not be hit too hard by becoming a regulated bank. Some also see the move as a vote of confidence in financial firms, which Mr Buffett has thus far avoided in this crisis, preferring the relative calm of energy, railroads and chewing gum.

That may be hoping for too much. Mr Buffett made clear that he considers Goldman's management a cut above. And he drew a contrast between its cautious valuation of illiquid assets and more "fanciful" marks at some other firms. Moreover, for all his hardheadedness he has a soft spot for Goldman, having befriended its one-time boss, Sidney Weinberg, as a young man and stayed close to the firm ever since

In any case, Mr Buffett's skill lies more in picking undervalued stocks with strong brands than in timing market bottoms—indeed, he bought into Salomon only weeks before the 1987 crash. Even when it comes to individual holdings, he is not flawless. He held Moody's, a rating agency, for too long.

Still, it is heartening that such a shrewd investor is beginning to spy opportunities in the rubble of a crisis he has dubbed "an economic Pearl Harbour." He confirmed this week what must already have been obvious: that he has been approached by almost every big financial institution in recent months. After Goldman, he can expect the phone to ring off the hook.

Economist.com FINANCE & ECONOMICS

Speculators

Shoot first

Sep 25th 2008
From The Economist print edition

Regulators—and just about everybody else—gun for speculators

IN 1918 Vladimir Lenin told the Petrograd Soviet that "speculators who are caught and fully exposed as such shall be...shot on the spot". There are as yet no firing squads on Wall Street or in the City of London. But a backlash against financiers has begun. It is partly political—leaders of all stripes are now demanding blood. Reflecting the mood, America's Federal Bureau of Investigation is probing 26 firms for possible accounting fraud, reportedly including Fannie Mae, Lehman Brothers and American International Group (AIG).

Regulators, meanwhile, are now prepared to use almost any tool to try to stabilise financial firms and prevent the kind of death spiral suffered by Lehman and AIG. To this end, authorities across the developed world have introduced blanket suspensions on the short-sale of financial firms' shares, and are eyeing curbs on credit derivatives.

As a matter of justice, the constraints on short-sellers, who bet that share prices will fall, are cruel. Some bears played a big role in uncovering the folly that banks were engaged in. Nor does it seem likely that their trades distorted prices. In the week before AIG's rescue the net increase in its stock on loan (and thus available to be sold short) represented only 5% of trading activity, based on statistics from Data Explorers, a research firm. Even on grounds of expediency the actions are questionable. Some financial shares covered by the ban have since plummeted.

In addition to their unconvincing experiment with short-selling, regulators have turned on credit-default swaps (CDS), contracts which insure against default. Some intervention is certainly needed to limit the systemic risk posed by this largely unregulated, over-the-counter market. The Federal Reserve Bank of New York is helping to create a central counterparty for CDS trades, which should prevent the kind of disruption created by the collapse of Lehman, a big CDS dealer. And the governor of New York State wants companies that sell CDS to insure customers' bond portfolios from default to be subject to solvency rules. That should help prevent a repeat of the AIG debacle. A poorly capitalised subsidiary of the insurance firm was relied on by many banks for credit protection.

Yet as well as being a shambles, the CDS market now stands accused of being a speculator's playground. One conspiracy theory is that hedge funds distorted CDS prices, which in turn spooked the stock market and caused a collapse in confidence. Even the Chairman of the Securities and Exchange Commission, America's financial regulator, says "significant opportunities...exist for manipulation".

CDS dealers insist this is unfair. One estimates that speculation represented only a quarter of recent trading volumes in distressed financial firms such as Lehman, with the bulk of activity involving rival firms desperate to protect themselves against counterparty risk. There was a comparable slump in cash bonds, which for technical reasons are hard for speculators to bet against.

Still, taking into account estimates of trading volumes and margin payments, it is conceivable that an individual hedge fund, if it had no regard for counterparty risk, could have dominated trading of an individual bank's CDS on any given day. Unless the market becomes more transparent, it will be hard for its supporters to refute such allegations.

One way of viewing the crackdown on speculation is as a purgative that will force sloppy markets to clean up their act. Yet there will also be a cost. Already absurd situations have arisen: somehow IBM, a technology company, has managed to get on the list of stocks protected from shorting. In the long run short-sellers, who improve liquidity and price discovery, will be wary of trading the shares of politically important industries. In America, one bear complains, it is now "capitalism on the way up, and socialism on the way down".

Buttonwood

A cautionary tale from the future

Sep 25th 2008
From The Economist print edition

This newspaper story has just come to light after falling through a gap in the space-time continuum

Illustration by S. Kambayashi

REGS CLAMP DOWN ON NAKED LONGS!

September 26, 2021

FINANCIAL authorities in America and Europe took sweeping powers yesterday to avert a financial crisis by imposing restrictions on markets. In their sights are a peculiar brand of speculators known as "long-buyers" who buy assets not to live off the income they generate but to profit from rising prices.

"Some of these people buy homes that they have no intention of living in," said Lord Poohbah, chairman of Britain's Financial Services Authority, "and others buy shares they plan to own for just days or weeks, rather than the prudent time period of several years." Their actions force prices up above fundamental valuation levels, critics say, causing some British tabloid newspapers to call leading fund managers "greedy pigs".

Particular criticism has been reserved for people dubbed "naked long-buyers", those who try to buy homes without putting up a deposit. "Such people are in effect renters with a free call option on rising house prices," said one financial analyst, "but they expect to be bailed out by taxpayers when house prices fall."

Not only is this a clear case of moral hazard (the encouragement of irresponsible risk-taking) but their activities drive up house prices, putting them beyond the reach of hard-working families who have diligently saved up to put down a deposit. Also in the speculative category are "buy-to-letters" who buy a string of houses with borrowed money in the hope of making outsize gains.

In America rising house prices have pushed up the level of inflation in recent years. The Labour Department was forced to include a proper measure of house prices in the inflation data by the Alan Greenspan memorial act, passed by Congress in 2020.

In the stockmarket long-buyers often buy shares after inadequate analysis of a company's balance-sheet because they believe a "greater fool" will purchase them at a higher price. This happened in the so-called dotcom bubble of the late 1990s, leading to massive losses that destabilised the economy and eventually prompted the Federal Reserve to cut interest rates.

In addition, naive long-buyers pushed up the shares of financial companies, such as banks, in the mid-2000s, prompting the banks to indulge in irresponsible lending that led to the housing bust of 2007-10, an event that awakened fears of a repeat of the 1930s Depression.

"We cannot let the long-buyers destabilise the markets again," said the American treasury secretary. He accordingly took powers to limit the scope of future price rises, including the creation of a so-called "Revolution Trust Corporation" that will issue a trillion dollars worth of shares in financial companies that will subsequently be sold in the market. The proceeds of the sale will be used to pay down the national debt, swollen by the costs of previous bail-outs of the financial system.

The plan to cap house prices will involve the introduction of capital-gains tax on housing profits. "If taxpayers have to subsidise house-price losses, it is only fair they should share in the gains," the secretary said. Homeowners may protest at the details of the plan but the sweeping powers taken to govern the financial system by the former Hank Paulson (now King Henry I of America) mean there is little they can do about it.

Industry analysts said that some of the damage done by long-buyers might have been prevented had a now defunct practice called “short-selling” been permitted. By speculating on falling prices, short-sellers could in theory prevent bubbles from being formed. However, their scope to trade was always limited by regulations and the tactic was killed off during the crisis year of 2008. “It drove us out of business,” recalled George Soros, a former hedge-fund manager, speaking in Central Park yesterday, before adding, “Do you want some ketchup with that?”

Before that crisis, the standard rubric on financial products said “Warning: share prices may go down as well as up.” Afterwards, the clause “but not if the authorities have anything to do with it” was added at the end. The result was the decade-long boom in house and share prices that prompted the authorities to step in yesterday.

Asked if he was blaming speculators for the inadequacy of American monetary policy, the treasury secretary abruptly ended the news conference.

European banks

While Rome burns

Sep 25th 2008
From The Economist print edition

Are European banks insulated from the panic in America?

AMERICAN plans to buy up assets that are clogging the financial system lack detail but no one doubts that a massive government intervention is coming. In Europe jittery investors have no such reassurance. European governments have yet to respond publicly to calls from Hank Paulson, the treasury secretary, to follow his lead. They look set to keep faith with the approach that they have used to handle the crisis so far—staving off liquidity worries by allowing banks to use facilities at central banks to swap their assets in exchange for ready cash.

That makes many watchers nervous. The crisis in America has dramatically grown from one of liquidity to one of solvency as well. Lehman Brothers had access to the Federal Reserve's discount window, after all, but still went under. The burning question now is whether banks have enough capital. On some measures, European banks look pretty well capitalised. The average tier-one ratio, which measures capital based on the riskiness of bank assets, stood at 8% in the first half of the year. That looks solid enough, if you assume that banks have a good handle on risk.

Sceptics on that point prefer to look at European banks' leverage ratios, which measure the amount of capital banks hold relative to total assets. By some estimates, Deutsche Bank, Barclays and UBS have leverage ratios of 1.2%, 2.4% and 2.1% respectively, which would make broker-dealers weep with fear. Get the risk calculations wrong (it can happen) and the cushion of capital looks horribly thin.

There is plenty of scope for further hits. European vulnerability to insurers of structured credit became clearer with the rescue of American International Group, an insurer that wrote more than $300 billion of protection on assets held by banks in Europe and America. The monoline bond insurers still have lots of potential to cause trouble. Many worry that even now, big losses are yet to be declared. "Lift up the bonnet of a bank in Germany, say, and you often find a steaming wreck inside," says one bank boss. Reports that KfW, a state-owned bank in Germany, merrily transferred €300m ($426m) to Lehman in a failed swap deal on the day it went bust will not calm nerves.

America's bail-out plan could even accelerate the pace of write-downs on structured credit if it sets a price below today's European valuations for nasty assets. And if the price is at or above current marks, which seems likelier, the plan risks creating a nasty dividing-line between European banks that have access to the facility because they have enough American business, and those banks that do not. Behemoths like Barclays, Deutsche and UBS may reasonably expect to find some shelter under Mr Paulson's tarpaulin. That is far less likely for an institution such as Fortis, a large Belgo-Dutch bank which saw its shares plunge this week.

Strains on capital will also intensify if European economies stall more severely than expected. The rates of deterioration in certain markets are striking. Bank of Ireland issued a starkly gloomy trading statement on September 17th, forecasting rising loan losses and cutting its dividend by half. In Spain the poorly diversified savings banks are warning that non-performing loans could rise sixfold from their levels in mid-2007. In Denmark the central bank felt obliged to bail out a small lender on September 22nd.

Funding pressures are tightening the vice. Lending between banks remains stifled, and demand for central-bank liquidity is consequently extremely high. The European Central Bank's auction of three-month loans on September 24th was more than three times oversubscribed.

What is more, about $1.4 trillion of bank debt falls due in Europe this year and next, just as bondholders have received their first big blow of the crisis thanks to Lehman's demise. Worries about how HBOS, a British bank, would roll over its wholesale obligations forced it into the arms of Lloyds TSB on September 17th. Other banks, notably in Spain, Iceland and Scandinavia, are even more dependent on the wholesale markets. The ECB plans to impose stricter conditions on its lending in February but that will be difficult while confidence remains low. Mr Paulson may yet have some imitators across the pond.

A bank run in Hong Kong

Text P for panic

Sep 25th 2008 | HONG KONG
From The Economist print edition

Amid the global storm, a soaking for the biggest Chinese bank in Hong Kong

AFP

In search of a financial rock

IN THE West it is not uncommon these days to hear rumours flying around financial markets about troubled banks. But in Hong Kong on September 24th the rumours were disseminated by text messages, and they were not directed at shareholders. They were received by depositors at the Bank of East Asia, Hong Kong's largest locally owned lender. As the day wore on, people lined the pavements outside the bank branches, quietly determined to withdraw their cash. "No worry, it is our culture," said one man, explaining the calm. He had been sent by his boss to transfer the money to HSBC, Hong Kong's historic financial rock.

The 90-year-old Bank of East Asia blamed "malicious rumours" for the incident and said they were false. The text messages had referred to the bank's losses through exposure to American International Group (AIG), the global insurance giant that was in effect taken over by the American government on September 16th, and Lehman Brothers, the Wall Street bank that collapsed a day earlier. To allay fears, the bank disclosed that it had exposure to AIG and Lehman of HK$473m ($61m), just under 1% of regulatory capital. It extended its opening hours, dispatched guards to ensure queues were orderly and distributed leaflets noting that it was heavily capitalised and liquid, a position endorsed by the local monetary authority.

Hong Kong has experienced bank runs before, most recently in 1997 during the Asian financial crisis. Deposit insurance used to be non-existent and it remains small, covering only the first HK$100,000. But banks in the city are thought to be well capitalised and fairly insulated from the global credit crunch. They are in better shape than others in the region, such as Australian banks, which have seen interbank funding costs soar, leading the Federal Reserve to open a dollar swap line this week with the Reserve Bank of Australia.

The Bank of East Asia is a special case in Hong Kong, however. In February its well-connected boss, David Li, settled American insider-trading charges. More recently, a "rogue trader" cost the bank HK$93m. On September 19th Moody's, a rating agency, shifted its outlook on the bank's debt to negative (although it is still investment grade).

In response to the run, the Hong Kong authorities voiced their support for the bank, and a tycoon bought shares. They rose on September 25th as normality returned. But banks everywhere should pay attention. As storms batter global finance, depositors' fingers are on the panic button. And that button may now be on their mobile phones.

Japanese banking

The big boys are back

Sep 25th 2008 | TOKYO
From The Economist print edition

Japan's big banks put their megabucks to work in the West

Reuters

LESS than a decade ago Japanese banks were the sick men of global finance. Today they are bouncing back. Having rebuilt their balance sheets, Japan's financial institutions are rich in cash while their foreign peers are helpless and in debt. And unusually for sumo-sized, bureaucratic Japanese firms, they are moving fast.

On September 22nd Mitsubishi UFJ Financial Group (MUFG), Japan's biggest bank, agreed to pay about ¥900 billion ($8.4 billion) for up to 20% of Morgan Stanley. The Japanese will have at least one seat on the board. In August MUFG also spent about $3.5 billion on the 35% of UnionBanCal, a bank based in San Francisco, that it did not already own.

Meanwhile Nomura, Japan's biggest broker, bought the Asian, European and Middle Eastern divisions of Lehman Brothers, the collapsed Wall Street bank—though not its trading assets or liabilities. The Asia-Pacific business, which employs 3,000 people in ten territories, cost Nomura $225m. The European and Middle East equities and investment-banking operations have 2,500 staff in around ten countries. Kenichi Watanabe, Nomura's new and atypically young (ie, 55-year-old) boss, called the deals "a once-in-a-generation opportunity". The price barely dents the ¥600 billion Nomura raised this year to expand overseas.

Other institutions are also looking abroad. Earlier this year Sumitomo Mitsui Financial Group (SMFG) and Mizuho, the other two big banks, invested about $1 billion in Barclays and Merrill Lynch, respectively. Before Warren Buffett's show of support, SMFG had considered putting fresh cash into Goldman Sachs, an old friend: since the 1980s the two groups have often helped each other through hard times.

Both MUFG and Nomura are giants at home but pygmies abroad, for lack of human capital rather than the more tangible stuff. Both hope the purchases will provide badly needed expertise in advising on international mergers and acquisitions, and equity underwriting.

But Nomura faces huge difficulties in managing two vastly different corporate cultures: Japanese salaryman and American psycho. Japanese companies prize loyalty and seniority, and pay is more or less egalitarian. By contrast, Americans are unafraid to change jobs, value youth at least as much as experience, and pay big salaries supposedly based on merit. Keeping staff—the most important asset in banking after money—will be hard. Welding together the IT systems will be, too.

There are also strategic concerns. In the booming 1980s Japanese banks gobbled up American ones at inflated prices, and then sold at a loss. Now their acquisitions may look cheaper, but they are buying into an industry in trouble. Profits could be thin for years, tighter regulation looms, leverage is a dirty word and fears of recession are growing around the world.

But no one has more recent experience of crisis than Japan. Japan's three "megabanks" were so busy cleaning themselves up after the 1990s mess that they largely avoided entrapment in America's subprime-mortgage boom. They have little domestic growth to speak of—Japan's households sit on about $15 trillion of assets, half in cash. Companies keep some $600 billion in cash on hand. With a weak economy and an ageing population, the only place to go is abroad.

And if Japanese banks have any unique skill, it may well be in coping with crisis. They also know how long the troubles can endure. That is why their vote of confidence in American banking is probably a good sign.

Deleveraging

A fate worse than debt

Sep 25th 2008
From The Economist print edition

Consumers and companies may be forced to cut back

IT IS ugly, but deleveraging is the word of the moment. Financial institutions, desperate to repair the damage inflicted on their balance-sheets by mortgage-related securities, sell assets. In doing so, they exacerbate the problem. Forced sales push down the prices of assets, worsening the balance-sheets of other investors, forcing more asset sales, and so on. In the end, the government is the only entity left in the game with a balance-sheet strong enough to keep buying.

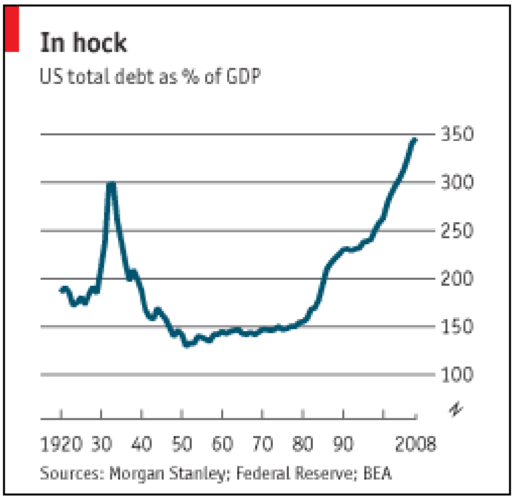
The Bush administration's bail-out plan, even if it gets through Congress, may not be the end of the finance industry's problems. The travails of investment banks will inevitably cause problems for hedge funds, which depend for their finances on institutions such as Goldman Sachs and Morgan Stanley.

Many hedge funds have already cut positions since the credit crunch started in the summer of 2007, and banks have tightened the terms on which they will do business with them. This has been particularly true for those that sought funding through the prime-brokerage arms of Bear Stearns and Lehman Brothers before they were wiped out.

The volatility of financial markets may intensify the pain, since both brokers and hedge funds use models which lead them to sell assets when prices move down sharply. Some hedge funds may have to give up altogether. Around 15% more were liquidated in the first half of 2008 than in the first half of 2007, according to Hedge Fund Research, a consultancy.

What hurts finance affects the rest of the economy in spades. Tim Bond, of Barclays Capital, reckons that, thanks to the gearing effect, a shortfall of bank capital of around $170 billion may reduce the potential supply of credit by $1.7 trillion.

A cut in overall lending would be a complete reversal of trend. Morgan Stanley reckons that total American debt (ie, the gross debt of households, companies and the government) has risen inexorably since 1980 to more than 300% of GDP (see chart), higher than it was in the Depression. Consumers, in particular, were encouraged to borrow by low unemployment and interest rates and (until last year) rising asset prices. Their debt jumped from 71% of GDP in 2000 to 100% in 2007, a bigger increase in seven years than had occurred in the previous 20.



If consumers start to save more or borrow less, spending suffers. In the last three months, America has seen the weakest car sales since 1993, according to Bloomberg. A general decline in demand will cause businesses to shed jobs, creating further falls in demand and more bad debts.

Once started, the process is hard to stop. "What the financial and household sectors are doing is unwinding more than ten years of a credit boom," says George Magnus, an economist at UBS. "The idea that they can rid themselves of this problem in a matter of months is pie in the sky."

Then there are businesses. Thanks to strong recent profits, many firms are less geared than they were earlier this decade during the telecoms bust. Nevertheless, there are plenty of big borrowers around, including carmakers and businesses bought by private-equity groups. They may struggle to refinance their debts as they fall due. Martin Fridson, of Fridson Investment Advisors, says that the default rate on high-yield bonds may climb to 10%.

Even firms that are not heavily in debt may think twice about expanding. According to Morgan Stanley, changes in bankers' attitudes to lending tend to lead business investment by three quarters. If the past pattern holds good, by the summer of next year investment may be falling at an annual rate of more than 10%. That will further depress economic growth.

The danger is of a "second-round effect", as the crisis in finance affects the economy, leading to further problems in finance. Mortgages may be the problem asset of the moment but next year the worry may be about credit cards, car loans and corporate debt.

The Bush administration's rescue plan aims to arrest this deleveraging cycle. But it will not be easy. "Eventually they will put the fire out," says Nick Carn, a partner at Odey Asset Management, a hedge fund. "The question is how much gets burned between now and then."

Oil

Contract killing

Sep 25th 2008
From The Economist print edition

A surge in prices may have been an aberration

“SPECULATORS are back and prices are up,” moaned James May, the head of the Air Transport Association, a trade group for American airlines, on September 22nd. He was referring to the record jump in the price of oil on the New York Mercantile Exchange (NYMEX) that day, from $104.55 to $120.92. At one point, the price was up by more than $25.

Mr May was not the only one to blame speculators. Truck drivers with similar views converged on Congress the following day, honking their horns in protest. The Democrats have vowed to pass a law crimping speculation. The Commodity Futures Trading Commission, which regulates NYMEX, has promised an investigation.

But oil analysts have a more prosaic explanation. The oil price had been falling because of the worsening prospects for the world economy and the closure of several refineries during recent hurricanes, which reduced demand for oil. Then it began to rise again, thanks both to the plans for a bail-out of struggling banks and to the reopening of refineries. That would not have caused such a huge leap in prices were it not for an accident of timing.

Traders on NYMEX deal in standardised futures contracts that fall due at the beginning of each month. September 22nd was the final day of trading for the October contract. Those who had promised to provide oil cheaply on October 1st on the assumption that the price would fall further than it did were forced to buy oil at any price to fulfil their obligations. But most traders had already stopped dealing in October contracts, leaving few sellers in the market. That, coupled with a hurricane-related shortage of oil in Cushing, Oklahoma, the delivery point for NYMEX contracts, caused prices to jump.

The rise will have little long-term effect on fuel prices. The November contract, which was more heavily traded that day, rose by just $6.62. The following day it fell back slightly. Moreover, argues Jeff Currie of Goldman Sachs, those who blame speculation are missing the point: to the extent that speculators were involved in the episode, they were betting that the price would fall. Those worried about rising prices should applaud that.

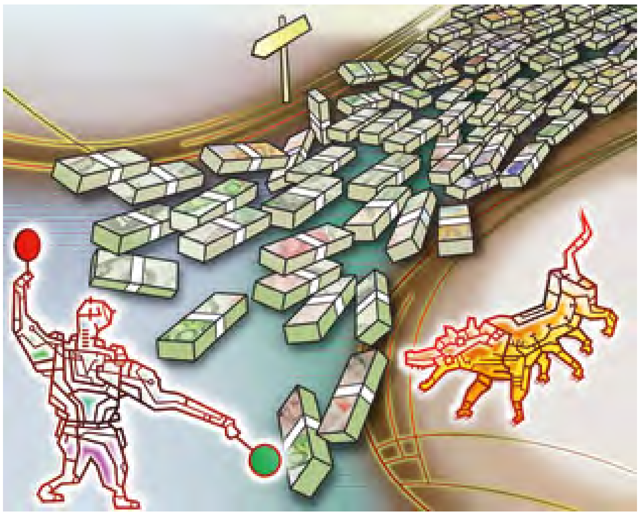
Economics focus

Capital bonanzas

Sep 25th 2008
From The Economist print edition

Does Wall Street's meltdown show financial globalisation itself is part of the problem?

Illustration by Jac Depczyk



"THANK God," said one Latin American finance minister earlier this year. "At least this time it isn't our fault."

The meltdown of America's financial system may look very different from the emerging-market crises that overwhelmed Thailand in 1997 or Russia in 1998. This time there has been no currency collapse, no government default. Then, there were no collateralised-debt obligations or credit-default swaps.

Yet the minister was justified in seeing parallels between America's crisis and the emerging-market episodes. In all of them vast current-account deficits were financed by huge capital inflows. The afflicted countries saw housing speculation, asset bubbles and cheap loans followed by a credit crunch and the seizing up of the financial system. And Wall Street's meltdown raises the same questions as the crises of a decade ago: what will the direct effects on emerging markets be? If the world's richest economies are vulnerable to global financial turmoil, should developing countries not seek to insulate themselves from it?

Two recent papers* cast light on these questions. They conclude that, although financial globalisation has big costs, these can be minimised and potential gains increased by better policy. Financial globalisation itself, they imply, ought to be seen not so much as a bad thing, but as too much of a good one.

Beware markets bearing gifts

Most emerging markets see their ability to attract foreign money as proof of good management. From this point of view, it should be a blessing that private capital flows to developing countries rose, according to the World Bank, to $1 trillion in 2007, the highest ever. Yet if the study by Carmen and Vincent Reinhart is anything to go by, this should be little cause for celebration.

Taking the experience of 181 countries since 1980, the authors reckon that middle- and low-income countries had a roughly 20% chance of suffering a banking crisis and a 30% chance of a currency crisis, external-debt default or inflation spike (to more than 20% a year) if they experienced what the authors call a "capital-flow bonanza" in the three years beforehand. (They define such a bonanza as an unusual shift of the current account into the red, using that as a proxy for capital inflows since the capital and current accounts mirror each other.) These seem unenviable odds.

The authors point out that countries might have suffered disasters anyway, without being showered with money. That turns out to be true—but their chances were quite a bit lower: between 14% and 24% for countries that did not attract so many dollars. In other words, a foreign inflow, as well as financing good things such as public infrastructure and corporate investment, is also associated with debt defaults, inflation and currency crises.

The authors focus on the level of capital flows, rather than their composition. Presumably, countries that attract more foreign direct investment suffer less than those that have a greater amount of footloose portfolio investment or short-term bank lending. But overall, most countries that suck in foreign money show the classic signs of an economic bubble. Using a subset of 66 countries for which there are more detailed figures, the authors show that share prices rose by more than 10% in real terms in the two years before what they call a bonanza, then fell relentlessly for four years, ending below where they started. House prices went up by more than that—15% in real terms over four years during a bonanza—before falling back.

So why would countries seek out foreign money at all, if its impact is so malign? The answer is that it is not so much the amount of investment that is the trouble; it is its volatility, and especially its tendency to dry up. That makes today's climate worrying. Mansoor Dailami, the World Bank's manager of international finance, says private inflows to emerging markets may fall from $1 trillion to only $800 billion-850 billion this year. That may be particularly troublesome because of another difference between this crisis and the Asian one: in 1997-98, more debt was sovereign. Now, much of it is corporate, taken out by Indian, Chinese and other emerging-market companies. That implies a global credit tightening could have as big an impact on emerging markets as slowing import demand in the rich world.

Critics of financial globalisation argue that these problems are so great that emerging markets ought to be insulating themselves through capital controls. Many have been doing so. Yet even setting aside doubts about how far this is desirable (it is hard to believe growth in India or Brazil would have reached today's levels without foreign capital), the studies raise questions about whether capital controls are really the right response.

The second study points out that "sudden stops" of capital inflows tend to be an inverted U-shape: the poorest countries are the least vulnerable to global financial shocks; middle-income countries are the most; but, as you get richer and more integrated into global finance, your vulnerability tends to fall again—and that remains true despite the crisis in America. So it might still make sense for countries like India and Brazil to carry on liberalising. Moreover, as the Reinharts show, a big part of the problem is that capital flows are endemically boom-bust: money floods in and out. They argue that fiscal policy should be used to smooth out such cycles: governments should reduce deficits or run surpluses during bonanzas—the opposite of what they usually do. This implies something of a paradox. Capital flows are supposed to be a reward for good economic behaviour. But as Dani Rodrik, a Harvard professor, says, "these policy conclusions turn capital inflows into an imperative for even deeper reform."

---

* "Capital Flow Bonanzas" by Carmen Reinhart and Vincent Reinhart. National Bureau of Economic Research (NBER) Working Paper No. 14321.
"Systemic Sudden Stops" by Guillermo Calvo, Alejandro Izquierdo and Luis-Fernando Mejía. NBER Working Paper No. 14026.

The Interphone study

Mobile madness

Sep 25th 2008
From The Economist print edition

Science Photo Library

The threat to human health from mobile phones, if any, is much disputed. A shame, then, that a massive multinational study on the question has ended in chaos

"LONG-TERM mobile-phone use increases risk of benign tumours!" "Clean bill of health for the mobile!" "Mobile phone-cancer link not proven!" Those who have followed the saga of whether or not mobile phones are damaging people's brains are used to contradictory headlines. A decade of coverage has left readers and viewers more confused than enlightened, with news reports alternating between alarming claims and soothing reassurances. Yet even by the standards of modern news, it is unusual to see such contradictory headlines about the same piece of research. Which is why a study, called Interphone, provides a cautionary tale.

Interphone began in 2000, ended in 2006, cost $30m and involved around 50 scientists working in 13 countries on 14,000 people. It has, however, still to come to a settled conclusion. A draft of its supposed findings was circulated in June, and Elisabeth Cardis of the Centre for Research in Environmental Epidemiology in Barcelona, who led it, thought until recently that a final paper would be submitted this month. Now, though, it looks as if that will not even happen this year.

The contradictory headlines are the result of national research teams releasing single-country reports, despite the fact that these inevitably involve smaller samples. The results from nine of the 13 single-country studies have been made available in this way, and the consequence is a farrago of misinformation. Many of the national reports suggest, for example, that ever having been a regular mobile-phone user offers statistically significant protection against some brain tumours. This finding is so counter-intuitive that it has led most of the people involved to acknowledge serious flaws in the study's design.

Please press "recall"

One problem was what statisticians call selection bias. Interphone began by gathering a group of people who had had the cancers of interest (glioma, meningioma, acoustic neurinoma and parotid gland tumour) and questioning them about their past use of mobile phones. The researchers then approached a number of healthy people in order to compare them with the cancer patients, and find out if there was a systematic difference in mobile-phone use between the two groups. Some of those approached agreed, and some declined. Of those who agreed to take part, 59% were regular mobile-phone users as defined by the study's protocol. Later on, those who had declined were recontacted and asked about their mobile use. Among this group, only 34% were regular users. That meant those in the control group were more likely than average to be regular users, and therefore were not representative of the population at large.

Moreover, the definition of "regular mobile-phone use" was itself questionable. Anyone who had used a phone just once a week for at least six months qualified. That is a pretty low rate of usage. If phones really do cause cancer, but only at high exposure, employing such a generous definition of regular use means that the effect might be diluted into undetectability.

Another potentially serious flaw is that participants asked in 2001-02 about their mobile use a decade earlier will have been using analogue, not digital, handsets. That would lead to a different pattern of exposure and therefore of potential risk.

How the shift from analogue to digital phones might have changed things is anybody's guess. But both the selection bias and regular-phone-use definition might be expected to mask any adverse effect of phones. The most serious flaw in the study, however, is generally reckoned to be recall bias, which would tend to work in the opposite direction, by suggesting problems with phones that do not, in fact, exist.

Recall bias happened because the study was retrospective rather than prospective. In other words it looked at what people had done in the past rather than following their behaviour into the future. In practice, that meant asking them about past behaviour, and relying on the accuracy of their memories.

Even a healthy person would probably have difficulty recalling exactly how often he used his mobile phone a decade ago, and which ear he routinely held it to. Someone subsequently diagnosed with a brain tumour might easily be biased, consciously or unconsciously, to exaggerate the former and misstate the latter. And that would be enough to account for the fact that several of the single-country studies found that ten years' mobile use was associated with an increased risk of brain tumours on the side of the head that people said was exposed to their handsets. It would also—more significantly—account for the studies' weird suggestion that the same amount of use stops tumours developing on the other side of the head.

The scientists involved in Interphone are, it must be said, well aware of these biases, and efforts to work out their effects and adjust for them were always part of the plan. In May Dr Cardis and her colleagues published a validation study in the *Journal of Exposure Science and Environmental Epidemiolog*y. This compared the recollections of about 500 Interphone subjects with their actual mobile use according to the records of the network operators. The researchers found a high level of recall errors. Participants underestimated the number of calls they had made by an average of about 20%, and overestimated call duration by 40%. Ominously for the statisticians, the recall errors of those with tumours increased with time.

Suitable (and legitimate) statistical massaging of all the data may be able to offset these biases in a way that could not so easily be done for the smaller data sets from individual countries. Nevertheless Dr Cardis admits the delays in releasing the report have been due to "the difficulty of interpreting the findings due to potential biases" and to the "conducting of additional analyses to try and disentangle the potential impacts of selection and recall errors on the risk estimates".

The Interphone researchers are split into three camps. One believes any increased incidence of tumours shown in the study is purely the result of the biases. Another thinks it really has found increased risks of certain tumours and wants to call for precautionary measures. A third group is just keeping quiet. One person who knows many of the scientists, but prefers not to be named, describes the relations between members of the three groups as "strained"—harsh language in the world of scientific research.

Regardless of what eventually gets published, some people have already decided the findings warrant action. Ronald Herberman, the director of the University of Pittsburgh Cancer Institute, made headlines in July with a memo to 3,000 members of his staff urging them to limit their use of mobile phones, to refrain from keeping their handsets near their bodies at night and to avoid using them when reception is weak as a phone will then boost the strength of its signal in order that the network can hear it. He based his warnings on "early unpublished data", and is believed to have been referring to Interphone.

Whatever the outcome, though, at least one lesson has been learnt. Follow-up studies now in the planning stage are expected to use prospective as well as retrospective data. In other words they will pick people at random and see what happens to them. That method takes longer to come to a conclusion—but it is more likely to be one you can trust.

Electrosensitivity

Mind your phone

Sep 25th 2008
From The Economist print edition

Sham radiation can cause real pain

WHETHER mobile phones can cause cancer remains moot (see article). But they are also accused by some of causing pain. A growing number of people around the world claim to be “electrosensitive”, in other words physically responsive to the electromagnetic fields that surround phones and the other electronic devices that clutter the modern world. Indeed, at least one country, Sweden, has recognised such sensitivity as a disability, and will pay for the dwellings of sufferers to be screened from the world’s electronic smog.

The problem is that, time and again, studies of those claiming to be electrosensitive show their ability to determine whether they are being exposed to a real electric field or a sham one is no better than chance. So, unless they are lying about their symptoms, the cause of those symptoms needs to be sought elsewhere.

Michael Landgrebe and Ulrich Frick, of the University of Regensburg, in Germany, think that the “elsewhere” in question is in the brain and, in a paper presented recently to the Royal Society in London, they describe an experiment which, they think, proves their point.

Dr Landgrebe and Dr Frick used a body scanner called a functional magnetic-resonance imager to see how people’s brains react to two different kinds of stimulus. Thirty participants, half of whom described themselves as electrosensitive, were put in the imager and told that they would undergo a series of trials in which they would be exposed either to an active mobile phone or to a heating device called a thermode, whose temperature would be varied between the trials. The thermode was real. The mobile phone, however, was a dummy.

The type of stimulus, be it the authentic heat source or the sham electromagnetic radiation, was announced before each exposure and the volunteers were asked to rate its unpleasantness on a five-point scale. In the case of heat, the two groups’ descriptions of their experiences were comparable. So, too, was their brain activity. However, when it came to the sham-phone exposure, only the electrosensitives described any sensations—which ranged from prickling to pain. Moreover, they showed neural activity to match. Some of the same bits of their brains lit up as when they were exposed to high temperatures.

This suggests that electrosensitivity, rather than being a response to electromagnetic stimulus, is akin to well-known psychosomatic disorders such as some sorts of tinnitus and chronic pain. A psychosomatic disorder is one in which the symptoms are real, but are induced by cognitive functions such as attitudes, beliefs and expectations rather than by direct external stimuli.

The paradoxical upshot of Dr Landgrebe’s and Dr Frick’s experiment is that mobile phones do indeed inflict real suffering on some unfortunate individuals. It is just that the electromagnetic radiation they emit has nothing whatsoever to do with it.

Earthquake detection

Shake it all about

Sep 25th 2008
From The Economist print edition

How to use your laptop to locate an earthquake

Reuters

Sauve qui peut

IF YOU drop your laptop computer, a chip built into it will sense the acceleration and protect the delicate moving parts of its hard disk before it hits the ground. A group of researchers led by Jesse Lawrence of Stanford University are putting the same accelerometer chip to an intriguing new use: detecting earthquakes. They plan to create a network of volunteer laptops that can map out future quakes in far greater detail than traditional seismometers manage.

Seismometers are large, expensive beasts, costing $10,000 or more apiece. They are designed to be exquisitely sensitive to the sort of vibrations an earthquake produces, which means they can pick up tremors that began halfway around the world. By contrast, the accelerometer chips in laptops, which have evolved from those used to detect when a car is in a collision and thus trigger the release of the airbags, are rather crude devices. They are, however, ubiquitous. Almost all modern laptops have them and they are even finding their way into mobile phones. The iPhone, for example, uses such a chip to detect its orientation so that it can rotate its display and thus make it easily readable.

On its own, an accelerometer chip in a laptop is not very useful for earthquake-detection, as it cannot distinguish between a quake and all sorts of other vibrations—the user tapping away at the keyboard, for example. But if lots of these chips are connected to a central server via the internet, their responses can be compared. And if a large number in a particular place register a vibration at almost the same time, it is more likely to be an earthquake than a bunch of users all hitting their space bars. To exploit this group effect, Dr Lawrence's Quake-Catcher Network (QCN) employs the same software that is used by the SETI@home project, which aggregates computing power from hundreds of thousands of volunteer computers around the world to analyse radio-telescope signals for signs of extraterrestrial intelligence.

Dr Lawrence and his colleagues have already demonstrated that the QCN works. It detected a quake near Reno, Nevada, in April, and one near Los Angeles in July. Merely detecting a quake, however, is not the point. Seismometers can do that. To be useful, the QCN needs to be able to do things that seismometers cannot.

One of those things is to measure the maximum amount of ground shaking. The sensitivity of seismometers means that strong signals would damage them if they were not designed to “clip” such signals when they exceed a certain threshold. The price paid is that information about strong, nearby earthquakes is lost. Laptop accelerometers are more robust. Though they cannot, if in America, tell you anything about an earthquake in China, they can sometimes do better than conventional kit when measuring local quakes.

The network's second benefit is of sheer numbers. This should allow the construction of far more detailed maps of the up-and-down and side-to-side motions induced by earthquakes. These vary a lot from quake to quake, and that means the damage done by a quake of any given strength is also variable. A better understanding of how movement and damage relate might help both building design and town planning in earthquake zones.

Of course, for that to work, you have to know where each laptop was at the moment of the quake. Ideally, this information would come from a Global Positioning System device fitted within the laptop, but few computers have them at the moment. In their absence, information automatically supplied about the site of the nearest router (a network device that computers use to connect to the wider internet) gives a rough location. This is imperfect, but pooling the data from lots of laptops means that location errors can be detected statistically and erroneous data discarded.

If that can be done quickly enough, the QCN could bring a third—and most valuable—benefit: warning. The speed of internet communication, coupled with a scheme for uploading data from each computer at brief intervals, means that Dr Lawrence's network could issue an earthquake warning within seconds. That is faster than traditional seismometer networks, which update less regularly, and, above all, is much faster than seismic waves travel. Warnings could thus be broadcast to places the earthquake waves had not yet reached, giving people vital time to find a place of refuge.

At the moment, the QCN has about 1,500 participating computers. But, as happened with SETI@home, the researchers expect numbers to grow once knowledge of the project spreads: qcn.stanford.edu, for those who want to join in the fun.

The Large Hadron Collider

Call a plumber

Sep 25th 2008
From The Economist print edition

The Large Hadron Collider springs a leak

AFP

IN RETROSPECT, perhaps, it was all going rather too well. On September 10th, to the world's acclaim, the physicists and engineers at the Large Hadron Collider (LHC), a sub-atomic-particle smasher just outside Geneva, sent the first beams of protons around their new toy. It worked perfectly. The press corps duly filed their stories and went home not expecting to write about the machine again until it was operating routinely and generating results. Unfortunately, on September 19th it started leaking helium and had to be switched off. The helium came from one of the cooling units that keep the LHC's superconducting magnets at 1.8°C above absolute zero. Fixing the leak means warming the broken part up, doing the repair, and then cooling it down again. That will take around two months, by which time the LHC is due for its Christmas break (it is scheduled to close down each winter to save the electricity bill). No Higgs boson this year, then.

Goldman Sachs

Into the whirlwind

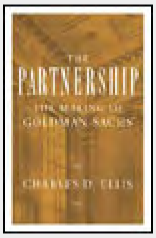
Sep 25th 2008
From The Economist print edition

Illustration by Daniel Pudles

As Goldman Sachs faces its greatest challenge, an important new history shows that the American investment bank is no stranger to adversity

WHEN Marcus Goldman, a Jewish immigrant from Bavaria, founded a small commercial-paper dealer in New York in 1869, he hardly could have imagined it would one day become the world's most envied and profitable investment bank. Equally shocking to him would have been the hurricane that has descended on markets this year, wrecking the investment-bank business model, which relies on fickle short-term funding, and laying low entire institutions. Three of America's five independent investment banks have been swallowed by rivals or the abyss. The two that remain, Goldman Sachs and Morgan Stanley, have opted under intense pressure from market forces to become bank holding companies, a move that will subject them to tougher capital requirements and supervision.

The Partnership: The Making of Goldman Sachs
By Charles D. Ellis



Penguin Press; 729 pages; $37.95. To be published in Britain by Allen Lane in November

Buy it at
Amazon.com
Amazon.co.uk

A year that has seen the emasculation of America's brokerages may not seem the ideal time to reflect on what made the erstwhile industry leader great. But, amid the torrent of negative news, Charles Ellis's exhaustively researched history of Goldman Sachs paints a convincing picture of an institution that has got most of the important things right. It is an organisation America can be proud of, even as it is forced to reinvent itself to survive.

Mr Ellis, a consultant who has worked with the bank for more than 30 years, sees strengths aplenty. Goldman attracts the best and, with a recruitment process that redefines rigorous, hires the very best. The accent has always been on regeneration: partners are encouraged to move on to allow fresh blood to come through; many go on to public service. Hank Paulson, America's treasury secretary and the architect of the restructuring of the banking system, and Bob Zoellick, head of the World Bank, are two examples.

The dedication of employees is legendary. Lloyd Blankfein, the chief executive, describes the culture as a blend of confidence and "an inbred insecurity that drives people to keep working and producing long after they need to. We cringe at the prospect of not being liked by a client." Even before the crisis, when Goldman was earning profits to make Croesus blush (it is still profitable), Mr Blankfein seemed more anxious than arrogant. Yet loyalty sometimes spills over into inexcusable behaviour, as when a female job candidate was asked if she would have an abortion rather than lose the chance to work on a big deal.

Much of the success comes from daring to think big. When Goldman said it wanted to break Deutsche Bank's stranglehold on Germany's biggest corporations, local staff laughed. But after years of persistence it managed to do just that, prompting Deutsche's then boss, Hilmar Kopper, to declare: "Nobody irritates me like Goldman Sachs. You get mandates we have not expected you to be even *considered* for!"

But in fighting for business, Goldman never reached the lows of brazenness of, say, Salomon Brothers in the 1980s. Indeed, its bankers were once dubbed "billionaire boy scouts", due to their talent for making lots of money while keeping their noses clean. It is, as one partner put it, "long-term greedy". Better to forgo profit today than take it and alienate a client that might produce a lot more business over the long haul. Goldman refused to advise on hostile takeovers until the late 1990s.

It has also trodden gingerly when it comes to grand strategic moves, avoiding the headline-grabbing mergers embraced by so many of its rivals. When he ran the firm, Mr Paulson nearly tied the knot with JPMorgan (now JPMorgan Chase) but balked at the last moment, fearing the deal would dilute Goldman's close-knit culture. One of the firm's 14 guiding "Principles" is that it should be big enough to serve any client, but small enough to maintain its esprit de corps.

Yet Goldman's progress has been interrupted by the occasional revolution. The biggest was its own flotation in 1999, after years of often rancorous debate among the partners. The move gave the firm permanent capital with which to expand, but exposed it to the vicissitudes of stockmarkets and, some felt, loosened the ties that had bound the firm's leaders closely together.

After its public offering, Goldman, long a leader in "agency" businesses such as underwriting and merger advice, moved aggressively into "principal" investing, risking its own capital in markets. The profit margins on the latter are bigger, but so are the risks, as the credit crisis has so brutally illustrated. In magnifying its bets with large dollops of borrowed money and peddling subprime securities, Goldman played a part in bringing America to the brink of financial catastrophe.

Thanks to sharp risk management, the investment bank has managed to navigate the turmoil better than its peers. While others were still loading up on subprime mortgages, it sensed a market turn and hedged its bets; Goldman traders made a mint betting house prices would drop even as the bank continued to sell mortgage-backed securities, leading some to question its claim that clients come first.

The challenge Goldman faces may be its biggest yet. It was almost felled by Goldman Sachs Trading Corporation, a Ponzi-like misadventure that unravelled in the 1929 crash; and by Penn Central, a rail company whose collapse in 1970 left Goldman exposed to piles of worthless debt. Two market quakes in the 1990s also left it badly shaken. Each time it managed to survive, learned its lessons and emerged stronger. This time may be no different, and backing from Warren Buffett, America's most admired investor, can only help. But, as Mr Ellis points out, its most valuable asset has always been its freedom to choose its own course. And that, for now, has been severely curtailed.

The Partnership: The Making of Goldman Sachs.
By Charles D. Ellis.
Penguin Press; 729 pages; $37.95. To be published in Britain by Allen Lane in November

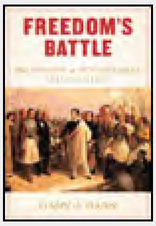
Humanitarian intervention

My brother's keeper

Sep 25th 2008
From The Economist print edition

THESE books provide two very different offerings on one of the central questions of our time or, indeed, all time: whether we have a right to intervene in the affairs of others to stop evil and relieve suffering. The first, by Gary Bass, a Princeton professor who has written for *The Economist*, takes a cool, erudite, historical view. The second, by James Orbinski, president of Médecins Sans Frontières (MSF) when the charity won the Nobel peace prize in 1999, tells the passionate tale of his own gore-filled experiences in dealing with atrocities around the world over the past two decades.

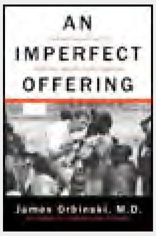
Freedom's Battle: The Origins of Humanitarian Intervention
By Gary J. Bass



Knopf; 509 pages; $35

Buy it at
Amazon.com
Amazon.co.uk

An Imperfect Offering: Humanitarian Action for the Twenty-First Century
By James Orbinski



Walker and Company; 448 pages; $27. Rider; £16.99

Buy it at
Amazon.com
Amazon.co.uk

Mr Bass traces the origins of morally motivated humanitarian intervention to the actions of the largely forgotten “atrocitarians” of the 19th century. The result is a delight. His book is full of fascinating quotations and anecdotes—it was Tsar Aleksandr I, for example, not Ronald Reagan, who coined the phrase “empire of evil” when referring to the foes of the Holy Alliance—and draws vivid parallels with recent events in Georgia, Darfur and Kosovo. History may not repeat itself exactly, but the arguments are often strikingly similar.

Sometimes, countries commit crimes “on so vast a scale and of such peculiar horror”, a president of the United States declared, that America had a duty to step in. Depending on the “degree of the atrocity and upon our power to remedy it”, it might even on occasion require the “force of arms…to put a stop to intolerable conditions”. The year, 1904; the president, Theodore Roosevelt; the cause, Spanish atrocities in Cuba. This could have been America’s first humanitarian intervention, had it not been sullied by imperialism.

Far from being some newfangled experiment of the 1990s, humanitarian intervention was a relatively familiar practice in Europe in the 19th century, Mr Bass says, and was understood as such, not just by the intervening countries, but also by those whose sovereignty was being violated. Then, as now, states would sometimes seek to cloak their rapacious imperialist designs in sanctimonious humanitarian rhetoric. But politicians are not always cynics or hypocrites, at least not always totally so, he argues. On occasion, states are genuinely driven by morality, even when it goes against their own interests.

Britain’s campaign against the slave trade and then slavery itself was waged at the cost of severe damage to its sugar industry, the souring of its relations with America and France, and the loss of some 5,000 British troops’ lives. Indeed, throughout the 19th century, Mr Bass says, Britain repeatedly went against its own realpolitik interests—notably its desire to check Russian expansionism—out of a genuine sense of humanity.

The doctrine of national sovereignty has always been fairly flexible, he argues. “Do not let me be told that one nation has no authority over another,” Gladstone thundered in 1894: “Every nation, and if need be every human being, has authority on behalf of humanity and of justice.” But the concept has always been subject to double standards; it is almost invariably the weaker states that invoke sovereignty and non-interference, while the stronger powers insist on their right to interfere.

Such niceties did not concern Dr Orbinski when he first started working with MSF in the early 1990s. He believed then that humanitarianism, based on the principles of neutrality, impartiality and independence, was outside—and even in some ways superior to—the messy business of politics. He soon discovered that politics matters a lot. Indeed, he now says that one of the greatest challenges facing humanitarianism is the blurring of boundaries between humanitarian assistance and the political objectives of military intervention. He offers no solutions; he simply tells the reader, through the tear-stained stories about those he has helped, why it is all so desperately important.

Freedom's Battle: The Origins of Humanitarian Intervention.
By Gary J. Bass.
Knopf; 509 pages; $35

An Imperfect Offering: Humanitarian Action for the Twenty-First Century.
By James Orbinski.
Walker and Company; 448 pages; $27. Rider; £16.99

Crowdsourcing

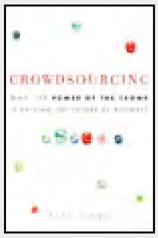
A people business

Sep 25th 2008
From The Economist print edition

ONLY one reader's letter appeared in the first issue of *The Economist* in 1843. Even today, readers contribute no more than one, or sometimes two pages to the newspaper. But at Economist.com, through comments and debates, they discuss everything from American politics to particle physics.

This is just a small example of what Jeff Howe calls "crowdsourcing": using an enthusiastic community to provide material for websites or solve problems. Mr Howe aims to show that groups of amateurs can often produce better results and do so far more cheaply than professionals. Mr Howe cites numerous crowdsourcing examples: for instance, Wikipedia, an online encyclopedia written by its users; Procter & Gamble asking amateur scientists for a detergent dye whose colour changes when enough has been added to dishwater; and iStockphoto allowing amateur photographers to earn money selling their pictures. Each one combines cheap and widely available tools, the internet for distribution and talented people with time to spare. Participants are generally not in it for the money, but rather to pursue a hobby and achieve recognition by their peers.

Crowdsourcing: Why the Power of the Crowd is Driving the Future of Business
By Jeff Howe



Crown Business; 320 pages; $26.95. Random House; £17.99

Buy it at
Amazon.com
Amazon.co.uk

Mr Howe's book grew out of a 2006 article for *Wired* magazine. The author presented crowdsourcing as straight-forward—almost something for nothing. He remains excited by the trend, but is more open about its limitations, quoting Theodore Sturgeon, a science-fiction writer, who asserts that "90% of everything is crap". Crowdsourcing is like panning for gold. Indeed, Jimmy Wales, one of Wikipedia's co-founders, dislikes the word and has said: "Any company that thinks it's going to build a site by outsourcing all the work to its users completely misunderstands what it should be doing. Your job is to provide a structure for your users to collaborate, and that takes a lot of work." Not providing sufficient structure is the reason why an experiment *Wired* carried out into crowdsourced journalism last year ended in failure, argues Mr Howe.

Crowdsourcing is changing some industries: the phenomenon is a threat to organisations that sell what the crowd will do much more cheaply. Open-source software is disrupting the IT industry, for instance. Getty Images, the world's largest provider of stock photographs, responded to the threat of iStockphoto by buying the company. Despite Mr Howe's spirited advocacy of the crowd, however, most companies will not be swept away.

Earlier this year, a Dutch teacher, Hanny Van Arkel, discovered a new type of blob in space, now called Hanny's *voorwerp* (the Dutch for "object"). She was participating in Galaxy Zoo, a crowdsourcing project to classify galaxies in telescope images. So, even if crowdsourcing does not change the world, it may achieve for some a kind of immortality.

Crowdsourcing: Why the Power of the Crowd is Driving the Future of Business.
By Jeff Howe.
Crown Business; 320 pages; $26.95. Random House; £17.99

“Battle in Seattle”

The world was watching

Sep 25th 2008
From The Economist print edition

When the WTO came to Hollywood

FIVE days at the end of 1999, when protesters with an array of gripes converged on the World Trade Organisation’s (WTO’s) first ministerial meeting on American soil, are the unlikely setting for a new film directed by an Irish writer and actor, Stuart Townsend. But as markets continue to seesaw and the American presidential election focuses more on economics, Mr Townsend may just have found his moment.

In this turn-of-the-century civic brawl, none of the main players in “Battle in Seattle”—neither the organisers of the protest, the police nor the mayor, Jim Tobin (played by Ray Liotta)—is really seeking a violent confrontation. However, the two activist-heroes, Lou (Michelle Rodriguez) and Ray (Martin Henderson), sense what is coming. “We have nothing against free trade as long as it doesn’t interfere with our human values,” explains Django (André Benjamin) to Jean (Connie Nielsen), a television reporter who has chosen to interview him because he is dressed like a giant sea turtle. When dissident anarchists start breaking windows, Jean joins the peaceful protesters and quickly lands in jail.

Putting faces to the furore, Mr Townsend also includes a made-up story about Dale (Woody Harrelson), a Seattle cop whose pregnant wife Ella (Charlize Theron) miscarries after being punched in the stomach by one of her husband’s colleagues. Ordered back into combat, Dale ends up trying to kill Ray when he chooses to taunt the policeman about picking on children. Dale later apologises, leading Ray to point out how sad it is that they are “the ones who have to fight each other”.

“Battle in Seattle” is melodramatic as well as sentimental, but melodrama serves Mr Townsend’s purpose well. Time was when melodramas largely involved people who were trapped in an emotional web of complicated family relations. Now film-makers, such as Mr Townsend and Stephen Gaghan, who made “Syriana”, George Clooney’s 2005 political drama about the oil industry, like to portray groups of people who are caught up in a web of economic and political circumstances that they are struggling to understand.

That idea is neatly conveyed at the beginning of the film, when protesters hanging a banner from a construction crane become tangled in their own ropes. Fortunately, Mr Townsend mixes humour in with the didacticism: as the city of Seattle mops up after the mob, you catch a glimpse of a banner outside a cinema that says, “Thanks WTO—It’s Been a Riot”.

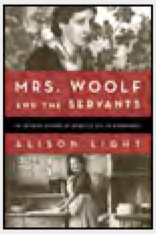
Economist.com BOOKS & ARTS

The Bloomsbury group

Pantry power

Sep 25th 2008
From The Economist print edition

Mrs Woolf and the Servants: An Intimate History of Domestic Life in Bloomsbury
By Alison Light



Bloomsbury; 400 pages; $30. Penguin; £20

Buy it at
Amazon.com
Amazon.co.uk

VIRGINIA WOOLF and her sister, Vanessa Bell, may have been early icons of liberated womanhood, but who made their lunch every day or ran the bath? Woolf was famously undomesticated while the more home-oriented Bell needed someone to help look after her children while she carried on with her work as a painter—and her love affairs. Put simply: without an army of staff much of the work produced by the Bloomsbury group of writers and artists might never have seen the light of day.

In her book which has just come out in America, Alison Light, a lecturer in English at Newcastle University, ferrets out the hidden toil of the working-class women who made sure that the lives of the group ran smoothly. She starts in 1880s Kensington, where the young Stephen sisters lived with their well-to-do parents and numerous servants, including Sophie Farrell, who joined the household as cook in 1886. After their parents died, Sophie accompanied “Miss Genia” and Vanessa to Bloomsbury where the girls were determined to try a new kind of living. Some of the old-fashioned ways of doing things—dressing for dinner, for example—went by the board, but the sisters still expected Sophie to produce three meals a day. And they did not help with the washing up.

This, really, is the crux of Ms Light’s absorbing book. Woolf and the other Bloomsbury group members regarded themselves as socialist and held what they considered to be “advanced” views on the mingling of different social groups—their servants were not expected to wear uniforms, for example, or address them as “sir” and “madam”. Yet they seem to have been quite clueless about what life was like below stairs.

Nowhere is this better illustrated than in Woolf’s diary. She complains endlessly about Nellie Boxall, who succeeds Sophie as her cook. Despite Woolf’s sympathy for these “obscure” women, her complaints have a nasty tone: “She is in a state of nature: untrained; uneducated…so that one sees a human mind wriggling undressed.” The cook, using the only power available to her, responds by giving in her notice 165 times, though she begs to be taken back.

Ms Light has done an excellent job of weaving together social history and literary criticism. Her book not only gives voice to previously silent subjects but also adds to our understanding of both Woolf and Bell, of whom it is sometimes easy to feel one has heard quite enough already.

Mrs Woolf and the Servants: An Intimate History of Domestic Life in Bloomsbury.
By Alison Light.
Bloomsbury; 400 pages; $30. Penguin; £20

Andrea Palladio

Songs of stones

Sep 25th 2008 | VICENZA
From The Economist print edition

A new exhibition celebrates Palladio's calm perfection

VICENZA is a pleasant, prosperous city in the Veneto, 60km west of Venice. Its grand families settled and farmed the area from the 16th century. But its principal claim to fame is Andrea Palladio, who is such an influential architect that a neoclassical style is known as Palladian. The city is a permanent exhibition of some of his finest buildings, and as he was born—in Padua, to be precise—500 years ago, the International Centre for the Study of Palladio's Architecture has an excellent excuse for mounting *la grande mostra*, the big show.

The exhibition has the special advantage of being held in one of Palladio's buildings, Palazzo Barbaran da Porto. Its bold façade is a mixture of rustication and decoration set between two rows of elegant columns. On the second floor the pediments are alternately curved or pointed, a Palladian trademark. The harmonious proportions of the atrium at the entrance lead through to a dramatic interior of fine fireplaces and painted ceilings. Palladio's design is simple, clear and not over-crowded. The show has been organised on the same principles, according to Howard Burns, the architectural historian who co-curated it.

Palladio's father was a miller who settled in Vicenza, where the young Andrea was apprenticed to a skilled stonemason. How did a humble miller's son become a world renowned architect? The answer in the exhibition is that, as a young man, Palladio excelled at carving decorative stonework on columns, doorways and fireplaces. He was plainly intelligent, and lucky enough to come across a rich patron, Gian Giorgio Trissino, a landowner and scholar, who organised his education, taking him to Rome in the 1540s, where he studied the masterpieces of classical Roman and Greek architecture and the work of other influential architects of the time, such as Donato Bramante and Raphael.

Mr Burns argues that social mobility was also important. Entrepreneurs, prosperous from agriculture in the Veneto, commissioned the promising local architect to design their country villas and their urban mansions. In Venice the aristocracy were anxious to co-opt talented artists, and Palladio was given the chance to design the buildings that have made him famous—the churches of San Giorgio Maggiore and the Redentore, both easy to admire because they can be seen from the city's historical centre across a stretch of water.

He tried his hand at bridges—his unbuilt version of the Rialto Bridge was decorated with the large pediment and columns of a temple—and, after a fire at the Ducal Palace, he offered an alternative design which bears an uncanny resemblance to the Banqueting House in Whitehall in London. Since it was designed by Inigo Jones, Palladio's first foreign disciple, this is not as surprising as it sounds.

Jones, who visited Italy in 1614, bought a trunk full of the master's architectural drawings; they passed through the hands of the Dukes of Burlington and Devonshire before settling at the Royal Institute of British Architects in 1894. Many are now on display at Palazzo Barbaran. What they show is how Palladio drew on the buildings of ancient Rome as models. The major theme of both his rural and urban building was temple architecture, with a strong pointed pediment supported by columns and approached by wide steps.

Palladio's work for rich landowners alienates unreconstructed critics on the Italian left, but among the papers in the show are designs for cheap housing in Venice. In the wider world, Palladio's reputation has been nurtured by a text he wrote and illustrated, "Quattro Libri dell'Architettura". His influence spread to St Petersburg and to Charlottesville in Virginia, where Thomas Jefferson commissioned a Palladian villa he called Monticello.

Vicenza's show contains detailed models of the major buildings and is leavened by portraits of Palladio's teachers and clients by Titian, Veronese and Tintoretto; the paintings of his Venetian buildings are all by

Canaletto, no less. This is an uncompromising exhibition; many of the drawings are small and faint, and there are no sideshows for children, but the impact of harmonious lines and satisfying proportions is to impart in a viewer a feeling of benevolent calm. Palladio is history's most therapeutic architect.

"Palladio, 500 Anni: La Grande Mostra" is at Palazzo Barbaran da Porto, Vicenza, until January 6th 2009. The exhibition continues at the Royal Academy of Arts, London, from January 31st to April 13th, and travels afterwards to Barcelona and Madrid.

Economist.com
PEOPLE
OBITUARY

Frank Mundus

Sep 25th 2008
From The Economist print edition

eyevine

Frank Mundus, shark fisherman, died on September 10th, aged 82

HIS boat was called *Cricket II*, not the *Orca*. But when you climbed on board, mentally noting the lumpy cushions, the rods trailing wires at the stern and the swivel fish-fighting chair bolted to the deck, you knew you were in the same place. His fishing methods were different: he used aluminium beer barrels as floats because wooden ones would break up in a minute, and rather than harpoons, with their stainless-steel darts that folded back and slipped right out of the fish, he preferred hand-held gaffs with a three-inch hook that went in and stayed there. But as you watched him work, dipping the ladle into a garbage pail of bloody chum and spreading a slick of it into the sea, or listened to him snapping at his customers to tighten the drag and hit the brake, you knew this was the same man. Frank Mundus was convinced he was Captain Quint, the fisher of monster sharks from Peter Benchley's "Jaws". And if Benchley denied it, as he always did, Mr Mundus was still determined to make a splash of his own.

The stories surrounding him were legion. That he had danced on the floating carcass of a dead whale while blue sharks, in a frenzy, foamed round it. ("I was the first one to stand on the whale and see if you could…get the sharks to take the bait; that whale was fresh, blood was still coming out of its mouth.") That he had grabbed a thresher by the tail and pulled it into his boat. ("That tail is all muscle, and it knows how to use it. It can give you a bruise that looks as though you've been run over by a truck.") That he had fed live kittens to sharks. ("No kittens. We tried 'em with a dead cat that we found on the road, but they didn't want it.") It was true, however, that he once grabbled a shark by the dorsal as it swam past the boat, and that another crashed up over the side and snapped its jaws three feet from his head. He was close enough to see the serrated edges on every three-inch tooth.

He had also caught, off Long Island, some of the largest sharks ever landed: a 4,500lb (2,000kg) great white harpooned in 1964, and a 3,400lb one, big as a Volkswagen, caught with rod and reel in 1986. The 4,500-pounder had swum up just after he had landed two sharks and was battling a third; it then took off for the horizon, needing five more irons to kill it. The 3,500-pounder resisted the first gaff for an hour and a half and thrashed for another hour before they got the tail-rope round it. Mr Mundus towed it into Amagansett at midnight to find crowds already waiting.

He wore a tooth from that shark round his neck ever after, as well as one big hoop earring and an Australian hat. Quint, who in the book wore a T-shirt and faded jeans and in the film had a beard and a bandanna, was a plainer dresser. But his "short, derisive bark" of a laugh, his Roman nose, and most of all his life with sharks, were just the same. Mr Mundus, too, once made the centrepiece of a classic "Jaws" scene, harpooning a great white in 75 feet of water off a beach where children played.

Poor man’s big game

Mr Mundus cared so much about Quint because he had helped Benchley with material, taking him out in *Cricket II* for weeks, and because a proper “Jaws” connection—though he thought the film “the funniest and stupidest movie I’ve ever seen”—would have brought in business. His charter-fishing enterprise, run for 40 years out of Montauk in Long Island, had started the sport of baiting and running sharks. They had been considered garbage before, but he promoted them as “fun”: a poor man’s big game at $400 a time, wily, beautiful and dangerous.

He knew their ways. They would haunt any place in the open ocean, but it was impossible to hunt one specific shark: “They don’t stay in the same place, they move. They got tails.” A 50-pound rod, his usual, would “just about handle anything that comes along”. It was nonsense to think that any fish could pull a heavy boat of the *Cricket II*’s size either forwards or backwards, as happened in the film of “Jaws”, though you needed a lot of line, double the depth of the water, when a baited shark dived to the bottom. Each fish he caught he said he felt sorry for, even though it was his opponent, and even though he had his own handicap, a left arm withered since childhood, which ached with the effort of keeping a taut drag on a line.

His critics, and he had many, doubted that he felt much regret. For years, before environmentalism made it illegal, he ground up small whales and basking sharks to make the best bait. Sometimes he shot sharks to finish them off. His boat would come into Montauk braying with victory and strung with the corpses of huge fish. But when the sharks themselves became endangered he began to use circle hooks, which caught in the jaw and let the fish be released, rather than gut-hooks which slowly killed it. And though his haul of dead sea beasts was immense, only seven great whites fell victim to him.

He survived his life almost uninjured, pesky and abrasive, full of advice about ways of fishing that were no longer allowed. And he could count himself lucky to die at 82 of heart trouble in his bed, not, like the Quint of the book, trailed behind a shark underwater, arms out and mouth open “in mute protest”; or, like the Quint of the film, chomped in half at the trouser-line, spouting scarlet blood like a whale.

Overview

Sep 25th 2008
From The Economist print edition

Financial markets gyrated as political in-fighting over the American government's $700 billion bail-out plan for banks jarred traders' nerves. Ben Bernanke, chairman of the Federal Reserve, told legislators on September 23rd that global markets remained "under extraordinary stress".

After the original euphoria on Friday September 19th, when shares rallied sharply, **stockmarkets** sagged.

The **dollar** weakened on worries about the impact of the bail-out plan in worsening America's public finances.

Money-market rates soared on September 24th as banks hoarded cash. Investors moved again into safe havens such as US Treasury bills, sending one-month rates below zero at one point during the day.

The **oil price** was volatile. It shot up by $16 a barrel on September 22nd, mainly for technical reasons, to close at $121. It fell back to $106 two days later.

Manufacturing and services activity in the **euro area** fell in September, reaching their lowest level since 2001, according to the purchasing managers' composite index. The survey implied that GDP shrank in the third quarter, which would constitute a technical recession after the second-quarter decline.

The IFO business-climate index for **Germany** fell sharply in September, adding further evidence that the European economy is weakening.

Output, prices and jobs

Sep 25th 2008
From The Economist print edition

Output, prices and jobs

% change on year ago

	Gross domestic product				Industrial production	Consumer prices			Unemployment
	latest	qtr*	2008†	2009†	latest	latest	year ago	2008†	rate‡, %
United States	+2.2 Q2	+3.3	+1.6	+1.3	-1.5 Aug	+5.4 Aug	+2.0	+4.2	6.1 Aug
Japan	+0.7 Q2	-3.0	+1.0	+0.9	+2.4 Jul	+2.3 Jul	nil	+1.6	4.0 Jul
China	+10.1 Q2	na	+9.8	+8.5	+12.8 Aug	+4.9 Aug	+6.5	+6.7	9.5 2007
Britain	+1.4 Q2	+0.2	+1.2	+0.6	-1.9 Jul	+4.7 Aug§	+1.8	+3.7	5.5 Jul††
Canada	+0.7 Q2	+0.3	+1.1	+2.0	-5.9 Jun	+3.5 Aug	+1.7	+2.5	6.1 Aug
Euro area	+1.4 Q2	-0.8	+1.3	+0.9	-1.7 Jul	+3.8 Aug	+1.7	+3.6	7.3 Jul
Austria	+2.2 Q2	+1.5	+2.3	+1.6	-0.4 Jul	+3.7 Aug	+1.7	+3.0	4.2 Jul
Belgium	+1.9 Q2	+0.9	+1.5	+1.1	-3.2 Jun	+5.4 Aug	+1.1	+4.4	11.2 Aug‡‡
France	+1.1 Q2	-1.2	+1.2	+1.0	-2.0 Jul	+3.2 Aug	+1.2	+3.3	7.3 Jul
Germany	+1.7 Q2	-2.0	+1.8	+1.1	-0.6 Jul	+3.1 Aug	+2.2	+3.0	7.6 Aug
Greece	+3.5 Q2	+3.1	+2.4	+1.5	-1.3 Jul	+4.7 Aug	+2.5	+4.6	7.3 Jun
Italy	-0.1 Q2	-1.1	+0.2	+0.5	-3.2 Jul	+4.1 Aug	+1.6	+3.5	6.5 Q1
Netherlands	+3.0 Q2	+0.5	+2.3	+1.3	-2.6 Jul	+3.2 Aug	+1.1	+2.4	3.9 Aug††
Spain	+1.8 Q2	+0.4	+1.4	+0.6	-3.0 Jul	+4.9 Aug	+2.2	+4.5	11.0 Jul
Czech Republic	+4.6 Q2	+3.6	+4.5	+4.9	+6.7 Jul	+6.5 Aug	+2.4	+6.7	5.3 Aug
Denmark	+1.3 Q2	+1.2	+0.8	+0.8	+0.4 Jul	+4.3 Aug	+1.1	+3.5	1.6 Jul
Hungary	+2.0 Q2	+2.3	+2.0	+3.3	+0.6 Jul	+6.5 Aug	+8.3	+6.5	7.5 Jul††
Norway	+5.9 Q2	+2.4	+2.5	+2.2	+1.9 Jul	+4.5 Aug	+0.4	+3.3	2.4 Jul***
Poland	+5.8 Q2	na	+5.4	+4.3	-3.7 Aug	+4.8 Aug	+1.5	+4.2	9.3 Aug‡‡
Russia	+7.8 Q2	na	+7.5	+6.8	+4.7 Aug	+14.7 Jul	+8.7	+14.0	5.3 Aug‡‡
Sweden	+0.7 Q2	-0.1	+1.7	+1.6	+0.9 Jul	+4.3 Aug	+1.8	+3.9	5.2 Aug‡‡
Switzerland	+2.4 Q2	+1.5	+2.0	+1.3	+6.1 Q2	+2.9 Aug	+0.4	+2.7	2.6 Jul
Turkey	+1.9 Q2	na	+4.5	+4.3	+3.4 Jul	+11.8 Aug	+7.4	+11.0	9.0 Q3‡‡
Australia	+2.7 Q2	+1.1	+2.7	+2.6	+2.4 Q1	+4.5 Q2	+2.1	+4.4	4.1 Aug
Hong Kong	+4.2 Q2	-5.5	+4.7	+4.4	-4.2 Q2	+4.6 Aug	+1.6	+5.3	3.2 Aug††
India	+7.9 Q2	na	+7.7	+7.1	+7.1 Jul	+8.3 Jul	+6.5	+7.1	7.2 2007
Indonesia	+6.5 Q2	na	+5.8	+5.5	+1.4 Jul	+11.8 Aug	+5.5	+10.3	8.5 Feb
Malaysia	+6.3 Q2	na	+6.0	+5.6	+1.8 Jul	+8.5 Aug	+1.9	+5.4	3.6 Q1
Pakistan	+5.8 2008**	na	+6.0	+4.4	-4.2 Jun	+25.3 Aug	+6.5	+18.6	5.6 2007
Singapore	+2.1 Q2	-6.0	+4.0	+3.8	-21.9 Jul	+6.4 Aug	+2.9	+6.5	2.3 Q2
South Korea	+4.8 Q2	+3.4	+4.4	+4.2	+9.1 Jul	+5.6 Aug	+2.0	+4.2	3.2 Aug
Taiwan	+4.3 Q2	na	+4.3	+4.4	+0.4 Aug	+4.8 Aug	+1.6	+3.4	3.9 Aug
Thailand	+5.3 Q2	+2.9	+4.8	+3.9	+10.9 Jul	+6.4 Aug	+1.1	+6.4	1.2 Jun
Argentina	+7.5 Q2	+8.7	+6.0	+3.5	+4.2 Aug	+9.0 Aug	+8.7	+9.3	7.8 Q3‡‡
Brazil	+6.1 Q2	+6.6	+4.6	+3.4	+8.5 Jul	+6.2 Aug	+4.2	+6.0	8.1 Jul‡‡
Chile	+4.3 Q2	+7.4	+3.6	+3.6	+3.0 Jul	+9.3 Aug	+4.7	+8.6	8.4 Jul††‡‡
Colombia	+3.7 Q2	+2.8	+4.5	+4.0	+0.7 Jul	+7.9 Aug	+5.2	+6.7	11.0 Jul‡‡
Mexico	+2.8 Q2	+0.6	+2.3	+2.5	-0.3 Jul	+5.6 Aug	+4.0	+4.8	4.2 Aug‡‡
Venezuela	+7.1 Q2	na	+5.2	+3.0	-2.5 Jun	+34.5 Aug	+16.0	+30.6	7.5 Q2‡‡
Egypt	+6.6 Q2	na	+7.1	+6.7	+7.5 2007**	+23.7 Aug	+8.1	+17.1	9.0 Q1‡‡
Israel	+4.9 Q2	+4.2	+4.0	+3.2	+9.7 Jul	+5.0 Aug	+1.0	+4.3	5.9 Q2
Saudi Arabia	+3.5 2007	na	+7.2	+5.1	na	+11.1 Jul	+3.8	+8.5	na
South Africa	+4.5 Q2	+4.9	+3.2	+3.5	+3.3 Jul	+13.7 Aug	+6.7	+10.3	23.1 Jun‡‡
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*									
Estonia	-1.1 Q2	-3.2	-0.6	+2.0	-5.2 Jul	+11.0 Aug	+5.7	+10.5	4.0 Jul
Finland	+2.4 Q2	+3.1	+2.6	+1.1	-1.4 Jul	+4.7 Aug	+2.3	+4.0	6.4 Aug
Iceland	+5.0 Q2	+20.9	nil	+0.8	+0.4 2007	+14.0 Sep	+4.2	+12.0	1.2 Aug‡‡
Ireland	-1.5 Q1	-0.9	-0.5	-0.1	-4.5 Jul	+4.3 Aug	+4.8	+4.0	6.1 Aug
Latvia	+0.1 Q2	na	-0.4	+0.5	-6.9 Jul	+15.7 Aug	+10.1	+15.8	5.7 Jul
Lithuania	+5.3 Q2	+4.5	+5.5	+4.8	na	+11.9 Aug	+5.6	+11.0	4.7 Aug‡‡
Luxembourg	+2.5 Q1	+5.3	+2.8	+2.6	+7.5 Jul	+4.0 Aug	+1.9	+4.0	4.1 Jul‡‡
New Zealand	+0.9 Q1	-2.3	+0.7	+1.6	+2.4 Q1	+4.0 Q2	+2.0	+4.1	3.9 Q2
Peru	+8.3 Jul	na	+7.9	+6.6	+7.0 Jul	+6.3 Aug	+2.2	+5.3	9.2 Jul††
Philippines	+4.6 Q2	+8.4	+4.7	+5.4	+5.1 Jun	+12.5 Aug	+2.4	+9.6	7.4 Q3‡‡
Portugal	+0.7 Q2	+1.4	+1.4	+1.3	-0.4 Jul	+3.0 Aug	+2.0	+2.7	7.3 Q2‡‡
Slovakia	+7.6 Q2	na	+7.5	+5.2	+1.8 Jul	+5.0 Aug	+2.3	+4.2	7.4 Aug‡‡
Slovenia	+5.5 Q2	na	+4.5	+4.0	-4.6 Jul	+6.0 Aug	+3.5	+6.0	6.5 Jul‡‡

*% change on previous quarter, annual rate. †*The Economist* poll or Economist Intelligence Unit estimate/forecast. ‡National definitions.- §RPI inflation rate4.8% in Aug. **Year ending June. ††Latest three months. ‡‡Not seasonally adjusted. ***Centred 3-month average

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

The Economist commodity-price index

Sep 25th 2008
From The Economist print edition

The Economist commodity-price index

2000=100

	Sep 16th	Sep 23rd*	% change on one month	% change on one year
Dollar index				
All items	219.7	226.0	−6.8	+4.4
Food	223.7	232.2	−7.0	+17.4
Industrials				
All	214.6	218.1	−6.5	−9.5
Nfa†	177.4	182.3	−3.6	+9.4
Metals	234.9	237.6	−7.7	−15.5
Sterling index				
All items	187.8	184.8	−7.6	+13.5
Euro index				
All items	143.9	141.9	−7.3	+0.1
Gold				
$ per oz	777.40	901.15	+8.9	+23.7
West Texas Intermediate				
$ per barrel	93.22	108.28	−6.7	+36.1

*Provisional †Non-food agriculturals.

Economic freedom

Sep 25th 2008
From The Economist print edition

Hong Kong stays in top place in ratings of economic freedom compiled by the Fraser Institute. Singapore takes second place and New Zealand comes third. Zimbabwe gets the lowest score. The Canadian think-tank's index is based on how countries perform in five main areas: size of government, security of property rights, sound money, free trade, and regulation. The lower government spending is, for example, the better a country will fare in the first component of the index. Similarly, low and stable inflation will favour a country's rating for sound money. The scores extend back to 1980 for 102 countries. Of these, 89 have got better over that period whereas 13 have got worse.

Trade, exchange rates, budget balances and interest rates

Sep 25th 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 $ Sep 24th	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	−844.6 Jul	−699.0 Q2	−4.8	–	–	−2.5	2.04	3.77
Japan	+88.2 Jul	+206.4 Jul	+3.7	106	116	−2.8	0.75	1.50
China	+252.5 Aug	+371.8 2007	+8.3	6.82	7.52	0.6	4.31	3.79
Britain	−187.4 Jul	−102.4 Q1	−3.4	0.54	0.50	−3.8	6.25	4.57
Canada	+49.3 Jul	+13.6 Q2	+0.9	1.03	1.01	0.2	2.37	3.69
Euro area	−10.8 Jul	−31.5 Jun	−0.3	0.68	0.71	−0.9	5.07	4.16
Austria	+0.1 Jun	+14.8 Q1	+2.9	0.68	0.71	−0.8	5.07	4.43
Belgium	+5.5 Jun	−1.1 Mar	+0.7	0.68	0.71	−0.6	5.14	4.65
France	−71.9 Jul	−51.3 Jul	−1.7	0.68	0.71	−2.9	5.07	4.41
Germany	+284.9 Jul	+271.9 Jul	+6.7	0.68	0.71	1.1	5.07	4.16
Greece	−66.6 Jun	−50.5 Jul	−14.0	0.68	0.71	−3.3	5.07	4.93
Italy	−13.1 Jul	−67.6 Jun	−2.6	0.68	0.71	−2.6	5.07	4.84
Netherlands	+61.4 Jul	+50.7 Q1	+5.8	0.68	0.71	0.7	5.07	4.41
Spain	−153.4 Jun	−167.3 Jun	−9.8	0.68	0.71	−1.6	5.07	4.64
Czech Republic	+6.1 Jul	−4.8 Jul	−2.7	16.6	19.5	−1.8	3.82	4.45
Denmark	+5.1 Jul	+3.9 Jul	+1.1	5.09	5.28	3.8	5.45	4.44
Hungary	+0.5 Jul	−7.2 Q1	−5.9	164	178	−4.0	8.66	8.20
Norway	+80.5 Aug	+78.1 Q2	+17.3	5.62	5.51	17.7	7.12	4.52
Poland	−19.7 Jul	−22.0 Jul	−4.9	2.27	2.68	−1.9	6.59	5.83
Russia	+182.7 Jul	+109.8 Q2	+6.2	25.0	25.0	4.5	11.00	8.53
Sweden	+18.7 Aug	+38.6 Q2	+7.7	6.59	6.54	2.4	4.40	3.90
Switzerland	+16.4 Aug	+91.4 Q1	+14.5	1.09	1.17	0.9	2.73	2.79
Turkey	−73.8 Jul	−47.1 Jul	−6.4	1.24	1.22	−2.7	18.49	7.17‡
Australia	−18.6 Jul	−61.1 Q2	−5.1	1.19	1.14	1.3	7.42	5.71
Hong Kong	−26.3 Aug	+27.5 Q2	+9.0	7.76	7.77	3.0	3.66	3.00
India	−93.3 Jul	−17.5 Q1	−3.2	45.9	39.7	−3.4	8.62	8.69
Indonesia	+35.6 Jul	+6.3 Q2	+2.8	9,335	9,161	−2.0	11.13	7.87‡
Malaysia	+39.7 Jul	+30.6 Q1	+14.4	3.42	3.43	−3.1	3.70	3.82‡
Pakistan	−21.7 Aug	−14.0 Q2	−8.6	78.2	60.7	−6.4	14.05	18.42‡
Singapore	+25.5 Aug	+32.8 Q2	+20.3	1.42	1.50	1.0	1.78	3.06
South Korea	−7.5 Aug	−1.8 Jul	−2.5	1,154	921	1.5	5.78	6.00
Taiwan	+9.3 Aug	+32.6 Q2	+5.2	32.0	32.9	−1.8	2.73	2.35
Thailand	+6.8 Jul	+11.4 Jul	+1.1	34.0	34.2	−2.9	3.85	4.48
Argentina	+11.3 Jul	+6.0 Q2	+3.1	3.10	3.14	0.7	13.81	na
Brazil	+29.5 Aug	−21.9 Aug	−1.6	1.84	1.85	−1.6	13.66	6.16‡
Chile	+17.8 Aug	+1.0 Q2	−0.3	539	512	6.5	8.28	3.91‡
Colombia	+1.2 Jun	−5.0 Q1	−2.6	2,139	2,013	−1.0	10.05	6.33‡
Mexico	−9.4 Aug	−5.3 Q2	−0.8	10.8	10.9	−0.1	8.15	8.52
Venezuela	+41.9 Q2	+37.8 Q2	+12.1	4.10	4.23§	1.6	17.11	6.55‡
Egypt	−22.2 Q1	−0.1 Q1	+0.2	5.46	5.59	−7.1	14.02	5.89‡
Israel	−13.1 Aug	+3.5 Q2	+0.2	3.42	4.03	−1.0	4.21	5.37
Saudi Arabia	+150.8 2007	+95.0 2007	+33.1	3.75	3.74	13.3	4.38	na
South Africa	−11.1 Jul	−22.5 Q2	−8.0	8.08	6.94	0.4	11.42	8.92
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*								
Estonia	−4.3 Jul	−3.4 Jul	−10.8	10.7	11.1	−0.4	6.33	na
Finland	+12.2 Jul	+11.5 Jul	+3.8	0.68	0.71	4.5	5.13	4.39
Iceland	−1.0 Aug	−4.5 Q2	−14.6	95.4	62.2	2.0	15.97	na
Ireland	+38.2 Jun	−14.7 Q1	−3.5	0.68	0.71	−3.9	5.07	4.61
Latvia	−7.1 Jul	−5.7 Jul	−13.8	0.48	0.50	−1.5	5.88	na
Lithuania	−7.9 Jul	−5.9 Jul	−14.0	2.35	2.45	−0.7	5.82	na
Luxembourg	−6.7 Jun	+4.9 Q1	na	0.68	0.71	0.5	5.07	na
New Zealand	−3.3 Jul	−11.4 Q2	−7.1	1.46	1.34	1.2	7.20	5.81
Peru	+6.3 Jul	−1.5 Q2	−1.1	2.95	3.11	2.3	6.55	na
Philippines	−8.2 Jun	+5.6 Mar	+2.8	46.4	45.2	−0.8	4.00	na
Portugal	−31.9 Jun	−27.9 Jun	−9.0	0.68	0.71	−2.5	5.07	4.71
Slovakia	−1.2 Jul	−5.0 May	−4.7	20.7	24.0	−2.1	3.63	4.98
Slovenia	−4.3 Jul	−3.2 Jun	−5.8	0.68	0.71	0.1	5.07	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

Sep 25th 2008
From The Economist print edition

Markets

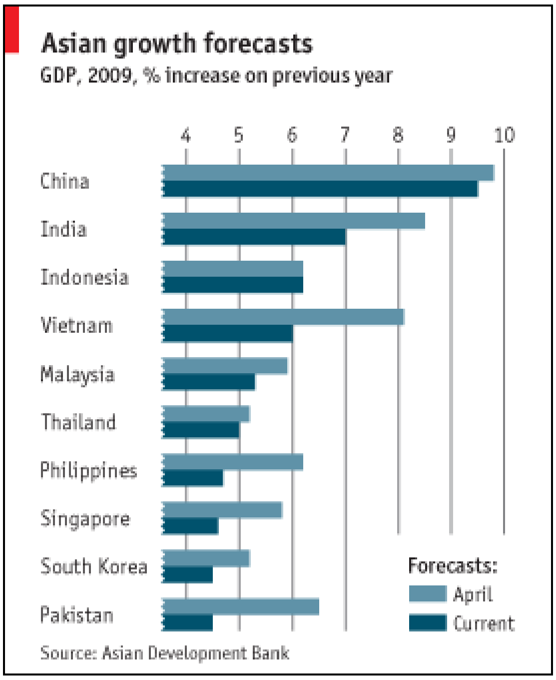
	Index Sep 24th	% change on one week	% change on Dec 31st 2007 in local currency	% change on Dec 31st 2007 in $ terms
United States (DJIA)	10,825.2	+2.0	−18.4	−18.4
United States (S&P 500)	1,185.9	+2.5	−19.2	−19.2
United States (NAScomp)	2,155.7	+2.7	−18.7	−18.7
Japan (Nikkei 225)	12,115.0	+3.1	−20.9	−16.6
Japan (Topix)	1,168.0	+4.2	−20.9	−16.6
China (SSEA)	2,328.1	+14.9	−57.8	−54.9
China (SSEB, $ terms)	126.8	+10.0	−67.6	−65.4
Britain (FTSE 100)	5,095.6	+3.7	−21.1	−26.6
Canada (S&P TSX)	12,513.4	+5.4	−9.5	−13.7
Euro area (FTSE Euro 100)	970.6	+3.1	−29.4	−29.2
Euro area (DJ STOXX 50)	3,119.8	+3.3	−29.1	−28.9
Austria (ATX)	3,123.8	+6.3	−30.8	−30.6
Belgium (Bel 20)	2,866.2	+2.8	−30.6	−30.3
France (CAC 40)	4,114.5	+2.9	−26.7	−26.5
Germany (DAX)*	6,052.9	+3.3	−25.0	−24.7
Greece (Athex Comp)	3,062.8	+3.5	−40.9	−40.7
Italy (S&P/MIB)	26,929.0	+3.9	−30.2	−29.9
Netherlands (AEX)	360.6	+1.0	−30.1	−29.9
Spain (Madrid SE)	1,189.1	+3.9	−27.6	−27.4
Czech Republic (PX)	1,283.1	+8.0	−29.3	−22.6
Denmark (OMXCB)	358.8	+3.9	−20.1	−19.8
Hungary (BUX)	18,579.2	+3.9	−29.2	−25.4
Norway (OSEAX)	410.2	+7.9	−28.0	−30.5
Poland (WIG)	37,486.1	+2.9	−32.6	−27.0
Russia (RTS, $ terms)	1,315.4	+24.2	−41.5	−42.6
Sweden (Aff.Gen)	250.5	+4.2	−26.4	−27.8
Switzerland (SMI)	6,780.3	+1.9	−20.1	−16.9
Turkey (ISE)	35,177.1	+7.5	−36.7	−40.1
Australia (All Ord.)	5,008.2	+5.0	−22.0	−25.8
Hong Kong (Hang Seng)	18,962.0	+7.5	−31.8	−31.5
India (BSE)	13,692.5	+3.2	−32.5	−42.1
Indonesia (JSX)	1,883.6	+6.4	−31.4	−31.0
Malaysia (KLSE)	1,028.4	+2.5	−28.8	−31.2
Pakistan (KSE)	9,190.8	−0.3	−34.7	−48.5
Singapore (STI)	2,477.6	+2.4	−28.5	−27.7
South Korea (KOSPI)	1,496.0	+5.0	−21.1	−36.1
Taiwan (TWI)	6,132.6	+5.7	−27.9	−26.8
Thailand (SET)	620.4	+2.5	−27.7	−28.3
Argentina (MERV)	1,655.8	+11.0	−23.0	−21.8
Brazil (BVSP)	49,842.0	+8.6	−22.0	−24.6
Chile (IGPA)	13,014.8	+1.9	−7.6	−14.5
Colombia (IGBC)	9,300.1	+3.2	−13.0	−18.0
Mexico (IPC)	24,944.3	+6.3	−15.5	−14.4
Venezuela (IBC)	38,573.0	−1.7	+1.8	−46.7
Egypt (Case 30)	6,950.1	−6.3	−33.6	−32.9
Israel (TA-100)	792.6	+3.3	−31.4	−22.7
Saudi Arabia (Tadawul)	7,133.5	−3.4	−35.4	−35.4
South Africa (JSE AS)	24,923.3	+2.5	−13.9	−27.2
Europe (FTSEurofirst 300)	1,101.6	+2.9	−26.9	−26.7
World, dev'd (MSCI)	1,244.0	+4.4	−21.7	−21.7
Emerging markets (MSCI)	831.3	+8.1	−33.3	−33.3
World, all (MSCI)	310.3	+4.8	−23.1	−23.1
World bonds (Citigroup)	757.9	+0.5	+3.8	+3.8
EMBI+ (JPMorgan)	421.1	+1.9	−2.9	−2.9
Hedge funds (HFRX)	1,201.6	+0.1	−9.6	−9.6
Volatility, US (VIX)	35.2	36.2	22.5	(levels)
CDSs, Eur (iTRAXX)†	116.5	−19.0	+130.2	+130.9
CDSs, N Am (CDX)†	172.6	−20.1	+121.6	+121.6
Carbon trading (EU ETS) €	24.6	+5.7	+10.7	+11.0

*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.

Economist.com
MARKETS & DATA
WEEKLY INDICATORS

Asian growth forecasts

Sep 25th 2008
From The Economist print edition



The outlook for Asian economies is darkening. New forecasts from the Asian Development Bank for GDP growth in 2009 are generally lower than the ones it made in April. Next year's growth projection for China has merely been shaved, from 9.8% to 9.5%, but forecasts for some countries have been shorn. Vietnam is now expected to grow by 6.0% rather than 8.1%; India by 7.0% compared with 8.5%. The bank says that emerging Asia is being hit by lower demand for its exports in developed economies and by tighter and more costly access to global capital markets as a result of the financial crisis. Growth prospects are also dimming because of steps taken in the region to tighten monetary policy so as to contain inflation.