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The Economist

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The trouble with Russia's economy

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Politics this week

Feb 28th 2008
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EPA

Thaksin Shinawatra, who was deposed as **Thailand's** prime minister in a military coup in 2006, returned to Bangkok after 17 months in exile. He faces corruption charges and is banned from politics (from which he says he has retired anyway). The ruling People's Power Party, which supports him, faced a new legal threat after the Election Commission disqualified the PPP's Yongyuth Tiyapairat, the parliament's speaker, for buying votes in last December's election. If Mr Yongyuth is found to have acted for the party, it might be disbanded. See article

The New York Philharmonic played a concert in Pyongyang, accompanied by an entourage that was the biggest American delegation ever to visit **North Korea**. Besides Dvorak, Gershwin and Wagner, the orchestra played the “Star-Spangled Banner”, which was heard respectfully. On a visit to Beijing, Condoleezza Rice, America's secretary of state, urged China to exert pressure on North Korea to end its nuclear programme. See article

In **South Korea**, Lee Myung-bak was inaugurated as the country's 17th president following a landslide victory in December's election. His celebrations were marred by the resignation of three of his nominees for cabinet posts over controversial property dealings. See article

Robert Gates, America's defence secretary, visited **India** to bolster military ties between the two countries and promote American arms sales. As he arrived, India announced that it had successfully tested a new type of ballistic missile.

Showdown

Hillary Clinton and **Barack Obama** sparred over NAFTA and Iraq at a debate. It was the last time the pair will meet before Ohio and Texas hold presidential primary elections on March 4th, which will probably seal the nomination for Mr Obama if he wins.

Conservatives rallied to the defence of **John McCain** after the *New York Times* ran a story detailing the Arizona senator's ties to a female lobbyist nine years ago. The newspaper was criticised for hinting, but not quite alleging, that the pair were romantically involved. See article

Michael Bloomberg, the mayor of New York, apparently ruled himself out as an independent presidential candidate after months of nudges and winks. There was no such coyness from **Ralph Nader**, who announced that he would run for president again. Asked why, the one-time scourge of corporate America replied that “The forces of injustice never take a holiday”. Mr Nader won 0.38% of the popular vote in the 2004 presidential election.

AP

The **Supreme Court** heard an appeal from Exxon Mobil against the precedent of compensation awarded to the 33,000 people whose livelihoods were impaired by the *Exxon Valdez* disaster. The tanker spilled its oil into Alaska's Prince William Sound in 1989. In 1994 a jury allotted $2.5 billion in punitive damages to those who were affected, around a fifth of whom are now dead.

Keeping it in the family

Raúl Castro was designated as **Cuba's** new president, succeeding his ailing brother, Fidel. The new vice-president is José Ramón Machado Ventura, another veteran Communist. In a speech, Raúl said he would streamline the government and raise living standards, but “within socialism”. See article

Colombia's FARC guerrillas released four former politicians whom they had held as hostages, turning them over to a delegation sent by Venezuela's president, Hugo Chávez. The FARC released two other hostages in January, but they still hold several hundred, including Ingrid Betancourt, a politician of dual Colombian and French nationality. See article

In **Canada** the Conservative minority government unveiled a modest budget, eschewing both big tax cuts and spending promises. The opposition Liberals said they would not trigger an election by voting against it.

Brazil rejected a request from Argentina to cede some of its contracted shipments of **natural gas** from Bolivia. Argentina, which froze many energy tariffs for several years, now faces shortages.

The language barrier

The warring linguistic parties in **Belgium** reached a deal on further devolution, paving the way for a new (Flemish) prime minister, Yves Leterme, who won last summer's election, to form a government at last.

German voters confirmed their swing left when they returned the Left Party to the state parliament in Hamburg. It also emerged that the Social Democrats might form a government in Hesse that relies on Left Party support, something they had previously promised not to do. See article

Cyprus's presidential election was won by Demetris Christofias, who will become the only Communist head of state in the EU. More significantly, Mr Christofias is keener than his predecessor was to reach a settlement with the Turkish-Cypriot north of the island. Talks will begin shortly. See article

A Turkish skirmish

Reuters

Thousands of **Turkish troops** attacked havens of the Kurdistan Workers' Party (PKK) in the mountains of northern Iraq, apparently with intelligence help from America. The Turks said they had killed at least 160 fighters, while the PKK, which is made up of Turkish Kurds, said it had killed almost as many Turks. Iraq's government in Baghdad and the Iraqi Kurds in their autonomous region told the Turks to leave. See article

Muqtada al-Sadr, a Shia cleric who commands the loyalty of the most powerful militia in **Iraq**, agreed to extend a ceasefire for another six months, raising hopes that the rate of sectarian killings between Shia and Sunni Muslims, especially in Baghdad, would stay far below that of a year ago.

Kofi Annan, a former United Nations secretary-general, announced that an understanding had been reached between **Kenya's** government and opposition in talks he is mediating on a power-sharing deal. See article

Fighting flared across **Israel's** border with **Gaza**. It was triggered after Israel killed five Hamas gunmen in a minivan and the Palestinians fired more than 40 rockets into Israel, far more than their usual daily dose.

Zimbabwe's president, Robert Mugabe, called Simba Makoni, who is challenging him for the top job in an election at the end of this month, a prostitute and a frog. **See article**

Business this week

Feb 28th 2008
From The Economist print edition

Visa confirmed it would proceed with a public offering this spring. The company hopes to raise $18.8 billion, making it America's biggest IPO. Visa takes fees from credit-card transactions; the risk from defaults on payments, a growing worry of late, is held by banks that issue the plastic. As shareholders in Visa, they will probably use money from a sale to help repair their balance sheets. See article

Moody's and Standard & Poor's reaffirmed their AAA+ ratings for **MBIA**, removing the threat of a downgrade to the world's biggest bond insurer—at least for the moment. With the credit markets in turmoil, bond insurers are desperate to retain the top-notch ratings that cities depend on when they borrow.

The federal regulator overseeing **Fannie Mae** and **Freddie Mac**, government-backed firms that finance and guarantee home loans, said it would consider lifting a cap on their ability to invest capital that had been imposed on the pair because of accounting irregularities. Meanwhile, Fannie and Freddie reported heavy quarterly losses partly because of higher defaults on loans and rising foreclosures. See article

Not much home improvement

Amid falling consumer confidence and another volley of statistics on the gloomy state of America's housing market, **Home Depot** reported the first drop in annual sales in its 30-year history.

Countrywide Financial said that “in light of recent events” it would cancel a business trip it had planned for 30 bankers to a swanky ski resort in Colorado. The mortgage lender has had to deny several rumours that it is bankrupt and only recently agreed to a takeover, for a fraction of its market value a year ago, from Bank of America. The high cost of the impending trip was criticised in some quarters.

BAA, Britain's biggest airport operator, said its chief executive was going, after a year of grumbling from travellers about flight delays and security queues at Heathrow. Its chairman has promised to restructure the company; competition regulators are to report soon on BAA's monopoly of London's airports. See article

Meanwhile, **Grupo Ferrovial**, the Spanish infrastructure company that owns BAA, posted a 49% drop in annual net profit partly because of service costs on its debt. Ferrovial has had to delay a debt-refinancing plan because of the credit crunch.

British American Tobacco went on a spending spree, picking up the cigarette business of Denmark's **ST**, for $4 billion, and Turkey's **Tekel**, for $1.7 billion. Big tobacco companies faced with falling demand in the West have rapidly expanded into developing markets. The latest deals give BAT a big presence in Poland as well as Turkey.

Electronic Arts, a video-game giant, unveiled a bid for **Take-Two Interactive Software**, the maker of the popular “Grand Theft Auto” series of games. With the newest title in the franchise due for release in late April, Take-Two said EA needed to raise its offer. See article

Ouch!

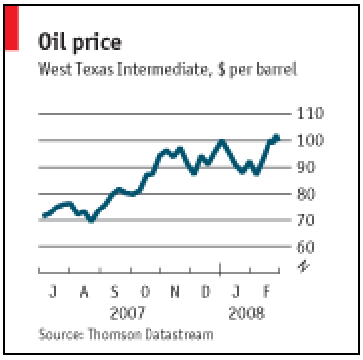
The **European Commission** fined **Microsoft** an additional *euro*899m ($1.35 billion) for non-compliance with an antitrust decision handed down in 2004, bringing the total penalty in the case so far to *euro*1.68 billion. The latest fine covers the period to October 22nd 2007, before which, the commission said, Microsoft ignored its ruling and charged competitors too much for patents and licences.

Google's share price slid again after comScore, a research firm, estimated that the number of clicks on ads on the search engine had fallen by 0.3% in January compared with the same month a year ago.

Nervousness about a recession and slowdown in advertising is a factor behind Google's tumbling share price: it is down by 32% this year.

Internet users around the world were unable to view **YouTube** for several hours, which analysts blamed on Pakistan's government. It ordered the country's internet service providers to block access to the website as it hosted a Dutch video criticising the Koran, fearing the clip would incite violence. Apparently an error in the computer code sent out by Pakistan's biggest telecoms company affected access to YouTube elsewhere.

Market transactions



Oil traded at record high prices. With the dollar falling to a record low of $1.51 against the euro, investors were ploughing their funds into oil and other commodities to hedge against inflation.

Food prices also continued to rise. The price of **wheat** jumped by 25% in just one day after Kazakhstan, a big exporter, moved to impose tariffs on grain leaving the country in an effort to curb inflation at home. For **sugar**, the market has been rather quiet.

KAL's cartoon

Feb 28th 2008
From The Economist print edition

Illustration by Kevin Kallaugher

Russia

Russia's uneasy handover

Feb 28th 2008
From The Economist print edition

The new Russian president, Dmitry Medvedev, faces an unpalatable legacy

MOST elections have an element of uncertainty about them. Not Russia's. This weekend, barring a miracle, Dmitry Medvedev, Vladimir Putin's handpicked successor, will win the Russian presidency by a landslide. The emasculation of the country's fragile democracy—from the Kremlin's monopoly over television to the crushing of any serious opposition candidates—is enough to ensure that. But so is Mr Putin's popularity: he enjoys an approval rating above 70%.

This figure is artificially exaggerated, as is to be expected in a country with no democratic tradition, almost no free media and no independent power centres. But there is little reason to doubt that many, perhaps most, Russians are satisfied with Mr Putin's apparently successful eight years in office and willing to accept his choice of Mr Medvedev. Yet Mr Medvedev's chances of maintaining this level of satisfaction seem remote.

Mr Putin's reputation rests on four chief claims advanced by his supporters, both at home and abroad. The first is that he brought political stability after the chaos of his predecessor, Boris Yeltsin. Second, he imposed peace in Chechnya and across the north Caucasus. Third, he restored Russia's rightful position as an influential world power. Fourth (and most important), he presided over sustained rapid economic growth and a sharp rise in Russians' living standards.

Claims of straw

Yet a closer look reveals big flaws in all these claims. Russia's purported political stability rests on a perversion of the normal meaning of democracy and an excessive concentration of power in the Kremlin that has wiped out regional autonomy and fostered corruption, thought by businessmen to be worse now than in the Yeltsin years. The so-called peace in Chechnya has been won by handing control of the republic to a former rebel, Ramzan Kadyrov; the rest of the north Caucasus is more troubled than ever (see article).

As for rising influence and higher living standards, both depend critically on the economy, which Mr Putin touts as his proudest achievement. Average annual growth rates for GDP of 7%, and for real wages in double digits, are certainly impressive at first blush. And it is true that, from early in his presidency, Mr Putin did much to restore macroeconomic stability through fiscal and monetary discipline and the appointment of liberals to the main economic posts—though, given Russia's debt at the time, he had little alternative. Even so, during the Putin presidency growth has been lower than in most other ex-Soviet countries. Moreover, it has relied heavily on surging commodity prices, especially for oil and gas (see article).

Russia's consumption splurge has, in short, been driven by a natural-resource boom. The competitiveness of the non-oil economy has eroded sharply since the devaluation of 1998. The concept of manufacturing for export scarcely exists, outside the arms industry. By the end of his first term, Mr Putin had abandoned most of his tentative attempts at economic liberalisation. Worse, the long-drawn-out Yukos affair, which began in mid-2003, presaged not only an assault on property rights and the rule of law but also a resurgence of state control over, and interference in, the economy. Russia's own history offers powerful testimony of the harmful effects that state intervention tends to wreak.

Even macroeconomic stability, the final legacy from Mr Putin, is under threat. Inflation has already crept up to double figures. It could rise further if the government gives way to growing pressure to spend more from the stabilisation fund, which has so far acted as a useful absorber of oil-and-gas revenues. The trade balance is deteriorating as imports boom. A weakening world economy will not only soften demand for primary commodities, but may even lead their giddy prices to fall.

A grim inheritance, Dmitry

In retrospect, Mr Putin was lucky to inherit a recovering economy and an incipient oil- and commodity-price boom from Mr Yeltsin. Mr Medvedev is in a much worse predicament. He will find it far harder than Mr Putin did to do his job as president at the same time as retaining the support of ordinary Russians. He will take over weakened institutions and a cash pile that promises nothing but headaches as people fight to spend it. The economy is simultaneously overheating and facing the threat of imminent global slowdown.

Mr Medvedev is a canny lawyer who owes his political career entirely to Mr Putin, for whom he worked in St Petersburg in the early 1990s (see article). He comes with two points in his favour: unlike Mr Putin and most other cronies in the Kremlin, he has no background in the security services, not least because he is too young (just 42) to have worked for them in Soviet times; and, as he has confirmed in two recent speeches, his instincts are to favour liberalisation and a reining-in of the state's role in the economy. Unfortunately, his failure to reform Russia's gas monopoly, Gazprom, when he was its chairman, offers less reason for hope.

Worse, Mr Putin will probably still be around as prime minister (he stood down as president only because the constitution sets a limit of two consecutive terms). Nobody can predict exactly how this duo will work, although Mr Putin has made it clear that he intends to be highly active, not least in foreign and defence policy. For his part, Mr Medvedev has promised to stick to the “successful” policies of his predecessor.

In some countries, a division of power might be welcome, not least to avert the risk of too much accruing to one man. But in Russia, where the notion of a tsar survived the Soviet Union, divided power is usually problematic. Maybe Mr Putin will slowly fade out, building up Mr Medvedev as a strong successor. More likely, either Mr Medvedev will be a figurehead atop a strong Putin government, perhaps an interim leader before Mr Putin returns as president; or he (and those around him) will set about using the president's immense powers to try to sap Mr Putin's strength. Either way, a double-headed government promises to be a source of extra instability. At a time when the challenges for the next president are harder than ever, that is the last thing Russia needs.

Economist.com OPINION LEADERS

Avoid that quagmire

Feb 28th 2008
From The Economist print edition

Turkey's latest assault on Kurdish guerrillas in Iraq is understandable but unwise

Get article background

TRYING to be nice, all at once, to the Turks, the Arab Iraqis and the various Kurds on all sides of the blurred borders between them is an almost ludicrous proposition. But it is what the Americans have to do, even if it means occasionally tilting back and forth, and never quite finding a playing field where all are treated on the same happy level.

In the past week they have leant back further than usual in a friendly manner towards the Turks, apparently helping them in their latest attempt to squash the guerrillas of the Kurdistan Workers' Party (PKK). In so doing, the Americans have winked at Turkey flouting Iraq's territorial sovereignty, as it attacks from land and air the PKK guerrillas in their hideouts in Iraq's rugged northern mountains (see article). This time, the Americans are probably right to do so. But sooner or later they may have to wobble back the other way—if they want to avoid ditching the right sort of Kurds along with the bad ones.

There are Kurds and Kurds. The PKK is generally a bad lot, though it may have dropped some of its nastier habits and beliefs over the years. It still kills Turkish soldiers in south-east Turkey and occasionally blows up civilians across the country, though it often blames breakaway groups for such atrocities. By contrast, the two Kurdish parties which jointly run an autonomous region in northern Iraq have been pretty good of late. Theirs is the most peaceful part of Iraq. They should keep the PKK at arm's length, though the Turks say they should clobber them, something Kurds are loth to do to each other.

It is understandable that the Turks want to swat the PKK. Whether they are wise to do so is another matter. Their prime minister, Recep Tayyip Erdogan, who is embroiled in a row between secularists and Islamists over whether female students at universities should be allowed to wear headscarves, may want to give the secular-minded generals a reward for their silence on the issue by letting them loose on the PKK. Mr Erdogan is a moderate Islamist who wants to let the headscarf be worn. Since he became prime minister five years ago, he has done rather well with the Kurds, persuading a lot of them to vote for him and steadily widening their rights, though he has been making hostile noises towards them of late. Plainly, bashing the PKK is not the best way to get the Kurds on side. Even with American help, the Turkish generals will not destroy the PKK. Mr Erdogan must himself tilt back and seek again to accommodate his Kurdish compatriots.

In the longer run, the Turks' biggest change of heart must be towards the Kurds of Iraq, who have been consolidating their autonomy for some 15 years and who, amid hiccups, have been strengthening economic ties with their Turkish neighbours. By the same token, Iraq's Kurds must reassure the Turks that they have no intention of expanding a quasi-independent Kurdistan into Turkey or of encouraging the PKK. Iraq's federal government in Baghdad, for its part, has been trying to conciliate the Turks, even as it criticises their incursion. The best hope is that, with their honour satisfied after pummelling the PKK for a week or two, the Turkish forces withdraw and, in time, seek to satisfy the Kurds by political means.

For the sake of peace, curb your enthusiasm

In so volatile a region, the forces of moderation will always find it hard to persuade Turks and Arabs and Kurds, let alone Persians, to resist making maximal demands. The Kurds too, especially in Iraq, though bound to harbour dreams of full-fledged statehood, will have to learn to accept something a little less—but far more than they have ever enjoyed before. And the Americans, while they are still there, must continue to hold the ring as best they can.

Economist.com OPINION LEADERS

Obamanomics

Hope and fear

Feb 28th 2008
From The Economist print edition

Democratic economic policy sounds worryingly populist

AP

FOR a man who has placed “hope” at the centre of his campaign, Barack Obama can sound pretty darned depressing. As the battle for the Democratic nomination reaches a climax in Texas and Ohio, the front-runner's speeches have begun to paint a world in which laid-off parents compete with their children for minimum-wage jobs while corporate fat-cats mis-sell dodgy mortgages and ship jobs off to Mexico. The man who claims to be a “post-partisan” centrist seems to be channelling the spirit of William Jennings Bryan, the original American populist, who thunderously demanded to know “Upon which side shall the Democratic Party fight—upon the side of ‘the idle holders of idle capital’ or upon the side of ‘the struggling masses’?”

There is no denying that for some middle-class Americans, the past few years have indeed been a struggle. What is missing from Mr Obama's speeches is any hint that this is not the whole story: that globalisation brings down prices and increases consumer choice; that unemployment is low by historical standards; that American companies are still the world's most dynamic and creative; and that Americans still, on the whole, live lives of astonishing affluence.

It is not fair, moreover, to blame Mr Obama exclusively. His rival, Hillary Clinton, is no less responsible for the Democratic Party's wholesale descent into economic miserabilism. Both candidates have threatened to pull America out of NAFTA, the free-trade deal with Mexico and Canada, unless it is rewritten. Both rail against oil companies, drug companies, credit-card companies—the usual suspects. Both want more government spending and regulation to protect individuals against predatory companies. Indeed, in some ways, Mrs Clinton is worse. She appears to be sceptical of all trade deals, including the multilateral Doha round which would produce big benefits for the world's poorest countries. Unlike Mr Obama, she has proposed a deeply unsound five-year freeze on interest payments for subprime borrowers, which would surely result in higher rates and scarcer credit for future borrowers.

Beyond the campaign

How worrying is their populism? The sanguine—and conventional—argument is that none of it matters much. Democratic candidates always veer to the left during primaries, because that is where the votes are. But come the general election, the winner will tack back towards the centre, where the crucial independent voter resides.

The winner, unless Mrs Clinton can stage a dramatic comeback in the big primaries on March 4th, is likely to be Mr Obama. If you look on his website rather than listen to his speeches, there are plenty of intelligently designed, reasonably centrist proposals to be found (see article). It is sensible, for instance, to make it easier for people to save for retirement by enrolling everyone in a scheme unless they specifically opt out. His plans for health-care reform, like Mrs Clinton's, are middle-of-the-road. And his economic advisers, even more than hers, are sound academic economists. So although it might seem odd to advise suspicious voters to ignore the rhetoric of a man whose principal appeal rests on his speeches, Mr Obama in office would surely seek to be something other than the capitalist-hating demagogue he has recently sounded like.

Yet there are reasons to worry. The longer the Democratic race grinds on, the more entrenched the candidates may become in their populism. As America moves into the election proper, there is every likelihood that it will do so against a backdrop of worsening macroeconomic figures and rising numbers of house repossessions. Both John McCain and the Democratic nominee will then be chasing swing voters who are, typically, white working men—the type already prone to pessimism about their prospects. This group is not a natural part of Mr Obama's constituency and, if he were the nominee, he might well be tempted to keep the populism turned up high. If he were elected president, backed by a Democratic Congress with enhanced majorities, Mr Obama might well feel obliged to deliver on some of his promises. At the very least, the prospects for freer trade would then be dim.

The sad thing is that one might reasonably have expected better from Mr Obama. He wants to improve America's international reputation yet campaigns against NAFTA. He trumpets “the audacity of hope” yet proposes more government intervention. He might have chosen to use his silver tongue to address America's problems in imaginative ways—for example, by making the case for reforming the distorting tax code. Instead, he wants to throw money at social problems and slap more taxes on the rich, and he is using his oratorical powers to prey on people's fears.

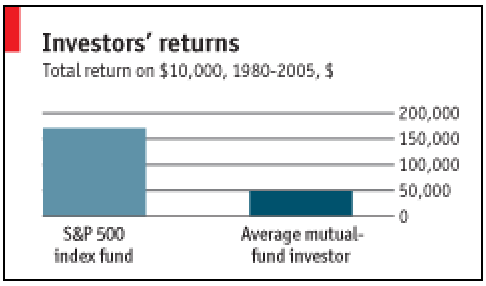
Mr Obama advertises himself as something fresh, hopeful and new. But on economic matters at least he, like Mrs Clinton, has begun to look a rather ordinary old-style Democrat.

Fund management

Trillion-dollar baby

Feb 28th 2008
From The Economist print edition

Investors pay too much to have their money managed



LOOKING after other people's money is a fine business. The asset-management industry long ago managed to secure a deal whereby its fee income rose in line with the markets; it can earn ever more money by doing nothing. The industry oversees some $64 trillion of assets and, at a conservative estimate, its costs in fees, dealing charges, custody and so on are around 1.5-2% a year—so investors are shelling out $1 trillion a year to the custodians of their cash.

As our special report in this issue shows, the industry puts a big chunk of this straight into its back pocket. A survey by Boston Consulting Group found that operating margins of fund-management firms were more than 40%. People like Steve Schwarzman of Blackstone and Ken Griffin of Citadel have become billionaires thanks to the way their private-equity groups and hedge funds look after other people's money.

You would have thought such a business would be an easy target for new entrants; competition would reduce margins and force fees down. But, by and large, this has not happened. A cheap alternative to traditional fund management arose more than 30 years ago, in the form of index-trackers, portfolios that mimic a benchmark such as the S&P 500. Trackers have gained a respectable market share but are much more popular with astute pension funds and insurance companies than with the general public.

Even pension funds entrust money to index-trackers with one hand and to high-charging private-equity and hedge-fund managers with the other. They appear to believe both that markets are so efficient that it is hard for fund managers to beat them; and also that markets are so inefficient that it is still possible to beat them after paying hedge-fund managers 2% a year, plus a fifth of all positive returns.

This dichotomy stems from the conviction that some special fund managers have skill, or “alpha” in the jargon. The fund-management industry has exploited this by persuading investors to judge it on past performance, rather than price. And you can always find some managers that have outperformed; in a range of 20 funds, at least four or five will probably have beaten the market. The industry has been able to advertise those funds and keep quiet about the rest.

You can see why investors want more than an “average” return when they learn that some managers have made 20% a year. And the records of some of these managers may indeed be due to skill, rather than luck. The problem lies in the difficulty of spotting such skilful managers before they have beaten the market, not after—when their run is over.

Consumers have often been their own worst enemies. If they are to save at all, they typically take a lot of persuading. Marketing costs eat into investors' returns. Salesmen have to be paid, and their commission creates an incentive to push higher-charging funds. If consumers were only willing to look more carefully at these costs, they could save themselves a lot of money.

Fooled by randomness

There is hope, however. A relatively new form of tracking vehicle, called exchange-traded funds (ETFs), has grown its assets even faster than hedge funds have this decade. Furthermore, as academics have studied the patterns of fund managers' returns, they have discovered that excess returns, which the managers attribute to their own skill, may well stem from things like a greater exposure to smaller stocks. You can design ETFs to mimic these factors cheaply. Even the returns of hedge funds can be copied.

Yet change will come slowly. It is hard for the average investor to see through the statistical fog; easy to be “fooled by randomness”, in the phrase of Nassim Nicholas Taleb, a writer and former trader. But small investors really ought to worry about cost. Figures from John Bogle, founder of the fund giant Vanguard, show that an S&P 500 index-fund returned 12.3% a year between 1980 and 2005, whereas the average mutual-fund investor, because of costs and poor timing, earned just 7.3%. That makes an enormous difference to wealth: $10,000 invested in the index fund grew to $170,800; a typical mutual-fund investor saw his money grow to just $48,200.

In a free market, regulators should not aim to control fees or even ban the advertising of past returns. But they should make sure that the full costs of fund management are clear. And when governments set up their own savings schemes—in pensions, say—they should make sure that costs are controlled. Let hedge-fund managers earn their yachts the hard way.

The potato

Spud we like

Feb 28th 2008
From The Economist print edition

In praise of the humble but world-changing tuber

Illustration by Claudio Munoz

IT IS the world's fourth-most-important food crop, after maize, wheat and rice. It provides more calories, more quickly, using less land and in a wider range of climates than any other plant. It is, of course, the potato.

The United Nations has declared 2008 the International Year of the Potato (see article). It hopes that greater awareness of the merits of potatoes will contribute to the achievement of its Millennium Development Goals, by helping to alleviate poverty, improve food security and promote economic development. It is always the international year of this or month of that. But the potato's unusual history (see article) means it is well worth celebrating by readers of *The Economist*—because the potato is intertwined with economic development, trade liberalisation and globalisation.

Unlikely though it seems, the potato promoted economic development by underpinning the industrial revolution in England in the 19th century. It provided a cheap source of calories and was easy to cultivate, so it liberated workers from the land. Potatoes became popular in the north of England, as people there specialised in livestock farming and domestic industry, while farmers in the south (where the soil was more suitable) concentrated on wheat production. By a happy accident, this concentrated industrial activity in the regions where coal was readily available, and a potato-driven population boom provided ample workers for the new factories. Friedrich Engels even declared that the potato was the equal of iron for its “historically revolutionary role”.

The potato promoted free trade by contributing to the abolition of Britain's Corn Laws—the cause which prompted the founding of *The Economist* in 1843. The Corn Laws restricted imports of grain into the United Kingdom in order to protect domestic wheat producers. Landowners supported the laws, since cheap imported grain would reduce their income, but industrialists opposed them because imports would drive down the cost of food, allowing people to spend more on manufactured goods. Ultimately it was not the eloquence of the arguments against the Corn Laws that led to their abolition—and more's the pity. It was the tragedy of the Irish potato famine of 1845, in which 1m Irish perished when the potato crop on which they subsisted succumbed to blight. The need to import grain to relieve the situation in Ireland forced the government, which was dominated by landowners who backed the Corn Laws, to reverse its position.

This paved the way for liberalisation in other areas, and free trade became British policy. As the Duke of Wellington complained at the time, “rotten potatoes have done it all.”

The YouTuber generation

In the form of French fries, served alongside burgers and Coca-Cola, potatoes are now an icon of globalisation. This is quite a turnaround given the scepticism which first greeted them on their arrival in the Old World in the 16th century. Spuds were variously thought to cause leprosy, to be fit only for animals, to be associated with the devil or to be poisonous. They took hold in 18th-century Europe only when war and famine meant there was nothing else to eat; people then realised just how versatile and reliable they were. As Adam Smith, one of the potato's many admirers, observed at the time, “The very general use which is made of potatoes in these kingdoms as food for man is a convincing proof that the prejudices of a nation, with regard to diet, however deeply rooted, are by no means unconquerable.” Mashed, fried, boiled and roast, a humble tuber changed the world, and free-trading globalisers everywhere should celebrate it.

Economist.com OPINION LETTERS

On farming, Barack Obama, Russia, religion, air tankers

Feb 28th 2008
From The Economist print edition

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European farming today

SIR – Charlemagne flayed the "idiocy" of the European Union's common agricultural policy, and attacked France's position in particular (February 16th). To answer his criticisms in general terms, yes, I believe in a CAP that includes a certain territorial balance. Rural areas cover 90% of the EU's territory and are home to around 50% of its population. The future of agricultural policy is not about "assistance", it is about rendering services to society, be it in terms of food security, the environment or the social development of rural areas. So intensive farming is not the only choice for the future; several agricultural models can coexist. It is viable economics to cater to and invest in high-end products, which are inevitably linked to the diversity of regional identities and produce.

As for milk quotas, the big issue is not about getting the 2% increase right. I think we agree that the more important question is how to overhaul the CAP in response to future strategic challenges: growth, rural development, and the dire need to produce more and better food in Europe.

You can be assured that France will be proactive and bullish about both reform and the future of European farm policy when it takes responsibility for the presidency of the EU council later this year.

Michel Barnier
Minister of agriculture
Paris

SIR – I agree that milk quotas make a poor fit with the reformed CAP and the European Commission will not propose to extend them again. However, the system has had a huge influence on investment decisions for many years, and I cannot simply walk into my office one day and switch it off: there would be chaos.

My task now is to get us to the end of the quota system in 2015 with as few bumps in the road as possible. My proposal of a quota increase of 2% would give producers valuable extra freedom and is fully justified by market conditions. In a strong global market for dairy produce, it should not only be producers outside Europe that get to lick the cream.

Mariann Fischer Boel
European commissioner for agriculture
Brussels

Political judgment

SIR – Your leader assessing what Barack Obama would do as president was reasonable enough, until the following sentence: "A man who has never run any public body of any note is a risk" ("But could he deliver?", February 16th). May I ask what public body of any note has either Hillary Clinton or John McCain run? Since the answer is "none" (unless you count Mrs Clinton's disaster of a task force on health care) then it is not fair to label Mr Obama a risk if that risk is not unique to him.

Moreover, Mr Obama's campaign is the only one that hasn't either had to restructure in the face of resources unnecessarily squandered (Mr McCain), or required an infusion of large amounts of the candidate's own cash because of a failure to think past Super Tuesday (Mrs Clinton). Now who looks more likely to be the most fiscally responsible president?

Sarah Weinberg
Mercer Island, Washington

East is east

SIR – State-inspired mythologies about Russia's Byzantine roots notwithstanding, there is a lot of fertile soil for a hotch-potch of history in the budding Orthodox empire ("A Byzantine sermon", February 16th). Many a Slavic state is given to such mythologies as well. In these states the adoration of the supposedly glorious past in the East and the abomination of the ignoble future in the West go hand in hand with crumbling economies overseen by so many hard-boiled crooks.

Moscow as a new and improved Constantinople will serve them all, and well. What is worse, the new Byzantium will have ample support from a large segment of the intelligentsia. In short, pointing out glaring historical inaccuracies in Russian mythology, as you do, will be far from enough in years to come, for we are not dealing with history here. Rather, we are confronted by a resilient ideology of considerable vintage.

Ranko Bon
Motovun, Croatia

Church and state

SIR – I do not agree with your assessment that there should be a smaller official role for religion in Britain and for the Archbishop of Canterbury ("Sever them", February 16th). Rowan Williams was right to say that aspects of *sharia* law are already accommodated in Britain. *Sharia* law forbids exploitative rates of interest (it is also frowned upon in the King James Bible, which calls the practice "usury"). Consequently, the number of *sharia*-compliant financial packages has grown in response to Muslims' beliefs about interest, with some mortgage products even disposing of double stamp duty.

Phillip Rice
Stepney Synod
London

SIR – *The Economist* is to be applauded for suggesting that religion should not receive preferential treatment when it seeks to influence public policy. Religion, in all its forms, is but another form of vested special interest, like labour unions or business associations, and should be treated as such. Competing interests do bring different perspectives to public policy, but some of the privileges that religions enjoy are a disservice to all, and must be changed to ensure a level playing field for our attention and support in the battle of ideas.

Jon O'Brien
President
Catholics for Choice
Washington, DC

SIR – I have lived in Britain for 25 years and work closely on social and educational interfaith activities and I totally disagree with your analysis. Britain is a democratic country where the right to dissent is acknowledged and safeguarded at all levels. I have arguments with my Christian colleagues on some issues but we all recognise that we have more in common than our differences would indicate.

Syed Faiyazuddin Ahmad
Leicester Council of Faiths
Leicester

SIR – Your yah-boo depiction of Archbishop Williams as a subversive would-be theocrat seems to neglect British fair play in favour of French legalism. To suppress the free conduct of affairs between consenting individuals without a jolly good reason is, frankly, not cricket. The public arena should indeed be "open"—to maximum diversity of expression and conduct, whether stemming from canon law, *sharia*, or Debrett's. Let citizens, not secularcrats, choose.

Alex Henley
London

Flying into oblivion

SIR – I have difficulty with the claims made by James Hart about the manoeuvrability of Boeing's new flying tanker (Letters, February 16th). I doubt that such a laborious behemoth, filled with thousands of gallons of fuel, would have the ability “to dodge anti-aircraft artillery” or missiles. If an aircraft of that type finds itself in that kind of peril its greatest “need” will be to be somewhere else. Aerial refuelling takes place in uncontested skies or it doesn't happen at all.

Paul Nash
Oakton, Virginia

Economist.com WORLD EUROPE

Russia's economy

Smoke and mirrors

Feb 28th 2008 | KALUGA, MOSCOW AND NIZHNY NOVGOROD
From The Economist print edition

As Vladimir Putin stands aside (sort of), how much has he to do with Russia's booming economy—and how long can it last?

Eyevine

FIRST appeared the wooden kiosks, selling everything from vodka to stockings. Vladimir Bulanov, a burly entrepreneur from Nizhny Novgorod, built them in his workshop in 1991. Then came his first shop, trips abroad, fridges from Belarus, mandarin oranges from Cyprus. By 1995 he was rich, sporting a red tie and a white linen suit: an archetype of *Novy Russkiy*, drawing jokes and contempt. Mr Bulanov no longer wears that suit, and fails to drive a Bentley (his dream car) only because “neither society nor the roads are ready for it.” Five years ago he bought an old and bankrupt factory making heating elements for samovars and submarines, and installed new German machinery which he shows off with delight.

The emergence of genuine businessmen like Mr Bulanov, and their acceptance in society generally, may be Russia's biggest achievement—and one reason why the economy is growing at 7% a year. But this has nothing to do with Vladimir Putin, who is standing aside as president this week. Mr Bulanov is no fan of Mr Putin; he prefers freedom to fear and corruption. “The only things that will stop me”, he says, “are a bullet or a prison cell.” The future of Russia will be determined by the contest between men like him and the machinery of the state.

Even Mr Putin's critics are impressed by Russia's transformation in the past few years. A country that almost went bust ten years ago now boasts a $1.3 trillion economy, foreign-currency reserves of nearly $480 billion and a $144 billion stabilisation fund for surplus oil and gas revenue. Annual growth of real incomes has been in double digits. GDP per head has risen from less than $2,000 in 1998 to $9,000 today at current rates of exchange.

Never before have Russians shopped or travelled so much. Restaurants, mega-malls and airports are heaving; streets are choked with foreign cars. Nor is the wealth confined to Moscow; every other city now seems to have a decent hotel, an Italian restaurant and a Hugo Boss store. Mr Putin boasts that this is the result of his presidency, and implies that most Russians would back Dmitry Medvedev, his chosen successor, even if the election were free and fair. Asked by a foreign journalist why there is no political competition and why Mr Medvedev has not taken part in televised debates, Mr Putin says: “The salaries here are going up by 16%. There's the answer to your question.”

Yet the truth is that Russia's economy began its rebound 18 months before he became president. Behind it lie three factors: a revival of private initiative, oil prices that have risen fourfold during his presidency and macroeconomic stability. Only the third can be credited to Mr Putin. The economy is now more dependent on oil than ever. And the outlook is bleaker: a slowing world economy means that oil prices may not rise further, and could even fall.

A benign inheritance

According to Mr Putin, the state was barely functioning when he took over from Boris Yeltsin in 2000. One of his most bellicose speeches lambasted his predecessors in the 1990s who “acted against state and society, who served the interest of oligarchic groups and squandered the national wealth, those who led Russia to the mass poverty and corruption with which we are struggling to this day.”

In fact, Mr Putin came to power at an unusually benign moment. The debt crisis and devaluation of 1998 had flushed out the financial system, removed constraints on the rouble and enforced fiscal discipline. With much of the economy in private hands and most prices liberalised, recovery inevitably took off. By the end of 1999 Russia was already growing by more than 6% a year. In 2000 growth accelerated to 10%, a rate still not matched eight years later. Symbolically, four days before Mr Putin was officially elected as president, the first IKEA store opened in Moscow.

To be fair, at first Mr Putin worked hard to consolidate growth. His government simplified and cut taxes. Budget reform brought clarity and stopped the government making unrealistic pledges on spending. Mr Putin not only chose a liberal economist, Andrei Illarionov, as his economic adviser, but also listened to him. For the most part Russia used its oil windfall prudently, repaying debt, building up reserves and filling its stabilisation fund. Many of the reforms conceived in the 1990s were passed at last, including legislation to improve the judicial system and allow a free market in land. The benefits of Mr Putin's early efforts are still felt today.

Where did it go wrong? Mr Illarionov, who quit his post in 2005, argues that the breaking point was the attack on Yukos that began in mid-2003. The significance of the Yukos affair went beyond the destruction of Russia's largest oil company and the imprisonment of its boss, Mikhail Khodorkovsky. It dictated the country's entire economic and political course.

The attack on Mr Khodorkovsky was presented as a crackdown on the oligarchs. Yet it created a new, more powerful and less visible caste that began to play a dominant role in the economy. The share of crude-oil production controlled by state and semi-state companies doubled. Growth in oil output, which before the Yukos affair had been running at about 9% a year, slowed to just 1% by the end of 2007.

Worse, the destruction of Yukos negated any efforts to strengthen the rule of law. “The problem is not that the Russian legal system is weak,” says Vitaly Naishul, who watches Russian institutions. “The problem is that it does not exist. The Russian justice system has as much to do with justice as the Soviet system of trade with trade.” That problem is as old as Russia, but under Mr Yeltsin the courts, however corrupt, were at least independent of the Kremlin. Under Mr Putin, judges have again turned into bureaucrats who rubber-stamp dubious administrative decisions.

The destruction of Yukos and the redistribution of its assets to Rosneft, a quasi-state oil company chaired by Mr Putin's deputy chief of staff, showed that property rights count for little. “After Yukos nobody can feel safe,” says the owner of a factory making kitchen shelves in Kaluga. Instead of cultivating the rule of law, as Mr Putin promised, Russia was subjected to the rule of thugs, says Mr Illarionov. What followed was not nationalisation, but a series of police-assisted raids and takeovers of private firms by new oligarchs. The targets included not only oil and gas companies but also a titanium producer, an airport operator and lucrative bits of property. As *Vedomosti*, a business daily, complained, “The practice is so widespread, it is impossible to list all the cases.”

Webs of corruption

Andrei Sharonov, a liberal reformer who left the economics ministry last year, says he underestimated the impact of arbitrary bureaucratic decisions. “We have turned our back on healthy competition. The system rewards those who are closer to the centre of power, not those who work better. It is easier to get a competitor into a jail than to compete with him.” Businessmen complain that corruption, already rampant in the 1990s, is now more entrenched, and the sums involved are getting larger.

Corruption is of two kinds. One sort is driven by private firms and individuals who bribe officials to turn a blind eye to the rules. This allows businesses to get around a net of conflicting and outdated laws. “If everyone followed every rule and instruction in Russia, the country would grind to a halt,” says Mr Naishul. The other kind of corruption emanates directly from the Kremlin and benefits state officials and their friends who double up as businessmen. Both damage the country, but the second is more insidious.

The deterioration of Russian institutions has been tracked by the World Bank, Transparency International, the World Economic Forum and Freedom House. Russia's corruption is on a level with Togo's. Yet foreign and domestic investment keep rising, along with Russia's credit rating. A survey of 106 foreign firms in Russia last year showed that 82% were broadly satisfied with the investment climate. Russian businessmen may grumble, but they still put up their money. Last year fixed capital investment rose by a record 21%, leading some economists to talk of an investment boom.

A recent raid by tax police on a small company that sells liquid oxygen explains the paradox. The taxmen came just before the new year to demand 5m roubles ($204,550) for “irregularities” in the accounts. The owners pulled local strings and, after a short negotiation, cut the demand to 500,000 roubles. They paid and the taxmen left. As one owner says, “It was unpleasant but didn't hurt much. Our monthly profit is 800,000 roubles so the bribe was just over half that. If we hadn't paid, the taxmen would still be here and we would lose more.”

The construction market in Russia is growing by nearly 20% a year. With a profit margin of 25%, the liquid-oxygen company can afford to pay bribes to a growing number of bureaucrats. “The inadequacy of political competition, the lack of media freedom will be felt over time. But for now there is enough low-hanging fruit for people not to take notice of it,” says Christopher Granville, an analyst at Trusted Sources, a research firm.

The real cost is one of lost opportunities. Growth of 7% sounds good, but it is far below Russia's potential. Over the past few years, Russia has been outstripped (though from a lower base) by the former Soviet republics of Ukraine and Georgia, which have no oil. If Russia enjoyed the rule of law, was not stifled by inefficient monopolies such as the gas giant Gazprom and had roads rather than vague directions, its growth—given the oil boom—could surely have been in double digits.

The structure of the Russian economy remains skewed towards a few giant companies, mostly forged from Soviet-era assets. Small and medium-sized businesses contribute less than 15% of GDP. The cost of opening a business is higher than in most other countries. Only 5% of firms have been created in the past ten years, according to the World Bank. And start-ups do not seem to push up the productivity of incumbents, a sure sign of weak competition. In even more worrying contrast to the 1990s, polls show that half of young Russians want to work in the government rather than go into business.

Russia's business climate and red tape also deter potential new investors. Although foreign direct investment (FDI) doubled last year to $27.8 billion, that is still only 2.2% of GDP—half the level achieved in Ukraine. Half of FDI went into mineral resources, and only some of it was genuinely foreign. (Tax havens are still the top investors in Russia.)

A dangerous addiction

The share of oil and gas in Russia's GDP has increased, according to the Institute of Economic Analysis, from 12.7% in 1999 to 31.6% in 2007. Natural resources account for 80% of exports. Like a powerful drug, oil money has masked the pain caused to the Russian economy by the Kremlin. But the disease remains.

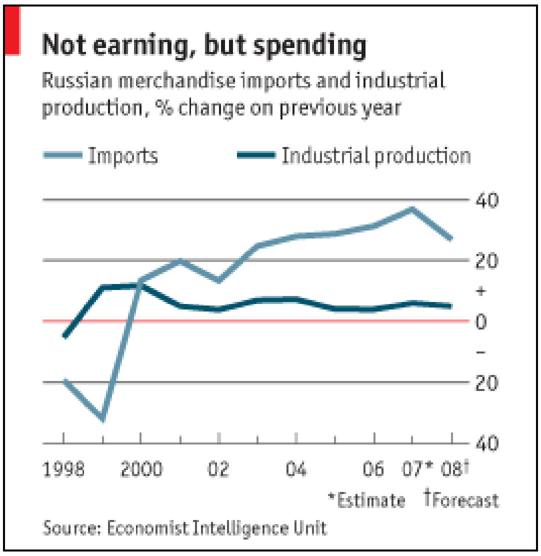
To appreciate the impact oil prices have on the economy, compare real GDP growth of about 7% with growth measured in international prices. In dollar terms, says Rory MacFarquhar of Goldman Sachs, Russia's economy has grown on average by 27% a year, the fastest of any big economy since 2000. The flow of petrodollars is fanning a massive consumption boom, making Russia the sixth-biggest market in Europe. Disposable incomes (and retail trade) have been growing twice as fast as GDP.

The problem, says Peter Aven, the head of Alfa Bank, is that Russia has failed to convert the oil stimulus into domestic production. Imports are growing much faster than manufacturing. The rapid real appreciation of the rouble is hurting Russia's producers, and many goods are of poor quality.

This is why Algeria says it wants to return 15 military jets it purchased from Russia.

Productivity remains far below that of most developed countries. In the first years after the 1998 crisis, labour and capital efficiency went up by 5.8% a year. But that growth was driven by using spare capacity left from Soviet times. Sustaining it will require more investment.

Meanwhile the economy, unable to digest the money generated by the oil-and-gas boom, is clearly overheating. Inflation moved into double digits in late 2007, pushed up by, among other things, a huge inflow of capital attracted by swelling reserves and the strong rouble. Unlike oil revenues, which can be partially channelled into the stabilisation fund, this money cannot easily be absorbed.



As Kirill Rogov of the Institute for the Economy in Transition explains, in most emerging markets the bulk of capital inflows come in as direct investment. In Russia, they take the form of loans. Investors clearly prefer to lend money to Russian companies, especially if they are state-controlled, rather than to invest directly. (In fact, FDI in sectors other than energy has fallen from 1.6% of GDP in 1999 to just 0.65% in 2007, according to Mr Illarionov.)

AP

Taking the credit on every channel

Russian corporate debt stands at $400 billion, only slightly below the official foreign reserves. By some estimates, about half this debt was accumulated by state-controlled banks and companies, such as Gazprom and Rosneft, in the course of taking over private assets and (in the case of Gazprom) buying up electricity-generating capacity. They were not spending money on their core business, or to boost productivity. Some state companies are now lobbying the Kremlin to pay off their debts. Cheap credit from foreign banks has oiled the emergence of Russia's state capitalism and its foreign expansion; but this economic model relies on rising oil prices and cheap money.

Officials have been trying to persuade themselves and others that Russia is an island of stability in a sea of economic troubles. But Yegor Gaidar, a liberal economist and former prime minister, says the Russian economy is highly sensitive to swings in the world economy. When global growth slows, oil and metal prices tend to fall and money flows out of emerging markets. (In January Russia saw a renewal of capital outflows.)

When the oil price is unpredictable and inflation is in double digits, spending more money seems unwise. Yet this is what Russia has been doing. After years of fiscal discipline, last year's budget saw spending rise by 20% in real terms. Over the past eight years spending on state bureaucracy and law-enforcement agencies has doubled as a percentage of GDP, and the number of bureaucrats has risen from 522,000 to 828,000.

The main beneficiaries of the spending increase last year were newly created state corporations, including those involved in nanotechnology and the 2014 winter Olympics—and those bureaucrats, who are skilled at enriching themselves. Russia ranks fourth in the world in creating new millionaires. A shiny new Bentley, spotted recently outside an expensive Moscow restaurant, carried a special pass on the windscreen linking it to the Supreme Court.

Posing harder questions

It is little wonder that the gap between the top 10% and the bottom 10% of the population is growing, along with a sense of injustice. Russians have turned a blind eye to all this because average incomes are rising. If the trend reverses, they may start to ask harder questions.

What happens next will depend on the government's flexibility. It could tap into reserves and the stabilisation fund. If the oil bonanza stops and the government continues to spend at its current pace, thinks Mr Gaidar, Russia's reserves will last for about three years at most. The alternative is to liberalise the economy, strengthen property rights and break up Gazprom. With Mr Putin's track record (and he has promised to be Mr Medvedev's prime minister), this second course is unlikely.

But Yevgeny Gavrilenkov, chief economist at Troika Dialog, says that swings in the balance of payments concentrate the minds of all Russian leaders. At the moment they can afford to be arrogant and aggressive. But if the oil price stabilises and money stops flowing in, the Kremlin may become a friendlier place. After a decade of growth, Russia is still only back to the level it reached just before the fall of the Soviet Union. And one thing is certain: it will not reach first-world prosperity, as promised by Mr Putin and Mr Medvedev, with third-world institutions. To grow further, it will need to dismantle the lawless system Mr Putin has created.

Economist.com
WORLD
UNITED STATES

Obamanomics

Dr Obama's patent economic medicine

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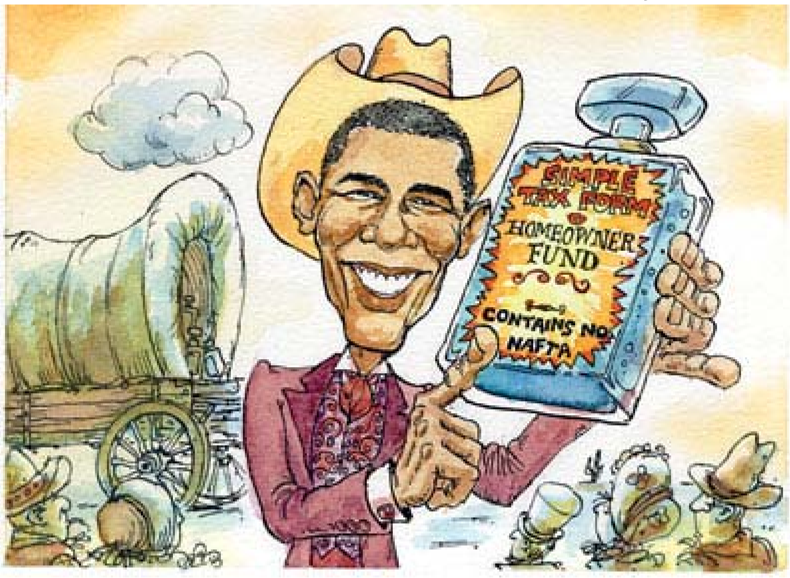
From The Economist print edition

Illustration by David Simonds



Is Barack Obama a populist, or just pretending to be one?

BUILD a better mousetrap and the world will beat a path to your door. The chap building inferior mousetraps, however, will go bust. Many people want the benefits of technology and trade without the disruption. Politicians often feed this delusion. Barack Obama is no exception.

He is not against technology, of course. That would sound stupid. Nor is he against Americans trading with other Americans. Nor, even, does he oppose trade with foreigners. But he has found an artful way of signalling to those who do that he agrees with them: he denounces NAFTA (the North American Free-Trade Agreement).

To many ears, this sounds like shorthand for denouncing globalisation—though that is not what Mr Obama actually says. More important, because NAFTA was signed by Bill Clinton, Mr Obama can blame his wife for it.

He does so in a reassuring tone of voice but in hysterical terms. During a debate this week in Ohio, where Mr Obama was wooing working-class whites before the state's primary on March 4th, he spoke of "entire cities that have been devastated as a consequence of trade agreements that were not adequately structured to make sure that US workers had a fair deal." To workers in a cold warehouse, he claimed that NAFTA has destroyed 1m American jobs, "including nearly 50,000 jobs here in Ohio". As president, he vowed, he will not "stand idly by while workers watch their jobs get shipped overseas."

Mrs Clinton finds this hard to parry. During the debate, she said she had been "a critic of NAFTA from the very beginning" but didn't say anything publicly out of loyalty to her husband's administration. No one believes this, not least because she publicly praised the deal several times. Mrs Clinton now says NAFTA was bad for America, that she always thought so and that Mr Obama is lying when he suggests otherwise. "Shame on you, Barack Obama," she added.

Mrs Clinton was right in the 1990s and is wrong now. Trade hurts some people, but helps many more. It raises overall income and allows Americans to buy a wider range of better goods more cheaply. And NAFTA has helped make Mexico less poor, which has contributed to its stability and democracy—something that should matter to Americans.

Mr Obama understands economics better than he lets on. In his book "The Audacity of Hope", he recognises that a tariff on imported steel may provide temporary relief to American steelmakers, but it will also make every American manufacturer that uses steel, from carmakers to housebuilders, less competitive. When put on the spot and asked whether he would repeal NAFTA, he says that would cause more job losses than gains.

So what would he do? Like Mrs Clinton (who calls for a "time-out" on trade deals, whatever that may mean), he is maddeningly vague. He would use the threat of pulling out of NAFTA, he says, to force Mexico and Canada to renegotiate. This is alarming them (see article) and raises wider worries about America's reliability as a trading partner. In all trade deals, he would demand tougher labour, environmental and safety standards. Whether this means small tweaks or the wholesale shutting out of imports remains to be seen.

Optimists shrug that politicians always talk populist claptrap during primaries and that Mr Obama has actually committed himself to very little. Pessimists reply that his eloquence encourages protectionist sentiment. Polls show that a majority of Americans believe that more foreign trade hurts American workers. One reason why they believe this is that politicians such as Mr Obama keep telling them that free trade means sending American jobs to China and getting toxic toys in return.

Who's the most liberal of them all?

Liberal voting record in the Senate*

100=most liberal

	Hillary Clinton Elected 2000		Barack Obama Elected 2004	
	Score*	Ranking†	Score*	Ranking†
2001	76.3	25th	-	-
2002	86.7	12th	-	-
2003	88.8	8th	-	-
2004	71.0	34th	-	-
2005	79.8	20th‡	82.5	16th
2006	70.2	32nd	86.0	10th§
2007	82.8	16th‡	95.5	1st

*Composite liberal score, representing how liberal the senators' voting records are on economic, social and foreign policy in relation to fellow senators †Liberal ranking among all senators ‡Tied with two others §Tied with one other

Source: *National Journal*

At best, it is hard now to imagine a President Obama using his golden tongue to revive global trade talks and push them forward. More likely, during the general election he will out-argue John McCain, a stout but not especially articulate free-trader, and nudge global opinion in a depressingly protectionist direction.

Mr Obama's other economic policies defy easy categorisation. His chief economic adviser, a respected young academic called Austan Goolsbee of the University of Chicago, is sensible and pragmatic. His plan to save millions of people from struggling to fill out their tax returns is a gem. Anyone who earns only a salary and bank interest, both of which are automatically reported to the taxman, will be sent a tax return that has already been filled in, which they can accept or reject. At a stroke, countless headaches would be averted. Mr Obama's health-care plan is more gradualist than Mrs Clinton's and may be more realistic (see article).

Influenced by Mr Goolsbee, Mr Obama offers a more measured response to the housing crisis than Mrs Clinton does. She would freeze interest rates on subprime mortgages for five years, which would hike rates for everyone else, accelerate the collapse of house prices and deter banks from lending to the impecunious. Mr Obama is content merely to set up a $10 billion fund to help homeowners avoid foreclosure, and to subsidise mortgage-interest payments for those who miss out on the existing tax break because they do not itemise their interest payments.

Mr Obama seems to approach economic questions with a keen intellect, an open mind and an aversion to radicalism. But he sometimes lets politics trump good sense. Last year, hoping for the support of Tom Harkin, a senator from the early-voting state of Iowa, he co-sponsored the Fair Pay Act, which would have obliged firms to pay men and women the same wages, not for the same work, but for work the government deemed “equivalent”. That bill failed but Mr Obama supports an almost equally bad one, the Patriot Employers Act, which would reward American companies for not expanding overseas.

Another concern, often raised by Republicans, is that Mr Obama would raise taxes. Mr Obama retorts that he would cut taxes for the middle class, and that he would pay for his health, infrastructure and other programmes partly by pulling American troops out of Iraq and partly by increasing taxes on the rich. Sceptics doubt that pulling out of Iraq will be easy, however. And they fret that Mr Obama's tax hikes for the rich, who already pay nearly all the income taxes in America, would have to be so high that the economy would suffer. By letting the Bush tax cuts expire, Mr Obama would hike the top rate of income tax from 35% to 39.6%. If he were to let the payroll tax apply to high incomes, too, he would add another 12.4%, split between employee and employer. Add state and local taxes, which are over 10% in New York City, and marginal tax rates for the well-off would be steep indeed.

Health care

Running for cover

Feb 28th 2008 | NEW YORK
From The Economist print edition

Will mandating the purchase of health insurance lead to universal coverage?

THE biggest domestic-policy difference between Hillary Clinton and Barack Obama almost certainly concerns health care. Mrs Clinton proposes individual mandates, which would require people to buy health insurance. To help the poor afford it , she promises subsidies from the government.

Boosters of the individual-mandate approach, with which Massachusetts is now experimenting, hope that it would lower average costs by forcing the many young and healthy people now currently without coverage to buy a health plan. As Mrs Clinton pointed out this week, such people do get health care, but in the most expensive way—by turning up at emergency rooms uninsured.

Mr Obama also insists he wants universal health coverage, but would require only some people to buy it: parents, who would face a mandate to purchase insurance for their children. Instead of requiring everyone to buy insurance, he hopes to reduce its cost so that people would buy it voluntarily. He argues that Mrs Clinton has not properly accounted for the cost of the subsidies needed to help the poor, and suggests that the many exemptions from the mandate likely to be given to the indigent would undermine her claim of universal coverage.

Who is right? It is too early to say for sure, but the experience so far in Massachusetts suggests that Mr Obama may be closer to the mark. The state's individual mandate has become law, but perhaps a fifth of its uninsured are likely to get a hardship waiver. The state has set up an insurance clearing-house with subsidised products in the hope of reining in health-cost inflation, but costs look set to soar again this year.

Look beyond Massachusetts to California, where the uninsured make up a bigger share of the population, and the theoretical advantages of an insurance mandate meet the hard realities of tight budgets. The staggering cost to the state was a big reason that Arnold Schwarzenegger's ambitious plan to extend universal health coverage with help from a mandate recently collapsed.

Mrs Clinton argued this week that the federal government “had more resources” than states had to finance her proposed shift to universal coverage. Maybe not, if a report issued by the official Centres for Medicare and Medicaid on February 25th is to be believed. The government's actuaries calculate that even without any new universal-care scheme, spending on health care in America will reach nearly 20% of GDP by 2017, up from about 16% last year, with Medicare spending nearly doubling over that period.

Polls

Obama by one. No, ten. No, five

Feb 28th 2008 | WASHINGTON, DC
From The Economist print edition

Why the polls have been so bad and what this tells you about the race

THE day before Super Tuesday Barack Obama seemed to have the edge in delegate-rich California. One survey from John Zogby, a pollster, showed Mr Obama leading Hillary Clinton by 13 points (49% to 36%). It was not to be. Mrs Clinton won California by ten points—and Mr Zogby was off by a whopping 23. Mr Obama has rebounded smartly. The pollsters' reputations will be harder to repair.

The average of published polls had Mr Obama beating Mrs Clinton by eight points in New Hampshire before the primary. The Illinois senator lost by two. On Super Tuesday, the polls on the Democratic side were wrong in California, Missouri, Massachusetts, Georgia and Alabama.

Mr Zogby explained his error by saying he had underestimated turnout among Hispanic voters, which was unusually high this year. Robert Blendon, a Harvard professor, argues that the high turnout among some groups in the Democratic primaries has confounded the screening techniques pollsters use to identify likely voters and the weighting they place on their results, which they base partly on previous years. The Democratic race has seen record-breaking turnouts in several states, buoyed by young, low-income and minority voters. In contrast, the Republican race has been more typical—and pollsters' numbers have been pretty accurate.

But Andrew Kohut, the president of the Pew Research Centre, a polling and research organisation, points out that everyone got New Hampshire wildly wrong. Mr Kohut speculates that the real problem lies in who picks up the phone. Pew released a report saying that pollsters have tended to overestimate Mr Obama's vote in states with relatively small black populations and underestimate it in states with a relatively high proportion of African-Americans. Why? Poor voters are less likely to answer poll questions than richer ones, Mr Kohut argues, and poor, white voters are less likely to vote for Mr Obama. Hence the industry-wide error in New Hampshire, which has a tiny black population.

Still, talk to nearly any Democratic primary voter and another factor becomes clear: volatility. A quarter of California's Democratic primary voters determined their final choice within three days of the vote. Pollsters are made fools of by last-minute shifts in voters' allegiances.

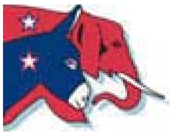
Mr Blendon argues that once the race becomes national, the importance of local demography will diminish and polling will get better. Mr Kohut points out that pollsters have a stellar record of forecasting presidential races. Perhaps, but with atypical candidates on the Democratic side, 2008 may yet be an outlier. For what it is worth, the polls show a tight race in Texas and a Clinton victory in Ohio.

The campaign trail

Primary colour

Feb 28th 2008
From The Economist print edition

Spoiler (1)
"Dissent is the mother of ascent. And in that context, I've decided to run for president."
Ralph Nader launches his bid. "Meet the Press", NBC, February 24th, three days before his 74th birthday



Spoiler (2)
"The only person excited today is John McCain, who will no longer be the oldest person in the race."
Donna Brazile, Al Gore's 2000 campaign manager, comments on Mr Nader's announcement. USA Today, *February 26th*

Not a spoiler (3)
"I listened carefully to those who encouraged me to run, but I am not—and will not be—a candidate for president."
Michael Bloomberg, Hizonner, writing in the New York Times, *February 28th*

Raging Bull
"Look, I'm the challenger, I'm the upstart. I'm the insurgent. She's, she's the champ...and, you know, if you're the title-holder then you don't lose it on points. You got to be knocked out."
Barack Obama takes a swing at Hillary Clinton. CNN.com, February 23rd

Extreme voting
"One is a supporter of Barack Obama, the other is a supporter of Hillary Clinton, and an argument of words turned bloody when one brother-in-law tried to choke the other and the victim then responded with a knife and stabbed his brother-in-law in the stomach."
Risa Ferman, district attorney in Pennsylvania. KYW1060.com, February 25th

Luddite
"Lifting whole passages from someone else's speeches is not change you can believe in. It's change you can Xerox."
Hillary Clinton on Barack Obama not keeping up-to-date with technological change, February 21st

Girly man
"I was not that upset. I didn't cry or anything."
Josh Romney, son of Mitt, hanging tough when his father ended his campaign. Deseret Morning News, *February 25th*

Bill's sweet tooth?
The Clinton campaign is the biggest donut consumer, spending almost $6,000 at various bakeries. The Obama campaign spent under $2,000; John McCain less than $1,000. Ex-candidate Rudy Giuliani burned through $5,100 at a single bakery in Las Vegas.
NYTimes.com, February 25th

Religion

Brand disloyalty

Feb 28th 2008 | WASHINGTON, DC
From The Economist print edition

America is a nation of spiritual shoppers

BARACK OBAMA is the son of a secular Christian mother and secular Muslim father. He spent time at a Muslim school in Indonesia. At Columbia University he was a student of Nietzsche. Later, he turned to God and joined an historically black Christian church in Chicago.

Mr Obama is clearly an unusual fellow. But his spiritual voyage is far from atypical. Two conclusions leap out from a huge new survey of the American religious landscape—based on interviews with no fewer than 35,000 people—from the Pew Forum on Religion and Public Life.

The first is that America remains an unusually religious country for an industrial nation. About eight in ten adults (78%) say that they belong to the Christian tradition in one of its manifestations and 5% say that they adhere to other faiths. The second is that the religious marketplace is extraordinarily fluid and dynamic.

Americans have less and less brand loyalty when it comes to God. More than one in four adults (28%) have swapped the religious tradition in which they were raised for another (eg, Catholicism to Protestantism or Judaism to “no religion”). Add changes within religious traditions to the mix (eg, from one type of Protestantism to another) and 44% of Americans belong to a religious tradition other than the one in which they were raised. People seem to accept religious diversity at home as much as in public: nearly four in ten (37%) of married Americans have a spouse with a different religious affiliation.

Why is America witnessing so much religious churning? The biggest reason is that it has a competitive religious marketplace. Churches compete for new members with the same enthusiasm that companies compete for customers. There are a huge variety of religious products on offer. Protestant America is highly fragmented: there are three major traditions (evangelicals account for 26% of adults, mainline Protestants for 18%; historically black churches for 7%) and hundreds of denominations. Immigration is adding new religions (Islam and Buddhism) to the mainstream.

America is also witnessing a striking rise in the number of people who claim to have no affiliation. Only 7% of Americans say that they were “unaffiliated” as children. But today 16% are unaffiliated, making them the fastest-growing “religious” group. They, too, are diversified: a quarter of unaffiliated Americans describe themselves as either atheists or agnostics. A majority of unaffiliated people describe themselves as professing no religion in particular. This group in turn is divided roughly equally between people who regard themselves as “secular” and those who describe themselves as religious but unattached. Unaffiliated does not necessarily mean irreligious.

Nor are unaffiliated Americans any more likely to stay connected to their lack of affiliation than other Americans are to their attachments. Over half of those who say they were unaffiliated at some point in their lives have now joined a church, temple or mosque.

Alexis de Tocqueville regarded religion as the foremost of America's political institutions because it acted as a constraint on Americans' tendency towards extreme individualism. That constraint seems to be diminishing by the day.

Ethanol and water

Don't mix

Feb 28th 2008 | MIAMI
From The Economist print edition

New reasons to be suspicious of ethanol

OFFICIALS in Tampa, Florida, got a surprise recently when a local firm building the state's first ethanol-production factory put in a request for 400,000 gallons (1.5m litres) a day of city water. The request by US Envirofuels would make the facility one of the city's top ten water consumers overnight, and the company plans to double its size. Florida is suffering from a prolonged drought. Rivers and lakes are at record lows and residents wonder where the extra water will come from.

They are not alone. A backlash against the federally financed biofuels boom is growing around the country, and “water could be the Achilles heel” of ethanol, said a report by the Minneapolis-based Institute for Agriculture and Trade Policy.

The number of ethanol factories has almost tripled in the past eight years from 50 to about 140. A further 60 or so are under construction. In 2007 President George Bush signed legislation requiring a fivefold increase in biofuels production, to 36 billion gallons by 2022.

This is controversial for several reasons. There are doubts about how green ethanol really is (some say the production process uses almost as much energy as it produces). Some argue that using farmland for ethanol pushes up food prices internationally (world wheat prices rose 25% this week alone, perhaps as a side-effect of America's ethanol programme). But one of the least-known but biggest worries is ethanol's extravagant use of water.

A typical ethanol factory producing 50m gallons of biofuels a year needs about 500 gallons of water a minute. Most of that goes into the boiling and cooling process, which is similar to making beer. Some water is lost through evaporation in the cooling tower and in waste discharge. All this is putting a heavy burden on aquifers in some corn-growing areas.

Residents went to court in Missouri to halt a $165m facility being built by Gulfstream Bioflex Energy LLC which was projected to draw 1.3m gallons of water every day from the Ozark aquifer. Projects are being challenged in Minnesota, Iowa, Nebraska, Kansas and in central Illinois, where eight ethanol facilities are situated over the Mahomet aquifer. Demand for corn is such that more land is also being ploughed up in drier regions of the Great Plains states to the west of the corn belt, where irrigation in required, increasing water demand further.

The good news is that ethanol plants are becoming more efficient. They now use about half as much water per gallon of ethanol as they did a decade ago. New technology might be able to halve the amount of water again, says Mike Fatigati, vice president of Delta-T Corp, a Virginia company which has designed a system that does not discharge any waste water. But others are sceptical. “There are things you can close loop [ie, recycle efficiently] and things you can't,” says Paul Greene, a senior director for biofuels with Siemens Water Technologies, designers of the water-purification technology used in ethanol factories. Perhaps ethanol just isn't as bio-friendly as it looks.

The beef business

Cows down

Feb 28th 2008 | OKLAHOMA CITY
From The Economist print edition

A recall reverberates down the food chain

JESS DROMGOLD of Hartshorne, Oklahoma, has a heavy moustache, a crushing handshake, and a raft of advice. Never keep a hired hand more than three years. Ranchers should humour their cows. Weaned steers fetch higher prices because they have been hardened by circumstance and do not bellow. “It's more inhumane for people to live in New York City than for cattle to live in a feed lot.”

But a darker side to the beef industry was revealed in January, when the Humane Society of the United States released a video showing sickening conditions at a California slaughterhouse. Cows too ill or injured to stand were shoved along by forklifts or dragged by their legs across the floor. Downer cows, as they are called, are unfit for human consumption. But many at the slaughterhouse run by the Hallmark/Westland Meat Packing Company were killed, processed, and their meat sent to the National School Lunch Programme. “They're going onto the plates of children,” said Wayne Pacelle, the head of the Humane Society.

On February 17th, the company recalled 143m pounds of beef—easily America's largest meat recall (the previous record was less than a quarter of that). The recall is contagious. Nestlé announced it would recall thousands of cases of Hot Pockets, a meaty snack, some of whose suppliers buy from Hallmark/Westland.

The agriculture department says there is no cause for alarm. Most of the meat was eaten long ago, and no one is known to have been made ill by it. But it is an additional blow to an industry with more than its share of troubles.

Producers are facing rising costs for feed and fuel, so even though beef prices are also rising, margins are tight. High prices make cheaper meat look more appetising. Pigs and chickens eat corn too, but they are not as gluttonous as cows, and they seldom have far to travel. Environmentalists complain that livestock farming is adding to greenhouse-gas production and water pollution. There were concerns over animal welfare even before the Humane Society's video.

Last year America had 21 beef recalls. Legislators are talking about centralising oversight of the food supply and increasing regulations: an additional burden on producers. But it might reassure consumers, assuming they have not already switched to salads.

John McCain's obstacles

No country for old men

Feb 28th 2008 | WASHINGTON, DC
From The Economist print edition

EPA

The Republican candidate has a difficult path to the White House

JOHN McCAIN, an enthusiastic gambler and inveterate collector of lucky charms, has the luck of the devil. For him to win the Republican nomination for president, Mike Huckabee had to beat Mitt Romney in Iowa, Rudy Giuliani had to pursue a deranged strategy, Fred Thompson had to contract narcolepsy, and the “surge” had to go well. Mr McCain has run the tables.

But will the senator's luck outlast the primary season? The past week or so has produced some ominous signs. On January 21st the *New York Times* ran a story alleging that Mr McCain had a too-close-for-comfort relationship with a female lobbyist. Four days later the Democratic National Committee filed a complaint with the Federal Election Commission, suggesting the McCain campaign had violated the law on spending restraints.

The short-term damage has been limited. The *New York Times* poisoned its own story by nods and winks. The debate about Mr McCain's campaign-finance behaviour is so convoluted that only lawyers understand it. The McCain campaign is now hoovering up more cash than ever, thanks to conservative rage at the “liberal media”.

Yet both stories point to a long-term problem: money, not sex. Mr McCain sells himself as a scourge of special interests and hammer of lobbyists. He also styles himself a hands-on reformer who has tried to fix America's campaign-finance system. For a presidential candidate, this might prove the equivalent of attaching a sign to your behind saying “Kick me”.

Mr McCain is no stranger to the world of lobbyists. Several members of his staff, including his campaign manager, Rick Davis, are lobbyists. So are about 60 of the most generous contributors to his campaign. The senator is not averse to taking lifts on corporate jets. The public-finance system Mr McCain helped design is so unwieldy that even the man who invented it finds it a nightmare.

The *New York Times* article points to another worry for Mr McCain: that swooning journalists may soon abandon him for a candidate even more to their liking. Mr McCain had no trouble wooing the media when his rivals were George Bush and Mitt Romney. A few hours shooting the breeze with the senator on the Straight Talk Express and most journalists are eating out of his hand. But what happens when his rival is the coolest kid in town?

Mr McCain's problems go further. In a normal year he would enjoy a huge advantage on national security. Mr McCain is a war hero who has spent most of his professional life cogitating on matters of war and peace. He is also a hawk in a country where hawkishness is normally considered a virtue. He was calling for “rogue state roll-back” in 1999 when Mr Bush was arguing for a more humble foreign policy (remember that?).

But this natural advantage has been upended by the Iraq war. Mr McCain is more closely identified with the war than anybody except Mr Bush and Dick Cheney. He was one of the loudest supporters of the surge. Exit polls show he is first choice among Republican primary voters whose top concern is Iraq. He has said it is “fine with me” if American troops remain in Iraq for “maybe a hundred years”.

But can you base a successful presidential bid on defending an unpopular war? Recent polls show that around two-thirds of registered voters want to bring the troops home within a year. That includes a third of Republicans as well as more than 90% of Democrats. The success of the surge has done almost nothing to reduce Americans' desire to leave Iraq to the Iraqis.

Mr McCain has recently bowed to public opinion on this. He has “clarified” his hundred-years remark (he was referring to a military presence rather than full-scale occupation). He has even suggested that America's involvement in Iraq will be “over soon” and that the insurgency will be handled by Iraqis. But this opens him up to charges of flip-flopping—or at least terminal confusion—on the issue that is at the heart of his campaign.

Mr McCain is on equally treacherous ground when it comes to domestic policy. The voters are in a strongly anti-Republican mood: they prefer Democrats on everything from health care to taxes. Democrats are more united than Republicans, who are at each other's throats over immigration and global warming. They are also more fired up: they have been raising more money and packing in bigger crowds than Republicans for over a year now.

The Dwight stuff

If Democrats were to deprive Mr McCain of the chance of running against Hillary Clinton, that would be the cruellest blow. Mrs Clinton would be a one-woman solution to the Republicans' problems, a guarantee that money will flow into the party's coffers and that true-red voters will troop to the polls. She has also proved to be an ineffective campaigner. It hardly bodes well for Mr McCain that he is using the same line of attack against Mr Obama—eloquent but empty—that Mrs Clinton has used, so far without stopping her rival's run of primary victories.

Dwight Eisenhower held on to the White House, in the face of Democratic majorities on Capitol Hill, because he was a war hero and national-security heavyweight. Mr McCain undoubtedly has a chance to repeat that feat. He has a natural constituency among white working-class men. His national-security credentials are second to none. But to pull it off he needs to halt Mr Obama's extraordinary political machine. Otherwise he risks looking like another Republican war-hero candidate—not Dwight Eisenhower, but the hapless Bob Dole, who lost in 1996.

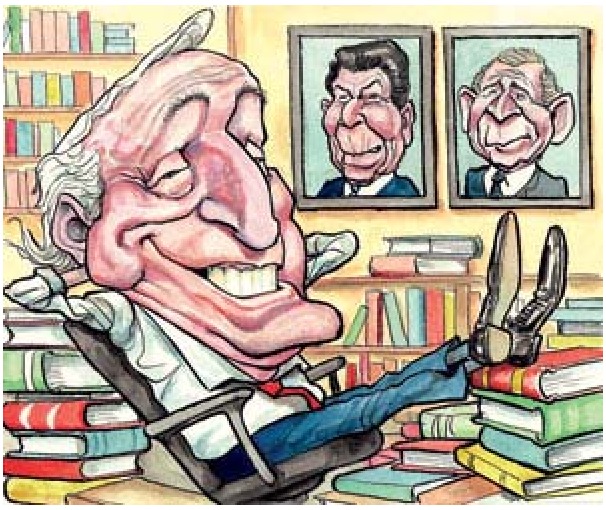
Lexington

The Buckley effect

Feb 28th 2008
From The Economist print edition

The grand old man of American conservatism died on February 27th

Illustration by Kevin Kallaugher



FEW intellectuals change the political weather. Even the most successful—an Arthur Schlesinger, say, or a J.K. Galbraith—usually tilt into the prevailing wind and enjoy the sail. William F. Buckley, who died in his study this week, aged 82, was a weather-changer.

When Mr Buckley decided to make his name as a conservative intellectual the phrase was an oxymoron. Dwight Eisenhower's Republican Party was as adamantly middle-of-the-road as it was middle-brow. Ike did not take it as an insult when people said of him that “his smile was his philosophy”.

At that time, America's tiny band of right-wing activists included a remarkable number of crackpots. Kent Courtney, the founder of the Conservative Society of America, accused Barry Goldwater of being “tainted by socialism”. The John Birch Society worried that Eisenhower was an agent of international communism. Lionel Trilling was right when he pronounced, in 1950, that “liberalism is not only the dominant, but even the sole, intellectual tradition” in the United States.

Mr Buckley devoted his life to changing this. He founded the *National Review* for the conservative intelligentsia at the tender age of 29. And he turned himself into a one-man opinion machine—tossing off articles and books with ease. All in all he wrote about 55. They included sailing memoirs and spy novels.

Mr Buckley famously said that the purpose of the *National Review* was to stand “athwart history, yelling ‘Stop’”. But in fact he did more than just stand athwart. He helped to drive the crazies out of the movement. He persuaded a disparate band of enthusiasts—free-marketers and social conservatives, anti-communists and American traditionalists—to band together against the liberal-collectivist foe. And he attracted a brilliant group of intellectuals to the conservative cause, including, for a while, such unlikely people as Garry Wills and Joan Didion, both (now) liberal writers.

What made Mr Buckley such a weather-changer? Money helped: his father was a multimillionaire and the young Buckley tapped both his personal wealth and his family's connections to finance his new magazine. But the young man also brought a rare collection of qualities to his self-appointed task.

The first was an appetite for bomb throwing. Just as radical artists like nothing better than baiting the bourgeoisie, Mr Buckley was at his happiest baiting the liberal establishment. His first book, “God and Man at Yale”, which he published shortly after graduating, took aim not just at his alma mater but at the academic elite in general.

The book turned him into a national sensation, with students queuing around the block to buy it and grandees such as McGeorge Bundy denouncing its author as a “twisted and ignorant young man”. It also linked two of the themes that were to drive forward the rise of the conservative movement—opposition to Keynesian economics (the man part of the book's title) and dislike of secular intellectuals (the God part).

Mr Buckley's second quality was his patrician style. He was a leading adornment of the establishment he liked to excoriate. He sailed his own boat and holidayed in St Tropez and St Moritz. He liked to hang out with such liberal luminaries as J.K. Galbraith (in the local book store in Gstaad, where they both went skiing, they would battle to get their books the best spot in the window). His wife, Patricia, was one of New York's leading socialites. Mr Buckley managed to be every liberal's favourite conservative as well as every conservative's favourite conservative.

Mr Buckley put both qualities on display in his television appearances. As the host of “Firing Line” from 1966 to 1999 he pioneered a type of televised political mud-wrestling that has since become tedious but was once regarded as ground-breaking. His style was all his own—he spoke in languid sentences, adorned with erudite allusions and polysyllabic flourishes, in an accent that had a touch of English-aristo. But he was not above raw populism. He was infamous for using the word “queer” on television (during a debate with Gore Vidal).

This belies the third thing that made him important—an inner core of seriousness. Mr Buckley was in it for more than the champagne. He was a committed Catholic, as were many of those around him at the *Review*. He felt that modern liberalism was corroding the foundation of Western civilisation, no less. For him, first things always came first.

Bill's children

Mr Buckley lived long enough to see the movement that he founded not just flourishing but ascendant. He saw two avowedly conservative presidents in the White House: Ronald Reagan, who was a close friend, and George W. Bush, who describes today's conservatives as “Bill's children”. He saw his fellow conservatives create a network of institutions from think-tanks to rival conservative magazines such as the *Weekly Standard*. The lone prophet became the father of a new establishment.

But it was not clear that he was entirely happy with the direction of the movement. He grew disillusioned with the Bush administration and even said publicly that, if America were a parliamentary system, Mr Bush would have resigned. He was uncomfortable with the Iraq war. He engaged in a fierce public debate with Norman Podhoretz over whether Iraq is, as Mr Podhoretz claims, “an amazing success”.

Indeed, Mr Buckley's death comes at a time when the movement he created is at one of its lowest points in decades. Conservatives are uncertain where to go after the Bush-Cheney years. They are showing signs of intellectual exhaustion. And the crackpots, once exiled, are beginning to define conservatism once again. The movement has never needed a new William F. Buckley more than it does today.

Canada and the United States

A fence in the north, too

Feb 28th 2008 | OTTAWA
From The Economist print edition

Eyevine

For Americans the border is a security issue; for Canadians it is a vital business artery that has become clogged

A DRAMA series about the border between Canada and the United States would once have induced a yawn in the television audience. Residents of both countries could pass through what was dubbed the world's longest undefended border, stretching for 8,900km (5,500 miles), with just a word or a wave of the hand. But since September 11th 2001, there has been enough action in the once-mundane world of Canadian customs and immigration officials to make “The Border” a surprise hit. Drivers of the 7m trucks and 30m cars estimated to enter the United States from Canada each year now face terrorist watch-lists and increased cargo inspections. Since January 31st, they must also show proof of citizenship.

The problem, argues Paul Frazer, a former Canadian diplomat who is now a consultant, is that Americans see the border as a security issue whereas for Canadians it is an economic issue. “So we are constantly working at cross purposes,” he says.

In a joint report last month, the chambers of commerce in both countries said they were increasingly worried about the impact of these measures on trade. Increased inspections, rising fees and longer waits are making the border “thicker, stickier, and more costly”, says Perrin Beatty of the Canadian chamber. Others argue that all this is starting to undermine the North American Free-Trade Agreement (NAFTA), which also includes Mexico.

Two-way trade last year totalled C$625 billion ($582 billion). Hardest hit are integrated industries such as carmaking. Before 2001 it made sense to shuttle parts back and forth between plants on opposite sides of the border in order to produce a finished vehicle. Now the stickier border is adding to the troubles of Detroit's uncompetitive carmakers. A ship carrying 4,000 cars from Asia landing on the west coast of the United States undergoes just one inspection; the components in a car made in North America will, all told, have gone through thousands, notes Jayson Myers of Canadian Manufacturers and Exporters, an industry body.

Some Canadian companies have responded by lengthening delivery schedules or setting up warehouses across the border to stockpile parts. Carmakers are relying more on parts from the same side of the border. “Just-in-case is replacing just-in-time,” noted a recent study by the Conference Board of Canada, a business think-tank. China has surpassed Canada as America's largest single source of imports. Some Canadian firms are seeking new markets overseas. Exports to the United States fell in 2007 (though they still account for three-quarters of the total).

The thicker border affects everyday life as well as business. Volunteer firemen from Quebec racing to fight a hotel blaze in upstate New York late last year were detained so long at the border that by the time they reached the scene the building had burned to the ground. After a Canadian ambulance carrying a patient requiring emergency surgery was stopped en route to Detroit, Stockwell Day, the security minister, asked Michael Chertoff, his American counterpart, to review border procedures. He may get short shrift: Mr Chertoff said recently that more than a dozen suspected terrorists had been apprehended trying to cross the northern border and that he worried more about Canada than Mexico. A DVD docudrama "Last Best Chance", made in 2005, shows terrorists driving an atomic bomb across the border from Canada.

Canadians reckon there are secure ways to unclog the border. Jim Prentice, the industry minister, wants to build a new bridge between Windsor and Detroit to supplement the existing one and a tunnel, both dating from the 1920s. He also wants to harmonise regulations. That might allow pre-clearance centres for goods, sited away from the border. Officials from each country use different radio frequencies, hindering communication. Canada requires American agents to deposit their sidearms at specified border crossings even if they are in hot pursuit of criminals.

Unsnagging bureaucratic barbed wire was supposed to be the job of the Security and Prosperity Partnership, announced with much fanfare by the leaders of the three NAFTA countries in 2005. But little has been achieved. Although there have been some small improvements, Canadian business leaders express disappointment with the slow pace of progress.

It does not help that NAFTA has become a swear word in the United States, not just in far-right circles but also in the campaign for the Democratic nomination. Mexico and its migrants loom much larger than Canada as a bugbear in middle America, but both countries are affected by declining support for an integrated North America. Canadian officials do not expect their American counterparts to push hard for free trade or unsnagging the border. More delays loom next year, when the United States will require returning American travellers to show passports at land borders. Not surprisingly, the makers of the soap about the border are planning a second series.

Cuba

Young blood

Feb 28th 2008 | HAVANA
From The Economist print edition

An appearance of continuity and hints of change

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Any expectation of a bold generational leap was quashed by the selection as Raúl's deputy of José Ramón Machado Ventura. Aged 77, Mr Machado is a year older than Raúl and fought at his side in the revolutionary war of 1956-58. There had been much speculation that the number two job might go to Carlos Lage, who oversaw economic reforms in the 1990s. But Mr Lage keeps his job as de facto prime minister, and some Cuba-watchers see in Mr Machado's selection a need to show unity while Raúl pushes through changes.

Whereas Fidel tried to manage everything himself, Raúl is a tidy administrator and a delegator. He plans to streamline the government, abolishing some agencies. The aim, he says, is “to reduce the enormous quantity of meetings, co-ordinations, permissions, conciliations, dispositions, regulations, circulars, etc, etc.” He promised, too, to scrap some of the many rules that circumscribe daily life. There is speculation that he could make it easier for Cubans to travel abroad, and let them stay in tourist hotels in Cuba, for example.

In his speech, Raúl also gave broad hints of economic changes. He recalled a commitment by Fidel in 2005 gradually to revalue the peso. Since many prices are set in hard currency, that is essential if wages are to rise above their average of $20 a month. This would take time, he said, but would involve moving away from the state-run rationing system and taking more account of wages and prices. That amounts to a move towards market mechanisms. And he praised decentralisation.

Decoded, this seems to signal a resumption of the economic reforms of the 1990s, later partly reversed by Fidel. Probable measures include further distribution of land to private farmers, more licences for family businesses, and perhaps allowing retired doctors to provide health services. But Raúl insisted that changes would be “within socialism”. He put much stress on greater efficiency and on enforcing a stricter work ethic as the route to higher living standards. There will be no explicit imitation of China and Vietnam and their open embrace of the market—even if many expect this to happen in practice.

At any rate, change will be slow. Officials say they want economic growth but not growing inequality. “Everyone agrees that things have to change,” says Max Lesnick, a Cuban-American radio commentator who has friendly relations with the Castros' government. “What they haven't worked out is how to do it.”

Venezuela

Propaganda, not policy

Feb 28th 2008 | CARACAS
From The Economist print edition

Hugo Chávez has not ended illiteracy

Get article background

FOR most of her life, Ana Silva was illiterate, even though she completed primary school. Then she joined Misión Robinson, a literacy programme organised by Venezuela's president, Hugo Chávez. Once a hospital cleaner, she is now a nursing auxiliary and hopes to study social work in Cuba. Her colleagues at work no longer have to help her decipher her payslip. “We live better,” she says. “We live like people.”

Mr Chávez's supporters would like the world to believe that Ms Silva's story is typical of the way their hero has revolutionised the lives of his country's poor. Sadly, there is growing evidence that in fact it is exceptional.

The literacy scheme was one of a clutch of social “missions” organised by Mr Chávez in 2003, when he faced possible defeat in a recall referendum on his presidency. The government claims that by October 2005 it had all but eliminated illiteracy. That claim has become a centrepiece of the international propaganda effort on behalf of Mr Chávez's “revolution”. But there is no data to support it. Many educationalists doubt it. Even the government itself has retreated from its initial figure of “less than 1% illiteracy” to a figure of around 4%, though it is not clear whether this refers just to adults or to the total population.

It is notoriously difficult to obtain precise literacy figures from census data, which rely on self-assessment. But Francisco Rodríguez of Wesleyan University in Connecticut and Daniel Ortega of IESA, a Caracas business school, have used household surveys from the national statistical institute to assess the programme. In an article in the latest issue of *Foreign Affairs*, Mr Rodríguez says that they found “little evidence” of any “statistically distinguishable effect on Venezuelan illiteracy”. Where the government says it taught 1.5m, the study found that only 1.1m were illiterate to begin with, and that the fall over the 2003-05 period was less than 100,000. Even this improvement could largely be explained by a long-term demographic trend (many illiterate adults are elderly and die off).

Adán Chávez, who is the education minister as well as the president's brother, has complained of statistical “manipulation” by the government's foes. But Mr Rodríguez, for one, is no reactionary; he was the chief economist of Venezuela's National Assembly in 2000-04, and was once a *chavista* sympathiser.

Last year the statistics institute launched its own study on the impact of the social missions. This was supposed to be ready by January. But delays in buying equipment mean it has yet to start, according to Irene Gurrea, the economist in charge. Asked if there were any reliable statistics on the impact of Misión Robinson, Ms Gurrea said: “As far as we know, no—that's why we're doing the study.”

Staff of an older literacy programme run by Fe y Alegría, a Catholic charity, say they continue to enroll students. In Machiques, near the Colombian border, 100 joined in the past semester. They say that up to 40% of the Warao Indians in the Orinoco delta are illiterate. In 2005 Mr Chávez told local officials to declare their towns officially “illiteracy free”. Knowing this to be untrue, the mayor of Machiques resisted, but gave in to pressure, according to Jesús Vilorio, who works for Fe y Alegría.

It is not hard to find individuals like Ms Silva who say their lives were changed by Misión Robinson. But the missions have gone hand-in-hand with neglect of schools and hospitals. Mr Rodríguez estimates that Robinson spent $1,000 for each of its literate graduates, compared with around $60 for other literacy schemes in Latin America. At the least, that money could have been better spent.

Cuba

Young blood

Feb 28th 2008 | HAVANA
From The Economist print edition

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Canada and the United States

A fence in the north, too

Feb 28th 2008 | OTTAWA
From The Economist print edition

Eyevine

For Americans the border is a security issue; for Canadians it is a vital business artery that has become clogged

A DRAMA series about the border between Canada and the United States would once have induced a yawn in the television audience. Residents of both countries could pass through what was dubbed the world's longest undefended border, stretching for 8,900km (5,500 miles), with just a word or a wave of the hand. But since September 11th 2001, there has been enough action in the once-mundane world of Canadian customs and immigration officials to make “The Border” a surprise hit. Drivers of the 7m trucks and 30m cars estimated to enter the United States from Canada each year now face terrorist watch-lists and increased cargo inspections. Since January 31st, they must also show proof of citizenship.

The problem, argues Paul Frazer, a former Canadian diplomat who is now a consultant, is that Americans see the border as a security issue whereas for Canadians it is an economic issue. “So we are constantly working at cross purposes,” he says.

In a joint report last month, the chambers of commerce in both countries said they were increasingly worried about the impact of these measures on trade. Increased inspections, rising fees and longer waits are making the border “thicker, stickier, and more costly”, says Perrin Beatty of the Canadian chamber. Others argue that all this is starting to undermine the North American Free-Trade Agreement (NAFTA), which also includes Mexico.

Two-way trade last year totalled C$625 billion ($582 billion). Hardest hit are integrated industries such as carmaking. Before 2001 it made sense to shuttle parts back and forth between plants on opposite sides of the border in order to produce a finished vehicle. Now the stickier border is adding to the troubles of Detroit's uncompetitive carmakers. A ship carrying 4,000 cars from Asia landing on the west coast of the United States undergoes just one inspection; the components in a car made in North America will, all told, have gone through thousands, notes Jayson Myers of Canadian Manufacturers and Exporters, an industry body.

Some Canadian companies have responded by lengthening delivery schedules or setting up warehouses across the border to stockpile parts. Carmakers are relying more on parts from the same side of the border. “Just-in-case is replacing just-in-time,” noted a recent study by the Conference Board of Canada, a business think-tank. China has surpassed Canada as America's largest single source of imports. Some Canadian firms are seeking new markets overseas. Exports to the United States fell in 2007 (though they still account for three-quarters of the total).

The thicker border affects everyday life as well as business. Volunteer firemen from Quebec racing to fight a hotel blaze in upstate New York late last year were detained so long at the border that by the time they reached the scene the building had burned to the ground. After a Canadian ambulance carrying a patient requiring emergency surgery was stopped en route to Detroit, Stockwell Day, the security minister, asked Michael Chertoff, his American counterpart, to review border procedures. He may get short shrift: Mr Chertoff said recently that more than a dozen suspected terrorists had been apprehended trying to cross the northern border and that he worried more about Canada than Mexico. A DVD docudrama “Last Best Chance”, made in 2005, shows terrorists driving an atomic bomb across the border from Canada.

Canadians reckon there are secure ways to unclog the border. Jim Prentice, the industry minister, wants to build a new bridge between Windsor and Detroit to supplement the existing one and a tunnel, both dating from the 1920s. He also wants to harmonise regulations. That might allow pre-clearance centres for goods, sited away from the border. Officials from each country use different radio frequencies, hindering communication. Canada requires American agents to deposit their sidearms at specified border crossings even if they are in hot pursuit of criminals.

Unsnagging bureaucratic barbed wire was supposed to be the job of the Security and Prosperity Partnership, announced with much fanfare by the leaders of the three NAFTA countries in 2005. But little has been achieved. Although there have been some small improvements, Canadian business leaders express disappointment with the slow pace of progress.

It does not help that NAFTA has become a swear word in the United States, not just in far-right circles but also in the campaign for the Democratic nomination. Mexico and its migrants loom much larger than Canada as a bugbear in middle America, but both countries are affected by declining support for an integrated North America. Canadian officials do not expect their American counterparts to push hard for free trade or unsnagging the border. More delays loom next year, when the United States will require returning American travellers to show passports at land borders. Not surprisingly, the makers of the soap about the border are planning a second series.

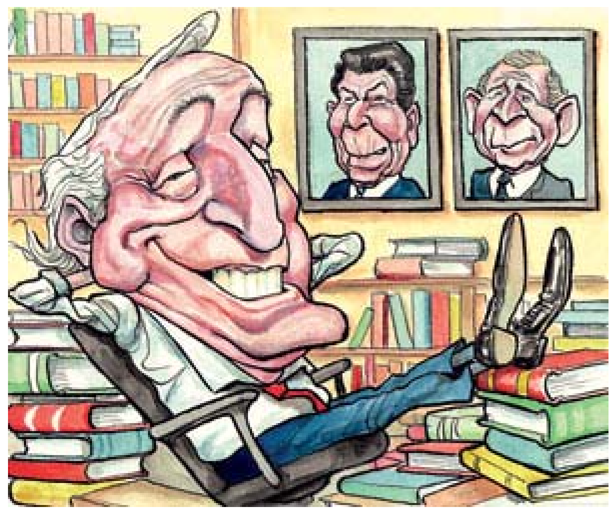
Lexington

The Buckley effect

Feb 28th 2008
From The Economist print edition

The grand old man of American conservatism died on February 27th

Illustration by Kevin Kallaugher



FEW intellectuals change the political weather. Even the most successful—an Arthur Schlesinger, say, or a J.K. Galbraith—usually tilt into the prevailing wind and enjoy the sail. William F. Buckley, who died in his study this week, aged 82, was a weather-changer.

When Mr Buckley decided to make his name as a conservative intellectual the phrase was an oxymoron. Dwight Eisenhower's Republican Party was as adamantly middle-of-the-road as it was middle-brow. Ike did not take it as an insult when people said of him that “his smile was his philosophy”.

At that time, America's tiny band of right-wing activists included a remarkable number of crackpots. Kent Courtney, the founder of the Conservative Society of America, accused Barry Goldwater of being “tainted by socialism”. The John Birch Society worried that Eisenhower was an agent of international communism. Lionel Trilling was right when he pronounced, in 1950, that “liberalism is not only the dominant, but even the sole, intellectual tradition” in the United States.

Mr Buckley devoted his life to changing this. He founded the *National Review* for the conservative intelligentsia at the tender age of 29. And he turned himself into a one-man opinion machine—tossing off articles and books with ease. All in all he wrote about 55. They included sailing memoirs and spy novels.

Mr Buckley famously said that the purpose of the *National Review* was to stand “athwart history, yelling ‘Stop’”. But in fact he did more than just stand athwart. He helped to drive the crazies out of the movement. He persuaded a disparate band of enthusiasts—free-marketers and social conservatives, anti-communists and American traditionalists—to band together against the liberal-collectivist foe. And he attracted a brilliant group of intellectuals to the conservative cause, including, for a while, such unlikely people as Garry Wills and Joan Didion, both (now) liberal writers.

What made Mr Buckley such a weather-changer? Money helped: his father was a multimillionaire and the young Buckley tapped both his personal wealth and his family's connections to finance his new magazine. But the young man also brought a rare collection of qualities to his self-appointed task.

The first was an appetite for bomb throwing. Just as radical artists like nothing better than baiting the bourgeoisie, Mr Buckley was at his happiest baiting the liberal establishment. His first book, “God and Man at Yale”, which he published shortly after graduating, took aim not just at his alma mater but at the academic elite in general.

The book turned him into a national sensation, with students queuing around the block to buy it and grandees such as McGeorge Bundy denouncing its author as a “twisted and ignorant young man”. It also linked two of the themes that were to drive forward the rise of the conservative movement—opposition to Keynesian economics (the man part of the book's title) and dislike of secular intellectuals (the God part).

Mr Buckley's second quality was his patrician style. He was a leading adornment of the establishment he liked to excoriate. He sailed his own boat and holidayed in St Tropez and St Moritz. He liked to hang out with such liberal luminaries as J.K. Galbraith (in the local book store in Gstaad, where they both went skiing, they would battle to get their books the best spot in the window). His wife, Patricia, was one of New York's leading socialites. Mr Buckley managed to be every liberal's favourite conservative as well as every conservative's favourite conservative.

Mr Buckley put both qualities on display in his television appearances. As the host of “Firing Line” from 1966 to 1999 he pioneered a type of televised political mud-wrestling that has since become tedious but was once regarded as ground-breaking. His style was all his own—he spoke in languid sentences, adorned with erudite allusions and polysyllabic flourishes, in an accent that had a touch of English-aristo. But he was not above raw populism. He was infamous for using the word “queer” on television (during a debate with Gore Vidal).

This belies the third thing that made him important—an inner core of seriousness. Mr Buckley was in it for more than the champagne. He was a committed Catholic, as were many of those around him at the *Review*. He felt that modern liberalism was corroding the foundation of Western civilisation, no less. For him, first things always came first.

Bill's children

Mr Buckley lived long enough to see the movement that he founded not just flourishing but ascendant. He saw two avowedly conservative presidents in the White House: Ronald Reagan, who was a close friend, and George W. Bush, who describes today's conservatives as “Bill's children”. He saw his fellow conservatives create a network of institutions from think-tanks to rival conservative magazines such as the *Weekly Standard*. The lone prophet became the father of a new establishment.

But it was not clear that he was entirely happy with the direction of the movement. He grew disillusioned with the Bush administration and even said publicly that, if America were a parliamentary system, Mr Bush would have resigned. He was uncomfortable with the Iraq war. He engaged in a fierce public debate with Norman Podhoretz over whether Iraq is, as Mr Podhoretz claims, “an amazing success”.

Indeed, Mr Buckley's death comes at a time when the movement he created is at one of its lowest points in decades. Conservatives are uncertain where to go after the Bush-Cheney years. They are showing signs of intellectual exhaustion. And the crackpots, once exiled, are beginning to define conservatism once again. The movement has never needed a new William F. Buckley more than it does today.

Romantic fiction in India

Sari-rippers

Feb 28th 2008 | DELHI
From The Economist print edition

India and slushy novels: a match made in heaven?

FOR more than 50 years, young Indian women have slipped into Lakshmi Book Store in central Delhi to request tales of lantern-jawed heroes and the beauties they unhinge with a glance. But until recently fresh imported Mills & Boon romances were often unavailable, says Ashim Sagar, the shop's owner. Today, however, he can point to a row of gaudy pink books, with titles such as “Bedded for the Italian's Pleasure” and “The Greek Tycoon's Defiant Bride”.

Indian women have been faithful to Mills & Boon romances, which are 100 years old this year, since the *raj*, but protectionist laws limited foreign companies' access to the market. However, since 2005 the government has allowed foreign firms to own 100% of non-news publications; and, as a result, Mills & Boon has set out to seduce an estimated market of 20m readers of English.

In February, it launched an operation in Mumbai. Every month it will publish ten new titles, with a 99-rupee ($2.50) price tag. The books will be chosen for India from the international range, but will not include the “Blaze” series, which features lesbianism and bondage.

India's still conservative sexual mores are one reason the books are popular; the semi-erotic romances have long been a source of informal sex education. Their fondness for love that breaches class distinctions has resonance in a caste-ridden society. And the formulaic plots are familiar to fans of Bollywood. “Boy meets girl; there's a conflict; it's overcome; happy ending,” says Andrew Go, head of Indian operations. He adds that as more middle-class women go out to work, they have more cash, “and a greater need for 'me time'. There's a lot of talk of 'me time' in India these days.”

More liberal publishing laws may change the books, as well as the business. Last year Condé Nast launched *Vogue India*. It is unmistakably Indian; one article weighed the pros and cons of the sari and the cocktail dress. Mills & Boon may yet go native: Mr Go says he might use Indian authors, settings and themes, if readers want. Indian tycoons' brides might start getting uppity too.

South Korea's new president

Chilly welcome

Feb 28th 2008 | SEOUL
From The Economist print edition

Just sworn in, Lee Myung-bak already seems out in the cold

HIS thunder stolen internationally by the arrival of the New York Philharmonic in Pyongyang (see article), Lee Myung-bak was sworn in as South Korea's 17th president on February 25th. In freezing weather in Seoul, Mr Lee pleaded for support. The audience, mostly from his Grand National Party (GNP), dutifully applauded—but with little enthusiasm. The president, elected last December, has made a poor start to his five-year term.

Mr Lee, cleared this month of any wrongdoing in a failed investment scheme, nevertheless faces public suspicion over the past business dealings that made him a multimillionaire. And some of his nominees for cabinet posts are already under clouds. Three of his ministerial choices—for sex equality, “unification” (ie, dealings with North Korea) and the environment—have resigned over criticism of their property dealings. This is a highly sensitive issue in Seoul, where many cannot afford to buy their own homes. Some of his nominees' children are foreign citizens. One was thus able to dodge the mandatory military service. This has raised hackles. Most South Koreans cannot afford to send their children abroad to acquire foreign passports.

Most economists think Mr Lee's bold promise of 7% annual growth is optimistic. His plan to build a canal system on the peninsula has united a coalition of civic and political groups in opposition. And his call for a “pragmatic not ideological'' relationship with North Korea has perturbed American leaders. In addition, Mr Lee has had to scale back his plans to trim the bureaucracy. Instead of 13 government ministries there will be 15, down from 18 under his predecessor, Roh Moo-hyun.

The president's difficulties are compounded by his shallow political base. In a pun on the name of a famous actress, South Koreans call it “Ko So Young”. “Ko” refers to his alma mater, Korea University, which has supplied him with prospective ministers and aides; “So” to the church he attends; and “Young” to the south-east of the Korean peninsula, which voted for him in huge numbers largely because Mr Roh is widely loathed in the region.

Even within the GNP, Mr Lee has few allies. Party heavyweights have long viewed him as an upstart without their own conservative convictions. Mr Lee is indeed a pragmatist. His landslide victory in December owed much to his success during his time as Seoul's mayor in solving practical problems, such as his reorganisation of the capital's traffic system.

Park Geun-hye, whom Mr Lee defeated to become the GNP's presidential candidate thanks to its system of open primaries, still commands more support within the party. She is engaged in a fierce struggle with him to have her nominees chosen as the GNP candidates at April's legislative elections. If she wins, or the GNP loses the election, the new president's legislative programme could be stymied.

Mr Lee is a somewhat remote and cold figure. He now needs to make himself popular. But both the economic and political climates on the peninsula seem to be worsening. Even when the snow that blanketed Seoul within hours of his taking the oath of office thaws, South Koreans may not warm to him.

Thailand

Thaksin comes home

Feb 28th 2008 | BANGKOK
From The Economist print edition

To a mixed reception in Bangkok, and a worsening insurgency in the south

EPA

Welcome back

IT HAS been Thaksinism in all but the presence of the man himself. Since taking office in early February, Thailand's new government has pursued policies almost identical to those of Thaksin Shinawatra, a former prime minister ousted by a 2006 military coup. On February 28th the missing ingredient arrived, as Mr Thaksin flew in to a rapturous reception at Bangkok's Suvarnabhumi airport, ending his exile. After touching the tarmac with his forehead, he was taken to the Supreme Court and granted bail on corruption charges. After the coup he was banned for five years from politics, which, to widespread scepticism, he anyway claims to have given up. But he remains popular, and his loyalists in the People's Power Party (PPP) romped home at the ballot box last December.

Samak Sundaravej, the prime minister and self-confessed "proxy" for Mr Thaksin, has been following his mentor's script: promising an expansion of rural micro-credit and small-business loans, a debt freeze for farmers, and big spending on infrastructure and public housing. He plans to revive Mr Thaksin's popular but controversial crackdown on drug dealers, which saw 2,500 people killed in 2003-04. And he has echoed his confrontational approach to a simmering insurgency in the Muslim-majority south, bordering Malaysia. Mr Samak has brushed aside questions about the death of 78 Muslim demonstrators in police custody in 2004.

A PPP-led government has taken office despite fears that the army or judiciary might thwart the popular will. However, the worries revived this week when the Election Commission found Yongyuth Tiyapairat, the speaker of the lower house of Parliament, guilty of vote-buying. If the courts find he was acting on behalf of the PPP, it risks disbandment.

As political tensions mount in Bangkok, the new government is neglecting one of Thailand's biggest problems: the separatist insurgency in the south. More than 2,800 people have died since January 2004, mostly civilians slain by shadowy gunmen or caught in bombings. Terrified Buddhists have fled insurgent zones or joined trigger-happy militias. Local Muslims who side with security forces become marked men. Militants sometimes behead victims and set bodies ablaze. Public schools, seen as symbols of Bangkok's rule, suffer repeated arson attacks and drive-by shootings of teachers. Southern Thailand is now among the most lethal conflicts in South-East Asia.

Since taking office Mr Samak has welcomed a proposal to disarm civilians and some soldiers and police in the south, but slapped down a minister who talked of giving the region autonomy. Politically, promising to solve a messy conflict with deep roots and few votes is a risky move. But the cost of inaction could be high. Most analysts believe that despite the avowed Islamism of the insurgents this is primarily an ethnic-separatist fight of Malays against Thais, rather than part of any international *jihad*. But letting such groups run wild is hardly a recipe for regional stability.

Naturally, the Thai army reckons it can lick the militants. Last year it launched its own "surge" in response to a spike in roadside bombings, pouring more soldiers into the south and resorting to mass arrests under emergency laws introduced by Mr Thaksin in 2005. Thousands of Muslim suspects were sent to army re-education camps. Yet the presence of more than 30,000 soldiers and police, as well as paramilitary units, has not halted the violence. In January the number of killings rose sharply to 55. Innocents wrongly detained at army camps, where human-rights groups say torture is rife, are eventually released, presumably ripe for recruitment to the separatist cause.

Pakistan

Coming to terms

Feb 28th 2008 | LAHORE
From The Economist print edition

Musharraf is down but not out; Zardari is up but not in

SO FAR so good. Fears that Pakistan's general election on February 18th might lead to prolonged confrontation and protest have as yet proved unfounded. A surprisingly fair poll saw the humbling of the Pakistan Muslim League (Q), or “king's party”, loyal to President Pervez Musharraf. In votes nationwide, the PML(Q) came second only to the Pakistan People's Party (PPP) of the late Benazir Bhutto, a former prime minister, assassinated last December. But the king's party kept just one-quarter of the seats in the national and provincial parliaments. Mr Musharraf, widely seen in Pakistan as the villain of the piece, has admitted defeat and promised to step back to become a “father-figure”.

Not so fast, though. Mr Musharraf is still the most powerful person in Pakistan. He can sack or bully parliaments, prime ministers and service chiefs through the National Security Council, a body headed by him and dominated by his appointees. A two-thirds parliamentary majority is needed to strip him of these powers or impeach him. Even if this were achieved in the National Assembly, or lower house of parliament, the upper house, or Senate, is still firmly in the hands of the PML(Q). Senate elections are not due for two years.

Mr Musharraf's foreign friends, especially the Americans and British, are urging the politicians to work with him. His office has been quick to squelch press reports that he is on the point of throwing in the towel. Most significantly, Miss Bhutto's widower, Asif Zardari, the leader of the PPP, says dethroning Mr Musharraf is not uppermost in his mind.

Mr Zardari's main challenge comes from the most populous province, Punjab, and Nawaz Sharif, another twice-elected prime minister, overthrown in 1999 by the then General Musharraf. After corralling independents in the provincial assembly, Mr Sharif's Pakistan Muslim League (Nawaz), or PML (N), boasts the numbers to form the Punjab government. But his price for a deal with Mr Zardari is the ouster of President Musharraf and a lifting of a ban on prime ministers serving a third time. Mr Sharif knows that the anti-Musharraf parties might not have the numbers to get rid of the president through parliament. To achieve the same end through the judiciary, he has been calling for the reinstatement of the 60 Supreme Court judges, including the former chief justice, Iftikhar Chaurdhry, sacked by Mr Musharraf.

Mr Zardari says this should be left to the new parliament to consider next month. He wants Mr Sharif to share power with him in both Islamabad and Punjab. Mr Sharif, however, argues for a PPP federal government in Islamabad while his PML(N) forms the provincial government in Punjab. This makes Mr Zardari queasy. He knows that unpopular decisions—about maintaining support for America's “war on terror”, dealing with inflation, food and power shortages—will have to be taken in Islamabad. If Mr Sharif is not on board he could exploit the inevitable backlash to demand fresh elections. Meanwhile, President Musharraf's supporters in the PML(Q) are making last-ditch efforts to persuade Mr Zardari to form a coalition with them rather than with Mr Sharif.

The challenge for the election winners in the next few weeks is not just to forge unity but to show their supporters that they have answers to Pakistan's myriad problems. Certainly, the election itself seems to have done nothing to solve the one that haunts Pakistan's allies abroad—its role as a base and target for terrorism. This week a suicide-bomber killed General Mushtaq Baig, the army's surgeon-general, and several other officers, at a traffic light in the garrison town of Rawalpindi not far from the army's headquarters.

Animal rights in China

A small voice calling

Feb 28th 2008 | BEIJING
From The Economist print edition

The stirrings of a new protest movement

HUMAN rights, or the lack of them, have long been a focus of China's critics at home and abroad. But a new rights movement—complete with idealistic local and foreign campaigners—is stirring: animal rights.

Animals are treated dreadfully in Chinese farms, laboratories, zoos and elsewhere. There are grim factories where thousands of live bears in tiny cages are tapped for medicinal bile. At safari parks, live sheep and poultry are fed to lions as spectators cheer. At farms and in slaughterhouses, animals are killed with little concern for their suffering.

According to Zhou Ping, of China's legislature, the National People's Congress, few Chinese accept that animals have any rights at all. She thinks it is time they did, and in 2006 put forward China's first national animal-welfare law. Her proposal got nowhere, and there is no sign of progress since. “There is so far”, she says, “only a small voice calling for change.”

Louder voices get short shrift from China's rulers. Even People for the Ethical Treatment of Animals (PETA), an activist group based in America, known for its robust approach, treads lightly in China. Its advertisements, featuring Chinese stars, are more playful than shocking. It is also working quietly with local officials, for example advising police in Nanjing on handling stray dogs—a growing problem in many Chinese cities where the keeping of pets, once rare, is becoming widespread.

Some Chinese animal-rights activists hope this trend heralds greater benevolence toward animals. One vegan activist and rock musician in Beijing, Xie Zheng, has adopted the slogan “Don't Eat Friends” to persuade people not to eat meat. That may be harder than getting them to forgo furs or bear-bile medicines. Vegetarian restaurants are spreading, but many patronise them to be trendy rather than ethical.

Campaigners are not discouraged. Jill Robinson, a Briton, spends most of her time in Sichuan province, caring for bears rescued from bile farmers, who are compensated in return for shutting down their operations. She says support from local young people is rising fast, and attitudes are starting to change. If China can stop binding women's feet, she asks, why should it not abandon cruelty to animals?

Zimbabwe

Simba Makoni is getting up steam

Feb 28th 2008 | HARARE
From The Economist print edition

Illustration by Peter Schrank

President Robert Mugabe may face a real challenge in the election on March 29th

Get article background

TRUE to form, Robert Mugabe celebrated his 84th birthday last week in high style, jovially dismissing his latest serious challenger for the presidency as a prostitute and a frog. But Simba Makoni, who was kicked out of the ruling ZANU-PF after he broke ranks last month to declare his candidacy for the presidency in an election on March 29th, is shaping up to be no joke for the incumbent.

Untainted by corruption, he is appealing to ruling-party and opposition supporters alike, especially the urban middle class and the young. His detractors admit he is competent. His surprise candidacy has breathed life into a poll that most observers presumed would be a shoo-in for Mr Mugabe. Immediately after Mr Makoni's declaration, thousands of people rushed to register. Eager volunteers throng his leafy campaign headquarters in the centre of Harare, the capital.

Morgan Tsvangirai, one of the two leaders of the Movement for Democratic Change (MDC), which split three years ago, still has quite a following, especially among urban working-class voters, and he still gets credit for opposing Mr Mugabe and his ZANU-PF for the past nine years. But feuds have weakened both parts of the MDC. Its appeal in rural areas is weak. And a smaller faction of it, led by Arthur Mutambara, has now endorsed Mr Makoni.

The former finance minister says he will try to embrace all political groups, including decent people from ZANU-PF, after he has won the election. “We believe the crisis is bigger than one group and requires the total mobilisation of this whole nation,” he says. Though Mr Mutambara has endorsed Mr Makoni, Mr Tsvangirai seems loth to close ranks before the poll. Mr Makoni claims that most of ZANU-PF's leadership supports him. None of the ruling party's heavyweights publicly admits to backing him; they will almost certainly hedge their bets until the election. But few have criticised him or tried to block his candidacy.

At a local level, grumbling in the ruling party is getting louder; bickering and division have marred its primaries. A long-standing ZANU-PF man running for a council seat on March 29th under the party banner admits that the party has lost its vim since independence and no longer attracts the young. Corruption, he laments, is endemic. “We used to laugh at Nigeria over corruption,” he says. “Not any more.”

Mr Makoni has launched his electoral ship with aplomb; it already seems surprisingly well-equipped. Ibbo Mandaza, one of Mr Makoni's advisers, says there is a team in every constituency. Businessmen and people from Zimbabwe's 3m-strong diaspora are said to be opening their wallets. Scarce fuel has been organised and scores of rallies and events scheduled across the country before polling day.

Though no picnic, opposition campaigning looks a bit easier than in previous elections. According to the Zimbabwe Election Support Network (ZESN), there has so far been little violence. Mr Mandaza says the ruling party's “machinery of violence” has collapsed. The ZANU-PF man standing for a local council says he now openly engages with his opposition rivals. A headmaster in a rural area east of Harare says that campaigning is much easier this time around. The opposition is contesting almost all parliamentary and local seats in his area—a ruling party stronghold. That did not happen last time.

But does this mean Mr Mugabe is on the skids? It is hard to gauge the electoral weight of rural voters, who provide most of ZANU-PF's support, but it is certainly heavy. “This is where the election will be won or lost,” says Sydney Masamvu of the International Crisis Group, a Brussels-based think-tank. A recent redrawing of the electoral map increased the weight of rural constituencies in parliament.

The ZANU-PF candidate for a local council predicts that, though Mr Makoni has the ability, vision and record to be president, he will make few inroads in rural areas, which the ruling party has controlled through intimidation and patronage—for instance, by distributing land, equipment and food to card-carrying party members. The rural headmaster also says Mr Makoni has little chance outside the towns unless his campaign takes off, which will require immense energy and organisation. “People here know Robert Mugabe and Morgan Tsvangirai, but not Simba Makoni,” he says.

Moreover, many voters who detest Mr Mugabe are suspicious of Mr Makoni. Some MDC people say he may even have been planted to divide the opposition in the towns. “He needs to say who backs him,” says one. Others who have been fighting Mr Mugabe's regime for years dismiss him because he was in ZANU-PF's leadership for so long. On the other side, diehard Mugabe fans think him a traitor.

Mr Makoni dismisses such concerns. “There's nowhere I go in the country where I am not greeted by name,” he says, adding that he is “nobody's tool”. But he does not disavow his long service in ZANU-PF governments. “I accept collective responsibility, but it does not operate on unanimity.” He says he tried to change the party from within, always speaking out against bad policies. He is banking on a groundswell of support to loosen ZANU-PF's grip in the rural areas. He is embarking on a country tour that will last until the election, starting with a rally in Bulawayo, Zimbabwe's second city and capital of the deeply disgruntled Ndebele minority.

Much will also depend on whether he can ensure that the election is not stolen. ZESN doubts the electoral environment can allow for a free and fair poll. A new constitution and reforms of repressive media and security laws were agreed on during negotiations between the opposition and the ruling party overseen by Thabo Mbeki, South Africa's president. But they will not be implemented before the poll.

There is no independent radio or television. The voters roll, which Mr Makoni's team is combing to spot and correct discrepancies, is highly unreliable. His people are also training thousands of polling agents to staff the 11,000 voting stations. They expect other tricks, such as the ruling party providing too few ballot papers in urban polling stations, where the opposition is strongest. But Mr Makoni's team thinks sympathisers in ZANU-PF will give valuable tip-offs to help stymie the rigging.

The presidential poll is a two-round affair. Mr Mugabe could well win the first round—but Mr Makoni's planners and the MDC bet he will fail to get more than 50% of votes cast. If they are right, the momentum should be with the challenger.

Kenya

A peace deal at last

Feb 28th 2008 | NAIROBI
From The Economist print edition

Kenya's quarrelling leaders have pulled back from the brink

Get article background

Reuters

Odinga eyes his prize

KOFI ANNAN, the UN's former secretary-general, is a patient man, but not that patient. After spending a month overseeing agonisingly slow negotiations between Kenya's government and opposition, he was close to a power-sharing deal to save the country from more killing and instability. But once all the peripheral issues had been tidied up and the negotiators were left to share out raw power, the talks stalled yet again. On February 26th Mr Annan suspended them: it was time, he said, for the disputed president, Mwai Kibaki, and the opposition leader, Raila Odinga, to face up to their responsibilities and cut a deal themselves.

Mr Annan's guile worked. Two days after the suspension, the hitherto obdurate Kenyan rivals, aided by the African Union's new chairman, Jakaya Kikwete, who is also president of neighbouring Tanzania, did Mr Annan's bidding. They struck a deal which all Kenyans hope will stick.

Mr Odinga will become prime minister, with wide-ranging executive powers; Mr Kibaki will stay as president. Cabinet posts will be shared between their nominees. Parliament will entrench some constitutional amendments to shift the balance of power between president and prime minister.

It remains to be seen how the sharing of power will work in practice, especially after all the bad blood that has been spilt between the pair over many years. But the creation of the post of prime minister, which had not existed, was a victory for Mr Odinga. Mr Kibaki's people had previously insisted that, if there were to be a prime minister, he should have limited executive powers. This, it seems, will not be the case.

The other most ticklish issue was whether the presidential election, which most independent observers reckoned was rigged, would be run again—and, if so, when. It is unlikely to be held in the near future. But it remained unclear whether Mr Kibaki would serve a full five-year presidential term.

It will take time for confidence to be rebuilt. Well over 1,000 people have been killed in the post-election violence. At least 300,000 people have been displaced by ethnic cleansing. Many of them will be wary of returning to their old homes soon. Kenya's economy has taken a bad knock. Above all, the country's reputation as a hub of stability and moderation in a volatile region has been sorely damaged. Even if the agreement signed this week holds, things will not easily return to normal.

Cameroon

Another president who won't go

Feb 28th 2008 | DOUALA
From The Economist print edition

Many Cameroonians are angry because their president refuses to retire

THE MAN who has presided over Cameroon for 25 years touts a simple slogan: “Paul Biya for peace”. But it no longer rings true. On February 24th and 25th, in Douala, Cameroon's commercial capital on the Atlantic coast, protesters lit fires on the streets, shooting broke out, and looters ran amok. Taxi drivers went on strike and many other people stopped work too. Shops and petrol stations were ransacked, cars burnt. Black clouds of smoke and the noise of gunfire enveloped the residential area along the main road out of Douala towards the capital, Yaoundé, where police later tear-gassed stone-throwing youths who had set up burning barricades.

The reason for the mayhem was the president's heavy hint, in an end-of-the-year address, that he might stay on for a third term of another seven years; the present constitution, which came into force in 1996, allows for only two terms. Since then, many Cameroonians, usually a quiet lot, have taken to the streets. Mr Biya has yet to make a clear bid to change the constitution but the issue has been widely aired in the newspapers, on television, and on street corners.

Mr Biya has reacted angrily. Several people who organised demonstrations against him have been arrested. Douala's governor has banned any more rallies. Earlier, the minister of communications closed one of the country's most popular private television stations for running too many programmes candidly discussing the prospect of a third term for Mr Biya. A musical artist, known as Joe La Conscience, was prevented from walking the 320 kilometres (200 miles) to Yaoundé from the town of Loum, north of Dowala, singing songs against the proposed constitutional change.

Many strikers say they are merely protesting against the high cost of fuel. But the problem runs a lot deeper. Mr Biya's bid for another term has unleashed a rare outbreak of public discussion and dissent at a time when the country has fallen heavily into debt. Transparency International, a Berlin-based lobby that measures corruption, says it has become “endemic” in Cameroon. Elections in the last few years have been so patently rigged that few voters bother to turn up.

Still, the opposition is weak, though Mr Biya excoriated “the apprentice sorcerers in the shadows”. More than 200 parties have sprung up since multi-party politics was allowed in 1990. Garga Haman Adji, a former minister in Mr Biya's government who is now in opposition, says that many opposition parties have been infiltrated and bought out by Mr Biya's party. In any event, the 75-year-old president has been badly rattled.

The Kurds

Turkey invades northern Iraq

Feb 28th 2008 | ANKARA AND ERBIL
From The Economist print edition

With scores of fighters on both sides killed, the latest battle between Turkey and its rebel Kurds with havens in Iraq may get out of hand

Get article background

THE latest incursion by Turkish forces into northern Iraq in an effort to squash the rebels of the Kurdistan Workers' Party (PKK), which draws its support from Turkey's own Kurds, is the biggest in a decade. It is also one of the most worrying for the region as a whole. The danger is that it may draw in the *peshmerga*, the Kurdish forces loyal to the government of the Kurds' autonomous region in northern Iraq, and destabilise all of Iraq, just when the insurgency across the country is gradually being contained. The most striking development is that America, whose relations with Turkey, its old ally in NATO, have been chilly, this time appears to have sided more plainly with the Turks. The Americans have even sent high-tech specialists to work alongside the Turks to provide "real-time" intelligence to help Turkish helicopters and artillery to target the PKK in its mountain fastnesses.

The government in Baghdad is dismayed by Turkey's breach of Iraq's territorial sovereignty, but seems grudgingly prepared to sit on its hands provided that the incursion lasts no more than a week or two and that Turkish forces do not penetrate deeper than 30km (19 miles) or so into the rugged mountains of northern Iraq.

It is a lot harder for Iraq's Kurdish regional government to stomach the intrusion, but it too is keen not to let its forces tangle with the Turks, despite rising anger among ordinary Iraqi Kurds against what they consider Turkey's aggression. Iraq's Kurds have little love for the PKK, and insist that they do not help it with logistics or weapons. But they also say the Turkish government should do more to accommodate Turkey's 14m or so Kurds by giving them greater cultural and political rights.

The Americans naturally still want to be friendly with all sides—an almost impossible task. Iraq's Kurds depend on what they see as an informal American guarantee of their right to secure their almost unprecedented autonomy—and there is no sign that the Americans are likely to ditch them. But more recently American diplomats and soldiers have been concentrating on trying to draw other Iraqi constituencies, especially the Sunni Arabs, as well as recalcitrant Shia radicals loyal to a fiery cleric, Muqtada al-Sadr, into a *modus vivendi* with the Shia-led establishment in Baghdad. In a hopeful move, Mr Sadr told his militia to extend a ceasefire that was due to expire last week.

What is new is America's readiness to risk annoying Iraq's Kurds by acquiescing in Turkey's latest effort to bash the PKK. George Bush has called the PKK "our common enemy". An American official has even called military co-operation between Turkey and America since November, when the Turks launched their latest round of attacks on the PKK, "the most intense since the Korean war" in the 1950s, when Turkish forces within the NATO alliance won a reputation for bravery.

Whether the latest campaign will succeed is another matter. The Turks say they must root out some 400 PKK fighters strung out in a swathe of exceptionally harsh mountains stretching some 100km from north of Zakho to the Kandil mountains near where Turkey, Iraq and Iran all meet (see map above). The Turks particularly want to destroy PKK bases in the Zap and Haftanin districts. Above all, they hope to stop the PKK spring offensive that usually begins later this month. Thanks to American intelligence technology, they may be better able to do so. "These are tailored, precise operations, taking place in a relatively small area," says a Western military observer.

Early claims of success by both sides are hard to verify. The Turkish press says that 10,000 troops have crossed into Iraq; non-Turkish analysts reckon the figure is 2,000-3,000. Turkish officials say at least 150 PKK fighters have been killed since the assault began, on February 21st, for the loss of a score of Turkish soldiers; the PKK says it has had minimal losses, but has killed at least 80 Turks.

What is likely, in any event, is that the fog, brutal terrain and deep snow will make it very hard for the Turks altogether to eradicate the PKK, which has been extraordinarily resilient since it started fighting for self-rule in 1984. Since then, some 40,000 people, mostly Kurds, have died. Numerous cross-border attacks have fizzled out. The PKK may be going through a bad patch; their logistics have been battered, their weapons stock may have been reduced, their morale may be low. And this attack may be more comprehensive than previous ones. But it is unlikely to knock out the guerrillas for good. "We will draw the Turks in and they will get stuck in a quagmire," says a PKK commander.

Moreover, Recep Tayyip Erdogan, the Turkish prime minister, who heads the ruling Justice and Development (AK) party, risks alienating the many Turkish Kurds who had proven increasingly ready to vote for him and his moderately Islamist party. But he has once again become wary, in recent months, of Turkey's self-appointed secular guardians, the generals, breathing down his neck and muttering baleful warnings against going too far down an Islamist path. In particular, a recent AK law (not yet enacted) to let female students wear the previously banned headscarf in universities has aroused the ire of secular-minded Turks, including the generals.

Mindful of such divisive emotions at home, Mr Erdogan has been using increasingly hawkish and nationalist language. He has dismissed the Kurds' latest demands for more education in their own language. This week, misty-eyed, he began reciting the works of a nationalist poet, Mehmet Akif Ersoy. Letting the generals have another go at the PKK may be part of this political strategy. During the latest row over headscarves, the generals have been notably—and unusually—silent.

At the same time, Mr Erdogan may still hope to promote Islam among the Kurds as the best antidote against Kurdish nationalism. His AK advisers even hope to win the mayor's race in Diyarbakir, the biggest Kurdish-dominated city in south-eastern Turkey, in elections due next year. "If the AK gets Diyarbakir, the Kurdish nationalist movement will suffer a major setback," says Serafettin Elci, a prominent independent Kurdish politician. "It will take them years to recover." But Mr Erdogan's recent hawkishness could turn many sympathetic Kurds against him.

In any event, hopes of an accommodation between the Turkish government and the Kurdish regional government in Iraq are less fanciful. There is still a chance that Jalal Talabani, Iraq's president, who is also the leader of one of the two parties that jointly run the Kurds' regional government, may make a ground-breaking visit to Turkey later this month. While Turkish troops have been battering the PKK, senior Turkish diplomats have been in Baghdad talking to Hoshyar Zebari, Iraq's foreign minister, and Barham Saleh, Iraq's acting prime minister (while Nuri al-Maliki is abroad for a medical check-up), both of whom are leading Kurds. A senior Turkish general also visited Baghdad to brief the central Iraqi government on Turkey's military intentions towards the PKK. Economic links between Iraqi Kurdistan and Turkey have continued to grow.

To complicate matters, the Iraqi Kurds, who have a history of internecine strife, may not be at one over how to react. Some say that the Americans are tiring of Masoud Barzani, the Kurds' president, who is said to be more hostile towards the Turks than is his nephew, Nechirvan Barzani, the

Kurds' prime minister. Others say that the Turks are keen to cultivate Mr Talabani, who has been notably reticent about the incursion, perhaps hoping to drive a wedge between him and the Barzanis.

An even bigger question, in the long run, is whether Turkey will ever really tolerate, let alone welcome, autonomy for Iraqi Kurds, which they fear may turn into virtual independence and act as a magnet for Kurdish nationalists in Turkey. Many Iraqi Kurds, including those who dislike the PKK, doubt whether the Turks will ever let them build up their proto-state. “Even if they withdraw now or next week and remove the PKK, they will come back,” says a senior Kurdish official. “Just wait and see.”

The Americans say that Iraq's Kurds have helped isolate the PKK, denying them weapons and logistics, and stopping journalists from visiting their camps, but must still do more. “Iraqi Kurdish leaders have taken steps to deter and block the flow of terrorists and their supplies,” says an American diplomat in Ankara. “We have urged those authorities to strengthen these efforts. It is in the interest of both Turkey and Iraq that the PKK be eliminated from northern Iraq and the two countries need to continue to work together towards that goal.” This week a White House official said: “Obviously we support Turkey and we support Iraq.” How simple.

Morocco

It isn't funny

Feb 28th 2008
From The Economist print edition

The royal regime has a sense-of-humour failure

READERS of a website devoted to Moulay Rachid, the brother of King Muhammad VI and heir to the Moroccan throne, might well take it for a spoof. “Nationally tailored ambitious plans reflect HRH Crown Prince Moulay Rachid's vision to bolster new developments,” runs one heading. “HRH Prince Moulay Rachid internalises aspirational notions of human rights,” enthuses another. A section for readers' comments on the site, kingofhearts.canalblog.com, includes such sage insights as “our prince is very handsome, he is helpful and he loves Moroccans”.

Followers of the news, hearing of a three-year jail sentence passed last week on Fouad Mourtada, a computer engineer, for the crime of posting a fake internet profile of the crown prince, might think Mr Mourtada was indeed the author of this purple prose. But the king-of-hearts blog, which lovingly details the prince's activities as patron of Moroccan golf, marksmanship and car competitions, is apparently the real work of a licensed admirer. By contrast, the 27-year-old Mr Mourtada, who hails from the commercial capital, Casablanca, was judged guilty of identity theft and of insulting the ruling family, both criminal offences in Morocco.

His lawyers protested that in creating a fake profile of the prince on the popular Facebook website, Mr Mourtada was only having fun. But that defence was rejected. An appeal by his family for clemency from Moulay Rachid has not been answered. Aside from Mr Mourtada's unhappy fate, the episode might have been dismissed as ridiculous. But Morocco's rulers seem increasingly inclined to ill-humour.

When Muhammad VI, now 44, replaced his famously dour father, Hassan II, in 1999, his subjects breathed a sigh of relief. Among other things, he freed political prisoners, set up a truth commission to investigate human-rights abuses, and unbanned the country's best-known satirist, Ahmed Senoussi, who goes by the stage name Bziz. But in recent years numerous journalists and rights campaigners have been heavily fined or sent to jail for defaming the state and damaging its prestige.

Mr Senoussi has again been banned from performing in his own country. One reason, say his fans, was that he cheekily called the king “Sa Majetski”, in reference to the monarch's love of noisy waterbikes. Bziz also recently drew attention to the plight of dissidents by appearing for an interview on the al-Jazeera satellite channel, bound and gagged. Asked to comment on a new code of ethics agreed at a gathering of Arab ministers of information to control the content of satellite television channels, Mr Senoussi said it was a wonder of Arab technological progress that their police were now patrolling outer space.

Nigeria

It all looks horribly the same

Feb 28th 2008 | ABUJA
From The Economist print edition

A tribunal decides that last year's presidential election was fair

Get article background

LOCAL newspapers called it D-Day, the day of judgment on the election which brought their president to power last April and which his opponents and an array of international observers deemed fraudulent. This week, as Nigerians pushed and brawled to get into a tiny courtroom where a tribunal was due to give its verdict, tension grew and security tightened. Had the tribunal annulled the election result, as many expected, a dangerous power vacuum could have threatened Africa's most populous country. But after the result was declared valid, people left more quietly than they had arrived. Turmoil did not ensue. For the moment, President Umaru Yar'Adua looks secure in his job.

Virtually all independent observers reckoned his election had been rigged. Even the new president admitted it had “some shortcomings”. But the Court of Appeal said there was insufficient evidence to overturn the result. Its judges spoke of technicalities but said little about electoral malpractice, not even issuing a general condemnation of fraud and violence, as many had hoped. Even if there had been a bit of hanky-panky, said the court's judges, the result would have been the same.

So far, Nigerians have reacted calmly to the tribunal's verdict. They have endured such judicial fecklessness before. The verdict of an election tribunal in 2003 which challenged the result that gave a second presidential term to Olusegun Obasanjo was struck down for similar reasons: any fraud, should it have occurred, would not have changed the result enough to warrant a fresh election. In a country where government controls the huge riches from oil, the political stakes are high. Many Nigerians, fed up with the venality of politics, fear that the political establishment will now feel it can be as crooked as it has been in the past—and get away with it as usual.

The joint petitioners against the president's election, Atiku Abubakar and Muhammadu Buhari, who were his chief election opponents, say they will appeal to the Supreme Court. Many tribunals elsewhere in the country are still sitting and have annulled a handful of the results of contests for the governorships of the 36 states. The election of the senate's president was annulled last week, subject to appeal. But many Nigerians still thirst for new presidential elections—and still quietly hope against hope that they will be held. As a professorial campaigner put it, “You don't own a stolen property just by its longevity in your possession.”

Serbia

The road of discontent

Feb 28th 2008 | BELGRADE AND PRISTINA
From The Economist print edition

AP

For now Serbia remains torn about whether to pursue its European vocation—but it is likely to return to it eventually

Get article background

MORE than a week after Kosovo declared its independence on February 17th the dust has not settled. But the outlines of what might become a new Balkan reality are starting to emerge. As expected, Kosovo has been recognised by America and most European Union countries. But the number of recognitions from other parts of the world have been few. At the same time, Serbia's politicians are split about which way to take their country.

Kosovo was—and according to Serbia still is—a Serbian province that had been under the jurisdiction of the United Nations since the end of the war in 1999. Some 90% of its 2m-odd people are ethnic Albanians. About half of its 120,000 Serbs live in the north, close to Serbia proper, and the rest in enclaves scattered through the rest of the territory.

On every day since February 17th Kosovo's Serbs have protested in the north of the divided city of Mitrovica. There have been several violent incidents, mostly around Kosovo's borders, but also in the Serb part of Bosnia. Serbs and Albanians in Kosovo's police force are no longer working together in northern and eastern Kosovo. But so far in the enclaves, life has carried on with little change. Vojislav Kostunica, Serbia's prime minister, has said that “Serbia intends to rule parts of Kosovo where loyal citizens still look to Belgrade for government.” It seems that his policy is to take full control of northern Kosovo first but to adopt a slightly slower approach to the enclaves, so as not to provoke an Albanian backlash and Serb exodus. How the EU, which is supposed to replace the UN mission in Kosovo, plans to tackle this is the next big question.

In Serbia itself the question is whether the government can survive. It is split between those like Mr Kostunica who think that Serbia should abandon the path of European integration and those like Bozidar Djelic, the deputy prime minister, who argue that, although Serbia must not recognise Kosovo, it should not abandon its EU ambitions. Pointing out that China, Brazil, India and Russia all support Serbia, he says cheerfully that “the future world is ours.” On February 25th Dmitry Medvedev, the next Russian president, flew to Belgrade to pledge his support.

A few days earlier, some 200,000 people gathered in central Belgrade to protest against Kosovo's independence. Mobs peeled off to loot shops and set the American embassy on fire. Fearing a hostile reception, the pro-European president, Boris Tadic, had contrived to spend the day in Romania. Inevitably some Serbs drew contrasts. Twenty years ago Serbs in mass rallies were listening to emotion-laden speeches about Kosovo by Slobodan Milosevic, who later led them to war, while Romanians were still crushed under the dictatorship of Nicolae Ceausescu. Mr Kostunica's speech was shockingly reminiscent of Milosevic's—but Romania is now in both the EU and NATO.

Marko Blagojevic, a pollster, notes that although Mr Kostunica's ratings are pitifully low, “you can't deny he is a very skilful politician.” Mr Kostunica's tactic seems to be to use the emotional issue of Kosovo to rebuild his support and trade on his patriotic credentials against those of his pro-European coalition partners. They are now being branded as traitors in much of the Serbian press.

Ivan Vejvoda, who heads the Balkan Trust for Democracy, a donor to good causes, thinks the government will keep going at least until autumn when, after all the emotion dies down, pro-Europeans can mobilise what he calls Serbia's silent majority. This is clearly Mr Djelic's strategy. He is bitter about the EU, arguing that since the fall of Milosevic in 2000 Serbia “has got nothing”. But he adds that now is not the time to retreat into a hole saying “we hate you”.

Serbia was recently blocked by the Netherlands from signing a stabilisation and association agreement with Brussels, the usual first step to EU membership. Hauling out a copy of the vast document, Mr Djelic says that Serbia needs to be deft. It will fight Kosovo diplomatically, he says, but he hopes that the situation on the ground will cool and insists that it remains in Serbia's best interest to implement the agreement anyway, to gain time. Mr Djelic believes that such canny politics might even yield full EU candidate status by the end of the year, plus visa-free travel to most EU countries to boot.

If Mr Djelic were in charge, this might happen—but he is not. Mr Blagojevic cautions that, since Kosovo is an emotional not a rational issue, predictions of how the Balkans will look after the dust from Kosovo settles are risky.

Cyprus

A Communist to the rescue

Feb 28th 2008 | NICOSIA
From The Economist print edition

A new Greek-Cypriot president raises hopes for a new unification plan

Get article background

MIGHT Cyprus replace Cuba as a holiday spot for starry-eyed Marxists? Demetris Christofias, leader of the Communist Akel party, comfortably won the run-off for president on February 24th, taking 53.4% to 46.6% for Yiannakis Kassoulides, a right-wing former foreign minister. Yet Mr Christofias, a builder's son educated in Moscow, is no red firebrand. He owed his victory to support from the nationalists, with whom he will be in coalition. He has abandoned Akel's Eurosceptic position (it tried to delay Cyprus's adoption of the euro this year) and promised to avoid tax rises. His party is business-friendly: it runs co-operative banks offering cheap mortgages, and Moscow-trained party members earn fat salaries working for accounting and law firms that look after Russian offshore companies.

Voters are more interested in hopes that Mr Christofias will make a fresh effort to unify the Greek- and Turkish-Cypriot parts of the island, split since 1974, when Turkey invaded in the wake of an Athens-inspired coup aimed at uniting Cyprus with Greece. Various peace initiatives have failed mainly because of opposition from Rauf Denktash, founder of the self-styled Turkish republic of northern Cyprus.

Hopes lifted the moment that Tassos Papadopoulos, the nationalist Greek-Cypriot president, was knocked out unexpectedly in the election's first round. Mr Papadopoulos had persuaded voters in 2004 to reject a unification plan backed by Kofi Annan, then United Nations secretary-general. A huge “no” vote a week before Cyprus joined the European Union meant that the Turkish-Cypriots were excluded, even though they had overwhelmingly backed the plan in a separate vote.

Mr Papadopoulos's defeat brought sighs of relief in Brussels. He had infuriated other EU countries by exploiting his membership to press Turkey into concessions over Cyprus. Eurocrats were irritated by a Greek-Cypriot campaign against EU-funded projects in the isolated north. Now, with pro-settlement leaders on both sides for the first time, the odds of a deal have improved. Mehmet Ali Talat, a moderate left-winger who replaced Mr Denktash as Turkish-Cypriot president, is as keen as Mr Christofias to try again. Contacts between Greek- and Turkish-Cypriot politicians withered under Mr Papadopoulos, but Mr Talat's party has kept in touch with Akel through trade-union leaders.

Direct talks under UN auspices on confidence-building measures should be the first step, say diplomats. Opening more border crossings, including one in Nicosia's main shopping district, is a priority. But it will be hard to find a deal that both allows the two communities to run their day-to-day affairs and gives Greek- and Turkish-Cypriots a chance to use or sell homes and land in the other half of the island. Turkey will also have to agree to pull out most of its 30,000 troops in the north.

There are plenty of obstacles ahead. Mr Talat is hampered by having to be guided by Ankara on big issues. Mr Christofias could find his nationalist partners, egged on by Mr Papadopoulos, unwilling to make concessions. UN officials, anxious to avoid a repeat of the 2004 fiasco, will set tough terms before putting any plan forward. To pull off a deal, Mr Christofias will need all the persistence he once learnt at political-science school in Moscow.

Russia's new president

The name's Dmitry

Feb 28th 2008 | MOSCOW
From The Economist print edition

AP

Medvedev and his heavy-metal pals

Just who is Dmitry Medvedev?

THREE years into his presidency, Vladimir Putin walked across Red Square to join the crowd for Paul McCartney's performance of “Back in the USSR”. The man expected to be his successor this weekend, Dmitry Medvedev, prefers Deep Purple. Three weeks ago the heavy-metal group was summoned to the Kremlin as a farewell present for Mr Medvedev from Gazprom, which he has chaired since 2000.

His taste for rock, his knowledge of English and his youth, plus the fact that he has never served in the Russian security services, have all earned Mr Medvedev the reputation of being a liberal. His rhetoric of the past few weeks has strengthened that image. “Freedom is better than non-freedom,” in Mr Medvedev's summary of his beliefs. Even more encouraging, he has said this applies to personal and economic freedoms as well as freedom of speech. A key component of the freedom is the rule of law, he said, which had been absent for much of Russian history. His talk was so liberal as to offend some nationalists.

His record is more mixed. A lawyer from St Petersburg, Mr Medvedev has been by Mr Putin's side for most of his professional life, even running his presidential campaign. In 2000, when Mr Putin became president, his protégé became his deputy chief of staff, and later a deputy prime minister. He was also entrusted with Gazprom, Russia's biggest and most important company. He helped to recover assets that had gone missing under previous management.

A report by two Kremlin critics, Boris Nemtsov and Vladimir Milov, finds that Gazprom has become neither more transparent nor more efficient under Mr Medvedev, even though its market value has risen dramatically. For example, control over Gazprom's multi-billion dollar insurance and (partially) pension funds passed to a private bank called Rossiya. Its largest shareholder is Yury Kovalchuk, supposedly a friend of Mr Putin's. “Rossiya: the country of opportunities,” its advert runs. (The pension fund also gained control of Gazprom's huge in-house bank.) Gazprom says these deals were about optimising the use of its assets. But they look opaque, at least.

According to a former official, Mr Medvedev was also the brains behind a complex legal scheme to allow a state-owned oil company, Rosneft, which took over most of the assets of Yukos, to keep the proceeds from its initial public offering rather than pass them to the state. But Mr Medvedev has always followed the letter of the law. According to one foreign banker, when an American court imposed an injunction on the sale of Yukos's assets, it was Mr Medvedev who pulled Gazprom out of a blatantly fixed auction.

Mr Medvedev's other task as deputy prime minister was to oversee spending on national projects such as health and education. Given the lack of reform in both areas, he has made little difference to the quality of either.

But it would be wrong to blame Mr Medvedev for the failing of the national projects or for the inefficiency and opacity of Gazprom. Over the past eight years, the key decisions for both Russia and Gazprom were made by Mr Putin, who has had unprecedented powers, even by Soviet standards. The big problem for Mr Medvedev is that Mr Putin may continue to make decisions after he steps down as Russia's president and becomes Mr Medvedev's prime minister.

As Mr Putin puts it, Mr Medvedev will “implement” or “complement” the strategy that he, Mr Putin, has set for Russia. The job of prime minister, he says, will give him plenty of power: he will not hang the next president's picture on his wall. Mr Putin recently criticised many of Russia's shortcomings, including corruption, inefficiency of the state's management and dependence on natural resources. “A rare leader would admit the failure of his rule while still in power. But there has never been a leader who, having done so, would then claim to stay in power,” argued Lilia Shevtsova of the Carnegie Moscow Centre in *Novaya Gazeta*. Many fear the system Mr Putin has designed is highly unstable.

Despite portraits all over Russia showing Mr Putin and Mr Medvedev walking side by side (Mr Putin slightly ahead in his leather jacket), there is a dissonance in their rhetoric. After the past few years of Mr Putin's truculent talk, Mr Medvedev's liberal language may come as a relief. There is hope, if not expectation, among parts of Russia's elite and around the world, that his arrival in the Kremlin will herald a thaw. At least, Ms Shevtsova argues, it could consolidate some of Mr Putin's moderate opponents around Mr Medvedev. But Kremlin infighting, already visible, may widen.

In a new report for the European Council on Foreign Relations, Andrew Wilson of University College London concludes that at first the system will have more control over Mr Medvedev than he will have over the system. After that, who knows? The result of this weekend's election may be certain, but its outcome is not. As one weathered tycoon puts it, despite Mr Putin's wish to keep the status quo, Russia will be a different place in a year's time.

Chechnya and the north Caucasus

And they call it peace

Feb 28th 2008 | GROZNY
From The Economist print edition

Vladimir Putin's presidency began in Chechnya; the region is restive as it ends

ON DECEMBER 31st 1999 Vladimir Putin flew to Chechnya, which had been under Russian bombardment for months. It was a suitable first trip for the new president, whose rise to power was intimately linked to the war in Chechnya. He vowed to pursue terrorists everywhere, famously adding “we'll wipe them out in the shithouse.”

As Mr Putin hands over to Dmitry Medvedev, he can claim that a war that cost 100,000 lives is over. Grozny has been transformed: ruins cleared away, bullet-ridden facades covered with plastic, fortified checkpoints gone. There are new schools, apartment blocks, roads, shops. You can fly into Grozny, take a taxi and go to a restaurant.

To achieve this Mr Putin simply sided with a former rebel, Akhmad Kadyrov, whom he pronounced president. When Mr Kadyrov was blown up in 2004, the mantle passed to his son, Ramzan, who has used money and brutality to bring the rebels on side. Others vanished. Sporadic fighting continues, but the idea of resistance is largely broken. “People can't fight any more. They are physically and morally exhausted. Call it preservation instinct,” says one man.

Besides, much of the cause is gone. Chechnya has de facto autonomy and money from Moscow. Mr Kadyrov pledges loyalty to Russia, particularly to “the one and only Mr Putin”. But he runs his own affairs. At elections, Chechnya gives the Kremlin a 99% vote, but Mr Kadyrov does not press people to turn out. He has his own army and control of the oilfields. As for 40,000 Russian troops, “they should stay to protect Russian international borders,” he says. Mr Kadyrov levies a tax for reconstruction, and makes women wear headscarves. His former image of brutal thug has turned into builder. He has reduced the kidnapping and torture of ordinary Chechens. He is no champion of human rights, but he is effective in his way, says Ekaterina Sokiryanskaya of Memorial, Russia's leading human-rights group.

Huge problems remain. Almost the only work is in security. Corruption and unemployment (maybe 80%) are so endemic that people pay bribes to get state jobs. Chechnya used to provide seasonal labour across the Soviet Union. Russian xenophobia has made that impossible. But the stress of war that wrecked people's health is gone. “All these years that we had been bombed I dreamt that I would fall asleep and that there would be no shooting. I don't care who the president of Chechnya is: I can now sleep,” says a Grozny resident.

The true legacy of Russia's war on Chechnya is that its violence has spread to other Muslim republics, notably Dagestan and Ingushetia. Each has its own problems, but the common thread is Russia's brutal and lawless methods. Ingushetia never asked for independence and did not even support the Chechen cause. Ms Sokiryanskaya says that, when insurgents seized its capital in 2004, locals were shocked to find that some were Ingush. Ingushetia now has a network of guerrilla fighters who destabilise the region by targeting non-Ingush people and police. Last year they killed several Russian-speaking people.

The Russian army has resorted to brutal mop-up operations involving methods little different from those of the terrorists. The result: a republic that was mostly peaceful at the beginning of Mr Putin's presidency now resembles a war zone. The local leader, Murat Zyazikov, a former KGB officer appointed by Mr Putin, can neither protect people nor give them work. Yet since Mr Putin scrapped regional elections, voters have no way of replacing Mr Zyazikov. When people staged a protest against the killing of a six-year old Ingush boy by Russian soldiers, they were met with violence. Journalists who came to cover the story were kidnapped and beaten up. Days later, Ingushetia reported 98.7% backing for the ruling party in a parliamentary election.

Predictably, the next protest was even more violent. The Kremlin blames foreigners. “Instead of solving problems, they suppress them,” says Ms Sokiryanskaya. Inevitably, they re-emerge.

German politics

On death and dying

Feb 28th 2008 | BERLIN
From The Economist print edition

The old rules for coalition-building in Germany have passed away

Get article background

THE reaction of Germany's political class to the demise of their four-party system is reminiscent of Elisabeth Kübler-Ross's “five stages of grief”. First came “denial”. In 2005 the Left Party won enough seats in Germany's parliament to stymie the two usual coalition options: a right-of-centre one between the Christian Democrats (CDU) and the liberal Free Democrats (FDP), or a left-leaning pairing of the Social Democrats (SPD) with either the FDP or the Greens. Instead, the CDU and SPD were forced into a “grand coalition”, from which each fervently hopes to escape after next year's federal election.

Now comes “bargaining”. In elections this year the Left Party—which marries heirs of East Germany's communists with an assortment of left-wing malcontents from western Germany—has entered the legislatures of three western states for the first time. In Hamburg, which voted on February 24th, the CDU could enter its first state-level coalition with the Greens. In Hesse the SPD may be about to end a deadlock by breaking its vow to shun reliance on the Left Party. These moves are a foretaste of what may happen nationally.

The long-term erosion of support for the two *Volksparteien*—the CDU and SPD—means they may often be forced to choose between a grand coalition and something new. In Hamburg the FDP failed to get into the legislature, so the re-elected mayor, Ole von Beust, is contemplating a tie-up with the Greens. He belongs to the CDU's liberal wing; the once-radical Greens have become a party largely of prosperous progressives. Their coupling in what one newspaper calls an “opera lovers' coalition” would not be unnatural (it has happened in some cities). It might not work. Some grass-root Green voters hate it, and the two parties are divided over local issues, such as whether to deepen the Elbe to give bigger ships access to Hamburg's harbour. But, says one Green politician, an alliance with the CDU would at last free the party from a “cage” whose only other occupant is the SPD.

More contentious is the SPD's flirtation with the Left Party, which remains a pariah to many western Germans. Its co-leader, Oskar Lafontaine, has called George Bush a “terrorist” and heaped praise on Venezuela's Hugo Chávez. The near-winner of Hesse's election, the SPD's Andrea Ypsilanti, prefers the FDP as a partner to round out a coalition with the Greens. But the FDP, its sights set on the 2009 election, has so far refused. So she may turn to the Left Party for the backing she needs to become Hesse's premier, even though she will not invite it into a formal coalition. The SPD chairman, Kurt Beck, has blessed this tactic, which has stunned the party's other leaders and may have cost it votes in Hamburg.

Mr Beck's carelessly executed U-turn has damaged his credibility. Though a national tie-up between the SDP and the Left Party is unlikely in 2009, “now is a good time to start the debate,” says Thomas Poguntke of the Ruhr University in Bochum. The SPD already governs with the relatively pragmatic eastern wing of the Left Party in Berlin. Nearly two-thirds of voters think the Left Party ought to be treated as a normal party, according to Forschungsgruppe Wahlen, an opinion pollster. If the Left Party matures, a partnership with it may come to seem more attractive to the SPD than either the quicksand of grand coalitions or the desert of opposition.

And the three other stages of grief? There will be plenty of “anger” and “depression” before German politicians reach the final tranquillity of “acceptance”.

Spain's election

Spanish customs

Feb 28th 2008 | MADRID
From The Economist print edition

Immigration becomes an voting issue

Alamy

Reading about my generation

WHAT exactly is a Spanish custom? Ahead of a close election on March 9th this is suddenly a matter of intense debate. The opposition People's Party (PP) leader, Mariano Rajoy, wants future immigrants to swear to respect Spain's customs. This has provoked jokes about siestas, bull-running and dancing in spotty dresses—three national customs. But it is also a reminder that the election is about more than an economy suffering from high inflation and a burst property bubble.

Mr Rajoy wants immigrants to sign a legally binding “integration contract”. This would oblige them to learn Spanish, to work hard to integrate—and to return home if they are unemployed for too long or commit a crime. The proposal was ridiculed by José Luis Rodríguez Zapatero, the Socialist prime minister. Spain's foreign-born population has increased fivefold to some 10% in the past seven years, but he claims this has caused few problems.

Mr Rajoy used a television debate with Mr Zapatero this week to accuse him of encouraging an avalanche of immigrants. The Socialists retorted that a xenophobic heart was beating in the PP; the PP said all it wanted to do was to restore order to a chaotic system. Many Socialists seem pleased that Mr Rajoy has chosen to play the immigration card. Mr Zapatero's government has devoted much time to social issues, an area where it feels comfortable. It has legalised gay marriage, made divorce easier, introduced a sex equality law and weakened the Catholic Church's influence over education. Most of these measures have proved popular; PP opposition has allowed the Socialists to preen themselves as a nice party fighting reaction.

A few months ago, however, the PP switched the thrust of its drive to win back the power it lost in 2004. With growth slowing, unemployment rising and inflation hitting 4.3%, it began to focus more on the government's economic competence. Mr Rajoy signed up Manuel Pizarro, a businessman who was formerly deputy chairman of the Madrid stock exchange, for his team (though he suffered a bruising defeat in a televised debate with the finance minister, Pedro Solbes).

Mr Rajoy's immigration plans have given the Socialists a chance to divert the debate away from the economy and claim once again to be more positive, caring and tolerant, painting the PP as a jumble of angry negatives. The interior minister, Alfredo Pérez Rubalcaba, asserted that, after months behind a moderate mask, Mr Rajoy had at last revealed himself as “authoritarian and anti-social”.

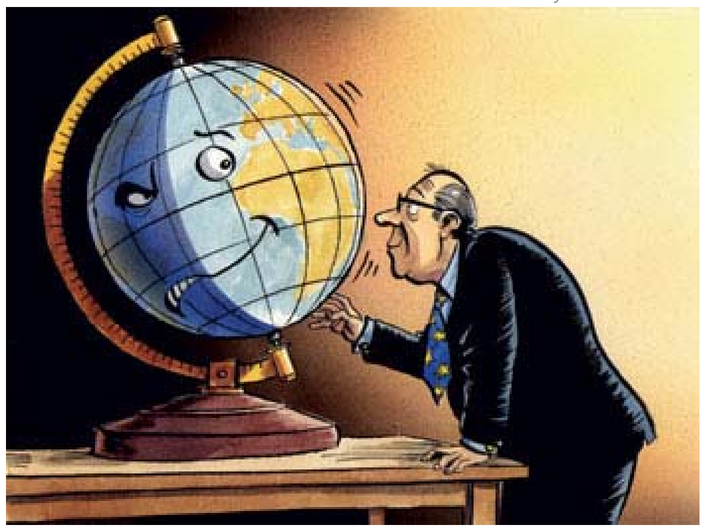
The voters may yet come to a different conclusion. A pre-debate poll in *El País* showed that 56% liked Mr Rajoy's immigration contract. The PP is aiming at working-class voters the Socialists usually rely on. They are often the first to worry about the impact of immigration on their neighbourhoods and local schools, as well as the first to lose their jobs in an economic slowdown. Mr Rajoy wants these voters either to switch allegiance or just to stay at home. Then Mr Zapatero may find that seeming nice is not enough.

Charlemagne

Winners and losers

Feb 28th 2008
From The Economist print edition

Illustration by Peter Schrank



Europe is a big winner from globalisation. If only politicians would say so

“LET us be frank about it: most of our people have never had it so good,” a British prime minister, Harold Macmillan, once said. The phrase entered the political lexicon, and “Supermac” went on to win re-election in 1959. The lesson seems clear enough: for a politician, delivering good news is a winner.

If only it were that simple. Half a century on, a growing body of research makes the case that, contrary to widespread belief, globalisation has made life better for most European citizens. What is more, Europe is unusually good at it. Yet political leaders seem wary of delivering the good news. With few exceptions, the political rhetoric when it comes to globalisation ranges from grim resolve (this challenge can be managed) to plain grim (we must tame this menace). Defending globalisation is left to a cottage industry of think-tanks, academics and business lobbies (although some of the most thoughtful studies are quietly financed by pro-market governments, from Finland to the Netherlands, or by the European Union).

What is going on? Politics, mostly. Today's Europeans fear that globalisation may not be good for most people. Or, to be more precise, even if they notice the diffuse benefits (cheap jeans and high-tech gadgets), they fret about the visible losers, starting with workers whose jobs are shipped overseas. Worse, with globalisation disrupting business models at an ever finer level of detail many citizens feel they cannot be sure if they will be next.

A new book* by a pair of academics from America's Johns Hopkins University finds lots of facts to cheer Europeans up. European consumers (ie, all Europeans when they are shopping) are big winners from globalisation, which has delivered cheap imports, held down inflation and kept interest rates low. Despite the fuss about China and India, the EU's share of world exports rose slightly between 2000 and 2006. What is more, two-thirds of Chinese exports involve foreign brands, a good chunk of which are European. Nor does a “made in China” tag mean big revenues for Chinese firms. In a recent speech defending globalisation, the EU trade commissioner, Peter Mandelson, cited a University of California study into who gains when an iPod is sold in America for $299. Only $4 stays in China with the firms that assemble the devices, Mr Mandelson explained. $160 goes to American companies that design, transport and retail iPods. A similar pattern holds for many European products.

Europeans worry a lot about wage competition. The researchers note that globalisation is not just about wages, but more broadly about finding efficiencies anywhere along complex supply chains. After all, most non-EU employees of European firms live in America, not China (EU and Swiss firms employ some 3.5m workers in America). Yes, European jobs have been lost by offshoring, but unevenly. In France only 3.4% of jobs lost in 2005 could be blamed on offshoring, though there has been a wave of factory closures more recently (see article). Portugal has suffered more: a quarter of its job losses between 2003 and 2006 involved jobs heading overseas, mostly to new EU members.

Stick to the data, and globalisation *Angst* in Europe can look like the tail wagging the dog. Italian producers have demanded anti-dumping duties of tens of millions of euros on Chinese air compressors, to preserve just 500 jobs. Yet in a political world, data get you only so far. A politician seen as heartless towards 500 workers risks punishment by millions of watching voters. EU economies may have created 18m more jobs than they shed in the past decade. But the jobs are different: like America, Europe has shed manufacturing and farming jobs, and created new ones in services. Many Europeans suspect these of being precarious and low-paid. President Nicolas Sarkozy of France is not alone in fuelling such suspicions, visiting factories to vow that France will remain an industrial power—with state help if need be—and deriding those who say that services are the future.

Services français

Such populism wilfully ignores European strengths. France has a particular genius for exporting services (if you are after striking symbols, a French firm, Sodexo, feeds both the American Marines and the British garrison on the Falklands). Furthermore, wages and conditions in services vary widely; and not all factory jobs were fun. Yet Mr Sarkozy and his kind may be expressing something else: a sense that a shift towards globally traded services involves a loss of control. Many Europeans have grown up in corporatist systems, dominated by trade unions, employers' groups and politicians. Globalisation is bad for such a model. That can be liberating, if annoying to French Gaullists. But it can be bruising as well.

Globalisation is one reason why European wage demands have been so restrained in recent years. It is easier for bosses to say no when workers fear that their jobs might be shipped to Shenzhen. That has been good for EU competitiveness. But it is not nice to hear your boss making the threat. Arguably, the European model has more niceness built into it than the American version, thanks to social safety nets of various sorts. Some, like Denmark's pricey “flexicurity”, look tailor-made for a globalised world thanks to their focus on supporting and retraining individual workers, not protecting jobs.

Politicians should not skate over risks (to be fair, in his 1957 speech, even Mr Macmillan confessed to worrying: “is it too good to last?”). But they should not conceal good news from voters, either, just because it runs counter to popular gut instinct. Although many Europeans do not seem to realise it, globalisation has been good for them—and the protection some crave would do far more harm than good. Will today's politicians ever be frank enough to tell them?

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* “Globalisation and Europe: Prospering in the New Whirled Order”. By Daniel S. Hamilton and Joseph P. Quinlan, Centre for Transatlantic Relations.

Private education

Is it worth it?

Feb 28th 2008
From The Economist print edition

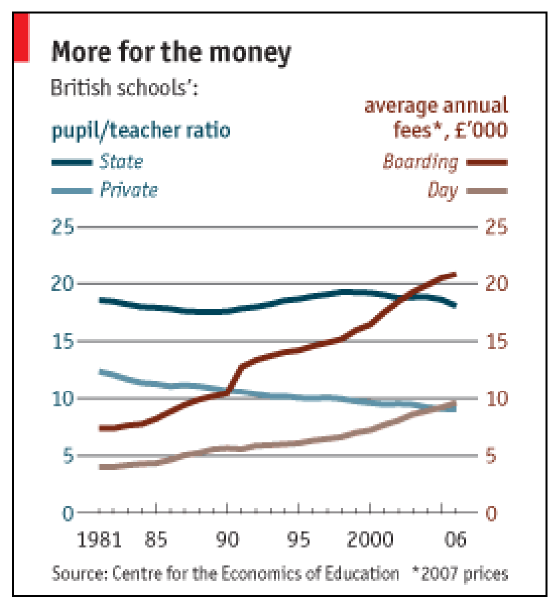
As the cost of private schools soars, we look at what parents get for their money

Getty Images

Get article background

FEE-PAYING schools have long played a giant part in public life in Britain, though they teach only 7% of its children. State-educated prime ministers (such as the current one) are a rarity; a third of all MPs, more than half the appointed peers in the House of Lords, a similar proportion of the country's best-known journalists and 70% of its leading barristers were educated privately. There is no sign that the elevator from independent schools to professional prominence is slowing: nearly half of the undergraduates at Oxford and Cambridge were privately schooled too.

Many ambitious parents would like to set their children off on this gilded path. But there is a problem: the soaring cost. Fees at private day schools have more than doubled in the past 20 years, in real terms; those at boarding schools have risen even faster (see chart). Since 2000 fees have risen by at least 6% every year, according to Horwath Clark Whitehill, a consultancy—double retail-price inflation and half as much again as the growth in wages. If this continues, a four-year-old embarking on a career in private day schools this autumn will have cost his parents around £170,000 ($335,000) in today's money by the time he completes secondary school. So even though more Britons than ever before describe themselves as comfortably off, the share of children being educated privately is barely higher than it was two decades ago.



Yet as the cost grows, so do the incentives. It is increasingly hard to be sure of securing an acceptable alternative. State-financed schools for the gifted are now scarce. Other time-honoured routes, such as finding God (and a place in a religious school packed with the offspring of similarly provident parents) or buying a house next to a good state school (the price will be hefty, but can be recouped by selling once the children have grown), are becoming harder. Ed Balls, the schools secretary, has signalled a shift away from increasing state-funded religious education, and many schools are thinking of choosing students by lottery rather than proximity.

On March 3rd parents all over England will get letters telling them which schools their 11-year-olds are to go to—and many will be watching with interest to see what happens in Brighton, on the south coast. For the first time, places in its eight secondary schools will have been allocated randomly within each catchment area.

Already the benefits are being felt by local private schools. Brighton College, in the town centre, has seen the number of 11-year-olds taking its entrance test rise by almost half. Its head teacher, Richard Cairns, says he is thinking of expanding.

Just what will these refugees from randomness be getting for their money? Researchers at the Centre for the Economics of Education have used data on earnings, social class and education to distinguish the effects of private schooling from other advantages that students at such schools may enjoy (such as having richer, better-educated parents). Those who left private schools in the 1980s and early 1990s can expect to earn 35% more in life than the average product of a state school, they found, around half of which can be attributed to education, not background. That, they calculated, means parents achieved an average 7% return on their investment in fees.

If that were the entire benefit their children received, it would not be bad—but there is more, says Francis Green, one of the researchers. “Private education is a consumption good, not just an investment. Long gone are the days of spartan dormitories and cold showers—kids in the private sector now have fabulous science labs and sports facilities, and access to a huge range of subjects and activities.”

The researchers also managed to pinpoint the way private schools work their magic: through better exam results, rather than through networking opportunities or better teaching of soft skills, such as etiquette or leadership. Once they compared state- and private-school leavers with identical qualifications, the earnings premium disappeared. “In the past few decades, private schools have transformed themselves into highly effective exam-passing machines,” says Mr Green. They hire better-qualified teachers, and more of them, offering higher salaries to lure those with qualifications in difficult subjects such as physics, mathematics and foreign languages, and now have twice as many teachers per pupil as state schools do.

Whether today's parents can expect similar returns on their investment depends partly on whether fees continue to grow at a similar pace. One insider thinks this unlikely: many parents have remortgaged to pay fees, and with house prices shaky and banks tightening their lending criteria, this route is fast closing off.

But parents willing to take a riskier route could reap greater rewards. Another group of researchers interviewed parents and children from 124 well-off white middle-class families in three English cities. The parents had made the decision to send their children to poorly-performing local comprehensives. The children did well, with excellent exam results and plenty of places offered by highly-regarded universities, including Oxford and Cambridge.

One reason for their success, the researchers suggest, is that the schools, mindful of their positions in official league tables, were keen to keep these valuable clients. Teachers paid the youngsters more attention in class than they did to dozier students and arranged extension activities for them. One school, desperate to keep a bright child in the sixth form, even ran an A-level drama course especially for her.

The parents were delighted by their huge savings. But they had to work hard. More than half became school governors, and all monitored their children's progress relentlessly. “They thought their children would do well being exposed to a more socially and ethnically diverse educational experience,” says David James, one of the researchers. “But as people must do with more volatile, risky investments, they watched closely and were ready to pull out if needs be.” So parents inclined to take this route must ask themselves two things: what their risk profile is, and whether they are willing to be activist investors.

Child abuse in Jersey

Not seen, not heard

Feb 28th 2008 | ST HELIER, JERSEY
From The Economist print edition

A grisly discovery raises questions about the offshore haven

FED on salmon and insured for £4.5m ($8.9m), Eddie is a prince among springer spaniels. The police sniffer-dog justified his lavish lifestyle on February 23rd, when he led officers to a spot at an old children's home where, under concrete, lay the remains of a child's skull. Police are digging up six more patches in the grounds of Haut de la Garenne, a Victorian “industrial school” that was a children's home until 1986. The excavations are part of a probe into child sexual abuse going back to the 1940s. Officers have taken phone calls from more than 160 people who claim to have been mistreated there, and fear that the home could reveal more bodies.

The discovery is the more shocking because it was made on Jersey, an island of just 90,000 inhabitants. Islanders, who hold British passports but are geographically closer to France and elect their own government, find it hard to believe that children could simply vanish without anyone knowing. Stuart Syvret, a former health minister, has put together a dossier of abuse in schools and care homes that he thinks has been hushed up for decades by “the establishment”, from social workers to politicians and judges, whom he accuses of being more worried about spoiling Jersey's reputation as a pretty place for offshore banking. The island is livid with rumour: backhanders, paedophilic cults and Masonic conspiracies are among the wilder theories swirling around.

Eddie and his colleagues have days of digging ahead of them. But the focus on Jersey has already exposed features of island life that could make abuses of all sorts more likely, and the reporting of them less so. One is the constitutional conflicts of interest that result from Jersey's small size. In his role as the island's “bailiff”, Sir Philip Bailhache is both president of the legislature and head of the judiciary. His brother, William, is the attorney-general, a role which on Jersey includes the job of chief prosecutor. Doubling-up such as this is partly why abuse has not always been rigorously pursued, Mr Syvret reckons. He wants judges to be flown over from the mainland for any trials that emerge from Haut de la Garenne, to ensure impartiality. On February 27th a group of British MPs backed his calls. The British government has yet to show its hand.

A lack of decent facilities—another consequence of Jersey's size—may also have contributed to some of the milder malpractice cited. Until recently, young offenders were remanded to a small converted farmhouse with windowless rooms and dingy attics. Those who tried to abscond were locked up in isolation—to punish them, according to a whistleblower from the mainland who was sacked last year, or because there was nowhere else secure to put them, according to social services. A new £3.5m home, opened in 2006, should improve matters.

At the root of many of the island's problems is its halting democracy. Though politicians are elected, voters have no say in who forms a government, since assemblymen are voted into ministerial posts by their peers. That is true in Westminster too, of course—but in Jersey almost all parliamentarians are independents, making it hard to know what sort of coalition will emerge from elections. Frank Walker, chosen as chief minister in 2005, had won fewer votes in the island-wide elections than Mr Syvret, who is now a backbencher. Voters are giving up: at the last election, in 2005, six deputies were elected unopposed, on a turnout of less than 40%. (On neighbouring Guernsey it was 63%.)

The arrival of dozens of journalists on Jersey is not welcomed by all, though it is good news for hoteliers and publicans. But there may be benefits to opening up the island to outside scrutiny. Links between government and the local media have caused many islanders unease before now. Until 2005 Mr Walker was chairman of the company that owned the island's only newspaper, the *Jersey Evening Post*. (Its reporters deny any bias, but say that there were regular arguments with Mr Walker over content.) Disaffected readers can always tune into local radio, of course—where they may hear the news read by one Fiona Spurr, who also goes by the name of Mrs Frank Walker.

British airports

BAA's double-whammy

Feb 28th 2008
From The Economist print edition

Why Britain's biggest airport operator needed a new boss

THE decision this week of Britain's dominant airport operator, BAA, to get itself a new chief executive is a measure of the bind the firm finds itself in. The unlucky owner of Heathrow is fighting irate airlines, passengers, creditors and regulators.

BAA's outgoing boss, Stephen Nelson, was a personable retailer. Its new one, Colin Matthews—who until last year was chief executive of Severn Trent, a water company—is a tough egg who knows all about running regulated utilities. He also understands the aviation business, having been director of technical operations at British Airways, BAA's biggest customer.

BAA will get some much-needed good publicity when Terminal Five, which it has spent £4.3 billion ($8.5 billion) to build and kit out, opens on March 27th. On time and on budget, Terminal Five is as grand as the rest of Heathrow is shoddy and dysfunctional. But BAA's problems dwarf the magnificent new terminal.

They stem, in part, from the highly leveraged £10.1 billion purchase of the company in 2006 by Ferrovial, a Spanish construction group. Ferrovial always intended to restructure the £9 billion it had to borrow to finance the acquisition in order to get more favourable repayment terms. It has found the job much trickier than it expected, however. Turmoil in the credit markets has sent interest premiums surging. And BAA itself is coming under increasing regulatory scrutiny.

Next month the Civil Aviation Authority (CAA) will announce new price caps for both Heathrow and Gatwick, Britain's second biggest airport and also owned by BAA. Most expect the regime to be tightened, and BAA's room to make profits restricted. To make matters worse for the airport owner, the Competition Commission, deluged with complaints from airlines and passengers alike about BAA's poor performance, is investigating a possible break-up of the company. It is due to publish its “emerging thinking” in the next few weeks.

Perhaps not surprisingly, beleaguered BAA argues that if it is hit by this double-whammy its investment programme will be jeopardised. BAA has committed itself to spending £10 billion over the next decade across the seven airports it owns to expand capacity and improve conditions for passengers, especially at Heathrow.

The company maintains that the current system of regulation is designed primarily to keep prices as low as possible. It is out of date, the firm argues, and needs to be replaced long before 2012, when the government says it will look at the structure again. A new, joined-up regulatory regime that sets out to encourage investment in future capacity, higher quality of service and more concern for the environment is required, the airport owner thinks. The CAA rejects the criticism, saying that it already takes these things into consideration. And others point out that Ferrovial's over-leveraged balance sheet has more than a little to do with BAA's plight.

BAA knows it will not succeed in convincing the government unless it achieves a consensus within the aviation industry. Of that, there is so far little sign. Mr Matthews will need to draw on every ounce of his experience in the months ahead.

The DNA database

Big, bigger, biggest

Feb 28th 2008
From The Economist print edition

The courts ponder how much genetic information the police should hold

IT IS an object lesson in the unwisdom of shopping your nearest and dearest after an argument. In 2001 Michael Marper was arrested after his partner complained of harassment; the couple were later reconciled and the case was dropped. But in the meantime Mr Marper had to give police a sample of his DNA—which is still sitting in Britain's DNA database, along with 4.5m others. That collection, already the world's largest, covers 7% of the population (and 40% of black men). It is still growing, boosted by samples taken from all those arrested for a wide range of offences and kept even if they are never charged.

Since this lovers' tiff, Mr Marper and a teenager known as "S", who was tried for attempted robbery and acquitted, have spent much time trying to get their records removed from the database. In 2004 the House of Lords rejected their claim that the retention was discriminatory and infringed their rights to privacy. On February 27th the European Court of Human Rights heard their case; a judgment is expected later in the year. If they win, up to a million of the samples in the database—taken in connection with arrests that did not result in convictions—may have to be destroyed.

Public opinion regarding the DNA database is being pulled, hard, in opposite directions. A series of government data blunders has led citizens to question the wisdom of entrusting officials with something as sensitive as their DNA. And this database has serious flaws. It recently emerged that one in seven of the entries are duplicates, stored under different names. When arrested and asked for a DNA sample, some people simply lie about who they are, it seems.

But strengthening the case for putting every citizen on the database are a pair of convictions in February for some particularly shocking murders. Steve Wright and Mark Dixie both came to the attention of the police because DNA found at crime scenes matched samples taken for relatively minor offences. The police officer who led the murder hunt for Mr Dixie has called for a compulsory national database, and the Association of Chief Police Officers says there needs to be a public debate on the issue.

The government rejects this call, saying that a universal database would raise "significant practical and ethical issues". Somewhat awkwardly, it also rejects the argument that being on the database stigmatises innocent people. "They have nothing to fear from providing a sample," says a Home Office spokesman. "Retaining this evidence is no different from recording other forms of information such as photographs and witness statements." Mr Marper, and other innocents and petty offenders, are urged to take comfort from the fact that they were added to the database for trivial reasons. The question is whether it would be fairer if the rest of the nation joined them there too.

The House of Commons

Out of order

Feb 28th 2008
From The Economist print edition

Used to disciplining MPs, the speaker is in trouble of his own

THE speaker of the House of Commons, one of Westminster's most ancient offices, is also one of its most cursed: before 1560 seven went on to be beheaded. The current holder of the title, Michael Martin, is unlikely to meet that gory end, but he is in a predicament nonetheless.

Elected by fellow MPs to the post in 2000, Mr Martin is under attack on several fronts. Many accuse him of being less than fervent in reforming the controversial taxpayer-funded allowances enjoyed by those sent to Westminster. After revelations in January that a Conservative backbencher had used his office budget to employ his son (a full-time student at the time), Mr Martin asked a Commons committee to report on allowances by the autumn. Under pressure from MPs anxious about Parliament's flagging reputation, he has brought the date forward to July, but the schedule still strikes many as leisurely.

Mr Martin is also criticised for making the most of parliamentary perks himself. He has claimed £4,000 in taxi fares for his wife's shopping trips, bought flights for his family using air miles gained on official trips and claimed thousands of pounds for his home in Scotland. Yet he has a plum job. The speaker's role is to chair debates in the Commons (ejecting recalcitrant MPs from time to time) and represent the Commons to the queen, the Lords and other outsiders. For that, he is given a salary of around £140,000 (the same as a cabinet minister) and an opulent residence. Prudence might suggest that he limit any additional recourse to the public purse.

Mr Martin's unpopularity in some quarters goes back further than the expenses row. He was a contentious choice to begin with. The recent convention is that the job of speaker alternates between the two main parties, yet he followed another Labour MP, Betty Boothroyd. His thick Glaswegian brogue—he was cruelly nicknamed “Gorbals Mick”—led many, snobbishly, to question his suitability for the job. Supposedly non-partisan, he had to apologise for appearing to support a government policy in 2001 and has made dubious interventions against successive leaders of the opposition.

Yet the case that Mr Martin should be hounded from his job forthwith is not compelling. He seems not actually to have broken any rules: MPs are encouraged to use air miles for future official travel rather than for personal travel, for example, but they are not forced to. When Mr Martin's spokesman resigned on February 23rd for unwittingly misleading a newspaper about the speaker's wife's expenses, he absolved Mr Martin himself of blame.

The speaker can count on the tribal loyalty of the many Labour MPs who see him as the victim of class prejudice demonstrated by sneering Tories and journalists. Nor is he under fire from party leaders—Gordon Brown praises his performance, the Tories' David Cameron says whether he goes is a matter for the Commons to decide and the Liberal Democrats' Nick Clegg speaks of a “witch-hunt”. And though a delegation of senior MPs may urge him privately to step down, there is in fact no formal procedure for removing a speaker.

But hope is widespread that Mr Martin will resign of his own accord before long. He has served almost eight years in the job, an average stint in recent times, and talk has already turned to his replacement. Potential candidates include Sir George Young of the Tories, Labour's Sylvia Heal and the Lib Dems' Alan Beith. They have the requisite seniority (all are in their 60s) and prestige in the Commons (Sir George chairs its Standards and Privileges Committee; Ms Heal and Mr Beith are deputy speakers). The election of a speaker is rarely riven with partisan enmity; if Mr Martin is pushed before he is ready, however, angry Labour MPs may ensure that next time is an exception.

Polyclinics in the NHS

The latest new new thing

Feb 28th 2008
From The Economist print edition

Ministers may be keener than patients on a big shake-up in medical care

TO PASSERS-BY in west London what catches the eye are the bright colours of the building. But the Heart of Hounslow Centre for Health, which opened last year, has also caught the eye of Labour ministers envisaging a controversial reconfiguration of the National Health Service.

Ever since the NHS began 60 years ago, there has been a division of labour between general practitioners and hospital consultants. The GPs, who are usually patients' first point of contact when they are ill, provide primary care in their local practices. Secondary care is provided in hospitals, whose consultants carry out specialist treatments and tackle emergencies.

The Hounslow centre could be the start of a new way of running the NHS that straddles the old divide between primary and secondary care. For one thing, it houses not just one GP practice but three, which together have 12 family doctors and over 20,000 patients. By contrast, the typical practice has four or five doctors, and some GPs continue to work on their own. As important, the health centre in west London is providing some medical services that would otherwise require a trip to hospital, such as treatment for leg ulcers.

The crossover between primary and secondary care in the Hounslow centre is still extremely modest. But it is the nearest thing Britain has yet to German polyclinics, which operate on a far bigger scale and offer many hospital-like services, including day surgery. The health authorities that organise medical care in London will shortly conclude a public consultation on a plan that envisages as many as 150 German-style polyclinics in the capital in ten years' time. The strategy is based on a report last July, which proposed that “the polyclinic will be the place where most routine health-care needs are met” and where most GPs would eventually work.

What London is planning may be coming soon to the rest of England, since that report and its ringing endorsement of polyclinics was written by Ara Darzi, a surgeon whom Gordon Brown appointed a health minister last summer. After sorting out what London should be doing, Lord Darzi has now turned his attention to the rest of the country. Surprisingly, his insubstantial interim review in October made no mention of polyclinics. But his enthusiasm for them in a recent interview suggests that they will feature large in his final proposals, which are due by June.

There are two main reasons why Lord Darzi is so keen on polyclinics. First, he believes they will provide more convenient and better care for patients, who will need to travel less often to hospitals. Second, he thinks they will be cheaper than the hospital care they are intended to replace.

The first argument is plausible but looks shaky on inspection. Polyclinics may be closer than hospitals but they will be farther away than GP practices. Many patients coming to see their family doctors will not require the follow-up care available in polyclinics and will find them less convenient than GP surgeries are now. The Royal College of GPs fears that polyclinics may rupture the personal link with a single family doctor that patients value.

Lord Darzi's second rationale is also questionable. The NHS will save money if hospitals strip out costs on activities being moved to polyclinics; but this may not occur on the necessary scale. It would also be very expensive to move from the current infrastructure of GP practices to the new health centres, points out John Appleby, an economist at the King's Fund, a health-policy think-tank.

The British Medical Association opposes polyclinics—one good reason, ministers may think, for introducing them. Relations have been strained since the doctors' trade union outsmarted the government in negotiating a new GP contract. The National Audit Office revealed this week that the contract cost £1.8 billion more, in the three years to 2005-06, than ministers originally intended. But in thinking about the future of the NHS, the government should bear in mind the crucial role that family doctors have long played in keeping overall costs down by acting as gatekeepers to expensive secondary care.

Polyclinics may be a good idea in Germany, where most hospitals have historically been unable to offer out-patient services. But the case for introducing them wholesale throughout the NHS is weak. There is plenty of scope to improve services and save money without re-inventing the health service.

Temporary workers

Marking time

Feb 28th 2008
From The Economist print edition

A row pits Labour against labour unions

THE vice-like grip of party discipline means that private members' bills—legislation sponsored by individual MPs rather than the government—rarely go anywhere these days. So when, on February 22nd, two-fifths of Labour MPs voted to support one brought by Andrew Miller, a Labour MP for Ellesmere Port, the government sat up and took notice.

At issue are the employment rights of Britain's hundreds of thousands of temporary workers. Currently, temps are often paid less than full-time workers doing similar jobs, receive fewer holidays and have less generous sick leave. Mr Miller's bill would give them the same rights as their full-time colleagues. If passed (which is unlikely, even with such strong support), it would effectively replicate the Agency Workers' Directive, European legislation that Britain has long opposed.

Opinions on the law are split along predictable lines. Business lobbyists argue that giving temps more rights defeats the point of using them in the first place, and say that anything that makes it harder or more expensive to hire and fire will reduce demand for their services. The Confederation of British Industry (CBI) thinks a quarter of a million jobs could be at risk.

The trade unions, however, point out that the CBI's worries sound eerily similar to those they expressed over the minimum wage, which, they predicted when it was introduced ten years ago, would have an apocalyptic effect on the economy. A decade's-worth of hindsight has proved such fears groundless, although business groups point out that the minimum wage was initially set rather low. The Trades Union Congress argues that treating temps as if they were permanent staff will make them less resentful of their better-treated colleagues and keener to work hard.

Stuck unhappily in the middle is Gordon Brown, caught between the Labour Party's socialist roots and the embrace of capitalism that brought it to power. Mr Brown is fond of trumpeting the virtues of Britain's flexible labour markets to his more rigid European colleagues, and it was his government that helped to block the passage of the Agency Workers' Directive last year. Yet opposing the bill risks eroding support for Labour among its traditional voters. A compromise proposed on February 25th—setting up a commission to investigate the matter—has been rejected by unions as a needless delay.

Such a delay could, of course, be exactly what Mr Brown needs. Despite British opposition, the French are thought to be keen on reviving the European version of the legislation when it takes over the EU presidency this summer. A heroic tale of eventual British defeat by meddlesome Eurocrats following plenty of glorious resistance is a tried-and-tested way out of such situations.

But Labour's careful balancing act between business and the trade unions is getting trickier. Many businessmen think less of the government for its handling of bust Northern Rock, a mortgage lender, and for its uncertain tack in taxing non-domiciled workers and capital gains. Support among the unions is already faltering, too. In 2004 Tony Blair bought off angry unions by accepting a list of their demands in a deal known as the Warwick agreement. One clause was equal rights for temporary workers. If unions think that the government is reneging on its promises, it will make Labour's high-wire act harder still.

Bagehot

Come to mama

Feb 28th 2008
From The Economist print edition

Contrary to conventional wisdom, the mother of parliaments is working better than ever

Illustration by Steve O'Brien

SITTING on his canopied chair, behind his bewigged clerks, smiling meekly and mildly calling “Order!”, Michael Martin, the speaker of the House of Commons, seems an inoffensive sort of chap. But he has become the subject of a mini-scandal and the symbol of a big malaise. The scandal involves air miles and expense-account taxis; the malaise concerns the alleged venality and utility of Parliament itself. David Cameron, the leader of the Conservatives, observed in the House of Commons this week that the public now doubts whether politicians offer value for money. Judging by newspapers and talk shows, the public has decided: the repute of the mother of parliaments is roughly equal to that of the Millennium Dome; MPs' status has fallen lower than that of estate agents, and maybe even journalists.

It is easy to see why. First there are the amateurish financial controls that have permitted dodgy accounting, generous loopholes and brazen nepotism—a system that Mr Martin himself has, perhaps unfortunately, been deputed to address. Many MPs seem unable to grasp the widespread anger that these fiddles arouse; they accuse journalists of confecting it—and defensively interrogate said journalists about their own expenses. Then there is the fact that the green benches in the Commons are often very green indeed, because very few people are sitting on them. Gordon Brown, like his predecessor, is scarcely ever there; MPs who do turn up are often outnumbered by the schoolchildren in the public gallery, who are also better behaved. And, alas, this neglect of the chamber is entirely rational.

Along with the taxis, Mr Martin has in the past been accused of undue partisanship (like all speakers he is an MP, in his case a Labour one). That too reflects a general problem with the House he chairs. Since the birth of modern political parties, the partisan loyalty of MPS (on pain of not being promoted) has hobbled the Commons in its supposed job of holding the executive to account. Real power was long ago displaced to the cabinet, then sucked from cabinet to the prime minister, and from him to the Scottish Assembly, Europe and so on.

Important debate takes place inside parties—and in the media: as a popular political joke has it, the best way to bury an issue is to make a speech about it in the Commons. Mr Brown's team once vowed to make policy announcements in Parliament first, but they soon reverted to the leaking and spinning of yore. The one parliamentary set-piece that commands attention—prime minister's questions (PMQs)—has, under the pressure of television, and of the mutual loathing of Mr Brown and Mr Cameron, become a weekly yelling match (badly policed by Mr Martin). On February 27th Mr Cameron tellingly used the occasion to challenge Mr Brown to extra-parliamentary televised debates.

Here comes the “but”: all of that is sad and bad, but little of it is new, and most of it has been worse. “The scene of noise and uproar which the House of Commons now exhibits is perfectly disgusting,” reported Charles Greville in 1835. Not only the manners but the morals of MPs used to be at least as lax; taxi abuse and other scams brought to light by improved scrutiny pale beside those of bygone eras now mistily regarded as halcyon. Attendance in the Commons has always been pretty slack.

The same is true of MPs' sycophancy: they are in fact much less docile than in the past. The original Bagehot records a Victorian description of Tory MPs as the “finest brute votes in Europe”; 50 years ago, more politicians may have been able to quote Thucydides, but they were even more obedient to the whips than their counterparts today. Though Labour's big majorities have disguised the sedition, the MPs of Tony Blair and Mr Brown have by post-war standards been peculiarly rebellious. Even if actual government defeats have been vanishingly rare, insurrections have forced ministerial concessions, as in the current wrangle over anti-terror laws. An opposite but encouraging trend is visible on the Tory benches: for all the pantomime adversarialism of PMQs, the Tories have actually become more co-operative over legislation during Labour's decade in office.

Dignified and efficient

Parliament isn't only less woeful than it used to be: in some ways it is even actively good. MPs spend more time than ever helping their constituents. That helps to explain why—as with attitudes to, say, the NHS—general and particular perceptions are contradictory: people respect their own MPs while believing that as a pack they are villains. Meanwhile, although House of Commons select committees are neither as powerful as congressional ones in America nor as independent as they could and should be, they are increasingly well resourced and influential; the prime minister now appears before one of them. Another relatively recent initiative is useful scrutiny of bills in draft form. All that is less fun than blood-and-thunder oratory, but in an age when the substance of politics is often dryly technocratic, committees aren't a bad place to conduct it.

But the biggest and least-noticed improvement has been in the House of Lords. There are still more walking sticks than ethnic minorities reposing on the red benches beneath the stained glass and gloomy statuary. But the affiliated Lords are now more fairly spread among the parties than in the days of in-built Tory domination. They are also more effective and assertive in rejecting and improving bills. Lacking a majority, the government has to resort to the quaint expedient of winning the argument. As it happens, there will soon be an election to the Lords: one of the 92 hereditary peers left among the appointees by the reform of 1999 has died, and another will be elected in her place. It is a crazy arrangement—but it is working.

Easy as it is to excoriate it, the mother of parliaments is not as senile as its many detractors, and the run of recent scandals, suggest. On the contrary: she is in finer fettle than ever.

Internship

Feb 28th 2008
From The Economist print edition

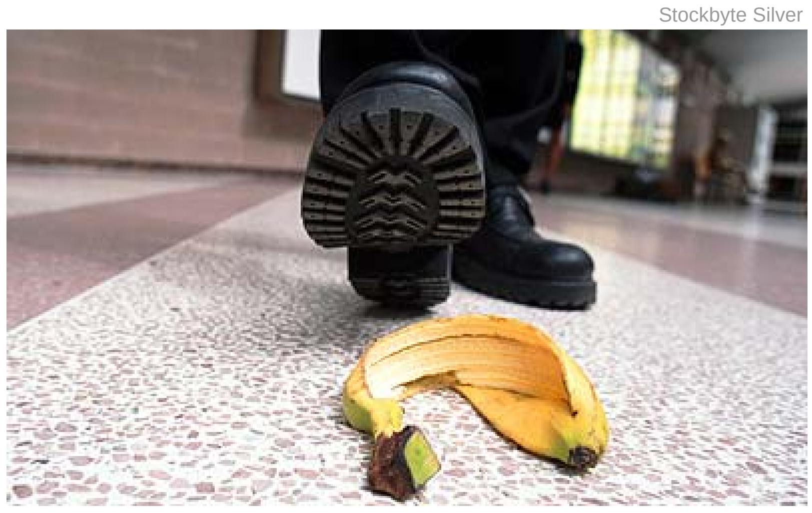
The Britain section will soon be choosing an intern to work for several months this summer. Applicants should send a letter and an article of about 600 words that they think would be suitable for publication. A small stipend will be paid. Applications must reach ursulaesling@economist.com by March 21st.

America, Europe and the management of danger

A hazardous comparison

Feb 28th 2008
From The Economist print edition

Stockbyte Silver



Americans like the idea (though not always the reality) of risk more than comfortable Europeans do. To Russians, both lots seem hyper-cautious wimps

ANYBODY who dabbles in transatlantic affairs has come across one giant stereotype: Americans admire risk-takers, whereas Europeans (at least in the rich, stable parts of the continent) are instinctively risk-averse, expecting the state to shield them from all sorts of dangers, including their own folly. Move a bit farther east to the ex-communist world, especially Russia, and you enter a place where things seem to have gone from one extreme to another: from an all-demanding, all-protective state to a free-for-all where life is full of deadly dangers, about which even the prudent can't do very much.

Like most windy generalisations, this transatlantic contrast has a grain of truth. Americans have embraced the fruits of biotechnology—in the form of foods based on genetically modified organisms—but Europeans see them as too dangerous for consumers and the environment. Even in the quietest American suburb, the rhetoric of the frontier is never entirely absent: people are expected to take responsibility for the security of their own homes (by shooting burglars), for their health and their financial future, in the knowledge that catastrophe looms if they make the wrong calls. A high rate of bankruptcy is seen in America as a sign of a healthy economy—and not, as Europeans often feel, as a threat to social peace. Americans are willing to invest in start-up companies or new financial products; the proverbial Belgian dentist prefers government bonds. It all flows, says Charles Kupchan, a Europe-watcher at America's Georgetown University, from the fact that American culture is more libertarian, whereas that of Europe is more communitarian.

This contrast may have more to do with rhetoric and self-image than with real life. In the regulation of car engines, for example, America took the virtuous step of mandating catalytic converters long before the European Union did. But in the (western) European climate, officious regulators have an easier time: people are more receptive to the idea that government should care for them. In America, demands for more regulation (of the internet, or air quality, say) have often been presented as calls to protect children; it's assumed that adults can fend for themselves.

On either side of the Atlantic, of course, the regulator's zeal can suddenly increase after an unforeseen event. The licensing of medicine by America's Food and Drug Administration has become slower since 2004 when a pain-killer, Vioxx, was withdrawn by its maker, Merck, because it increased the risk of heart attacks and strokes. But in America's regulation wars, there will always be lots of people who point out that caution can also cost lives. Psychologically at least, Europe is an easier place to make the case for being careful.

In any case, by comparison with most other parts of the world, and with any other era of human history, the United States and western Europe are converging in their attitudes to danger. Most kinds of risk have been successfully removed from everyday life. Women hardly ever die in childbirth; miners generally make it back above ground; fishermen usually return to shore; and having a drink of water no longer means dicing with cholera. Of course, some people—bungee-jumpers and rock-climbers—take risks freely; but the unwanted perils that once haunted people's lives are mostly a thing of the past.

What Americans and Europeans alike are now attempting to do is squeeze out the last few drops of risk, with results that are often counter-productive, because risk is simply transferred from one place to another. That is true in an obvious sense when, for example, companies dump toxic waste or use risky technologies in countries whose regulation is relatively lax. But there are also more subtle ways in which efforts to eliminate risk can simply move the danger along. Some good instances come from behaviour on the roads, where people may act more recklessly as safety measures (their own and other people's) make them bolder.

In one experiment, a British psychologist, Ian Walker of Bath University, simply got on his bicycle and monitored the behaviour of 2,300 vehicles that overtook him. When he wore a helmet, drivers were much more likely to zoom past him with little room to spare; when he was bare-headed (and indeed when he wore a female wig) the amount of space that motorists left would increase. An experiment in Munich found that the drivers of taxicabs fitted with anti-lock braking systems were involved in no fewer accidents than those without. That is because the former used those superior brakes not to practise prudence but to drive more aggressively.

Such unintended effects are not confined to Europe. John Adams, a transport expert at University College London, has compiled data from all over the world to show that laws making drivers wear seatbelts do not make roads safer; they move deaths from inside cars to outside them because they encourage bad driving. The number of young children killed on the roads has fallen in recent years, he notes—but mainly because they are rarely allowed out alone, so today's teenagers have less skill at navigating hazardous roads; and as a result, the number of teenagers killed in car accidents has jumped. He lauds the Dutch experiment in “naked streets” where most road signs and markings were removed to force travellers to keep their wits about them.

Where America and Europe may differ is in the main cause of their risk-reducing zeal. America's proverbially litigious culture makes all players in the public arena, be they government agencies, companies or schools, intensely keen to delimit their responsibilities, and within those limits to minimise the risk of liability. To many Europeans, an “ambulance-chasing” legal environment, which sees every mishap as an opportunity for a lawsuit, is an unwelcome pathology that has spread in their direction from the United States.

But Europe has pathologies of its own, especially that of the over-ambitious bureaucracy, such as the European Union agencies that regulate food and the environment. In the wilder fringes of the EU there are citizens who understandably trust the Brussels mandarins to monitor their beaches and air more fairly than their own country's bureaucrats ever would. So regulatory zeal becomes a source of legitimacy for EU institutions that badly need it.

Mission creep is not peculiar to Brussels. All bureaucracies are keen to survive and, if possible, grow. For survival, it is useful to estimate the level of the risks they are supposed to manage at close to, but not quite, zero. Higher and the institution may be regarded as failing; lower and it may be regarded as unnecessary. And growth can be achieved by bringing more risks within their remit. Britain's Food Standards Agency, for example, has decided to target not only the traditional problems of contamination by microbes or poisons, but what it calls the “downstream risks” of food: what people choose to eat. The agency is now introducing a food-labelling scheme with what its chairman, Dame Deirdre Hutton, says is the “absolutely intended consequence of getting manufacturers to change their products”. This reflects a mentality that refuses to see the overweight as fallible gluttons: now they are victims facing a risk which the government has a solemn duty to abate.

On both sides of the Atlantic, the net result is the same: a huge risk-avoidance endeavour which reflects the illusion that everyday life can be made almost perfectly safe. Whenever something bad happens—a child has an accident on a school trip; a window-cleaner falls off a ladder—the immediate call is for something to be done, and if the state doesn't oblige, lawyers will. Discontent with this state of affairs is no monopoly of the rugged American: some Europeans are worried too. Nils Brunsson, a professor of management at the Stockholm School of Economics, says muddled ideas about risk and regulation need correction by a third R: responsibility. “If you want responsibility, you take decisions,” he says. “If you don't, you get others to make decisions, and then say you had no choice.”

Some people, of course, find cruder and less rational ways of protesting against the search for a risk-free life. All over the rich world, there are parents who leave the child-proof lids off medicines because they find them so fiddly, and office workers so irritated by self-closing fire doors that they prop them open.

But those cultural differences persist. Americans who move to western Europe are often dismayed by a mentality that seems wary of technological or social innovation: they sense a resistance to “rocking the boat” by any actions whose effects are unpredictable. Europeans who settle in the United States are at once frightened and exhilarated by a place where people may yearn for a life free of risk (inside gated communities, for example) but know in their hearts they can never get it.

At the same time, both those shocks are mild compared to the one experienced by Westerners who move to Russia—and find themselves in a place where life is so full of lethal danger that some people see little point in reducing risk at the margins: a world of gaping pot-holes, tipsy ambulance-drivers and melting icicles which hang from ledges like daggers. The idea of regulators caring for the public in an accountable way, or of courts where a humble citizen can seek redress, would sound naive to many Russians. In a land where life expectancy (at 59 for males, lower than in Guatemala or Bangladesh) is lamentably short, people apparently see little value in driving slowly, or in cutting down on alcohol or tobacco.

Raw political power and/or hard cash are assumed to trump every other kind of authority, including the courts. But that does not mean that Russians are totally irrational in their choices. Individuals or firms that openly flout the law may do so in the well-founded belief that they are too powerful for the law to touch them. If people are prudent enough to settle their debts, it is not through fear of prosecution, but because much more unpleasant forms of private revenge may be in store. And as Mark Kirsh, a British lawyer in Moscow, points out, Russians are making a logical calculation when they rely more on friends than on state agencies or courts.

Few Americans or west Europeans would trade their relatively risk-free existence for the tingling dice with death that can go with daily life in Russia. But many would endorse the insistence of the Russian writer, Fyodor Dostoyevsky, on the sanctity of the right to incur danger: “What man wants is simply independent choice, whatever that independence may cost and wherever it may lead.” Being reckless from time to time preserves what is “most precious and most important—that is, our personality, our individuality.”

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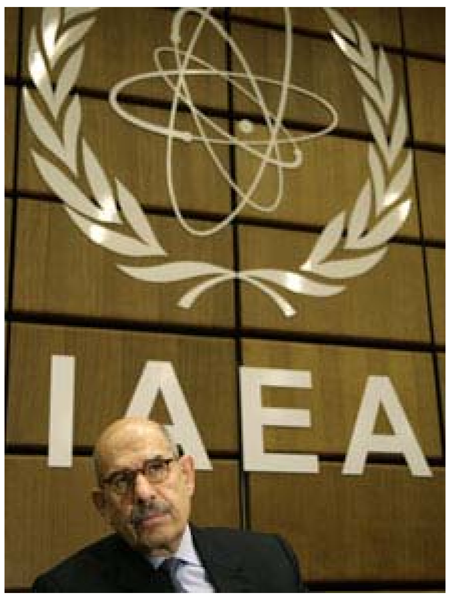
Nuclear proliferation

Why not just blow your whistle?

Feb 28th 2008
From The Economist print edition

Its latest Iran report highlights the problems of the UN's atomic watchdog

AP



ElBaradei: please elaborate

Get article background

SO IS Iran trying to build the bomb or not? Iran says it is not. Israel says it is. America's intelligence people say it was trying to until 2003 but probably stopped—and is still keeping its options open. Wouldn't it be splendid if an independent referee, with full access to the evidence, could rule for sure one way or another?

Such a body does exist. But the latest report from the International Atomic Energy Agency (IAEA), published on February 22nd, shows how tentative the UN's nuclear watchdog must sometimes be. Iran took the report as proof of its innocence. America and several European countries drew the opposite inference. They say that although the IAEA has still found no clear evidence of a bomb programme, the report leaves ample grounds for suspicion.

A look at the report's careful equivocations shows why it can be used as ammunition by both sides. Of the “outstanding” technical issues between Iran and the IAEA, Mohamed ElBaradei, the agency's director-general, claims his people have clarified all but one. But (there is said to be tension between the director-general and his safeguards experts) that is not quite what the report actually says. To anyone of a suspicious cast of mind, these “clarifications” leave something to be desired.

Why, for example, did Iran possess a 15-page document describing among other things how to machine enriched uranium metal into hemispheres, which are components of nuclear weapons? Iran's explanation is that the nuclear smuggling network run by Pakistan's Abdul Qadeer Khan had sent it this document in 1987, along with other documentation on centrifuges Iran had received, but that Iran had not asked for it. The agency says it is still waiting for further details on this from Pakistan.

In the case of other issues that Dr ElBaradei now calls clarified, what the report actually says is that Iran has provided explanations that are “consistent with” (or “not inconsistent with”) information available to the agency, but for which it is still “seeking corroboration”, even though it considers the question no longer outstanding “at this stage”. That is the formula the report applies, for example, to Iran's explanation for having conducted research on polonium-210, which can be useful for triggering nuclear weapons. This, say the Iranians (with supporting documents) was just basic science carried out at the personal initiative of the project leader.

The IAEA's ability to be more definitive is hampered by limited access to the evidence. Having run a secret nuclear programme for nearly two decades, Iran suffers from what Mr ElBaradei delicately calls a “confidence deficit”, which he urges it to correct by embracing fully the so-called “additional protocol”, giving his inspectors the right to a much closer look at its nuclear doings. But the agency's knowledge is also determined by the amount of information that foreign intelligence services choose to offer—or withhold.

In mid-February the Americans at last gave the IAEA permission to show Iran a batch of evidence, much of it reportedly recovered from an Iranian laptop, suggesting that it had conducted work on uranium conversion, missile-warhead design and high-explosives testing—all possibly related to nuclear weapons. This, says the IAEA's latest report, “is a matter of serious concern”. But on being shown the new evidence before the agency's report was compiled, Iran called the allegations baseless and the supporting documents forged.

The world's supposedly independent nuclear referee, in short, is stumped for the present. It has verified that none of the nuclear material that Iran has already declared has been diverted for a weapons programme. It has received some “consistent” explanations of previously fishy-looking activities. It says it knows more than it did about Iran's programme, but that it has not yet received complete information. And now it has to deal with an impasse over the evidence from America that Iran dismisses as a fabrication.

Iran says it would sign the additional protocol as Mr ElBaradei asks if the UN Security Council got off its back and its nuclear file was returned to the IAEA to handle alone. Fat chance. Having ignored two resolutions ordering it to stop enriching uranium, Iran now faces the prospect of a third. Nothing Mr ElBaradei's men say looks able yet to dispel the cloud of Iranian secrecy and Western suspicion that hovers over Iran's nuclear programme.

Torture and deportation

The ban stays absolute

Feb 28th 2008
From The Economist print edition

A ruling that will frustrate governments and please libertarians

IN A landmark decision, the European Court of Human Rights ruled on February 28th that a government may not deport an individual to a state where he may be at risk of torture or other ill-treatment. The unanimous ruling by the court's Grand Chamber, whose decisions are final, marks a big setback for every country that is struggling to rid itself of suspected foreign terrorists.

Civil-liberties groups were delighted by the judges' reaffirmation that the ban on torture under the European Convention on Human Rights and in international law remains absolute, even in the face of threats such as terrorism or war.

The Strasbourg court also poured cold water on the value of obtaining “diplomatic assurances” that a deported person will not be abused. Both Britain and America have been using such assurances, which human-rights groups call worthless, to justify sending suspected terrorists back to countries such as Jordan, Libya, and Egypt.

Before Europe's judges was the case of Nassim Saadi, a Tunisian living in Italy with his Italian partner and their eight-year-old child. In 2002 Mr Saadi was arrested on suspicion of plotting to commit acts of terrorism abroad. In May 2005 he was found guilty of criminal conspiracy (references to terrorism were dropped) and given four-and-a-half years in jail. On his release in 2006, he was ordered to be deported to Tunisia.

Meanwhile, a Tunisian military court had sentenced Mr Saadi in his absence to 20 years' imprisonment for membership of a terrorist organisation and “incitement to terrorism”. Claiming that he risked suffering torture and other violations of his fundamental rights if returned, Mr Saadi appealed to the European Court to prevent his deportation. Britain was given leave to intervene in the proceedings as a third party.

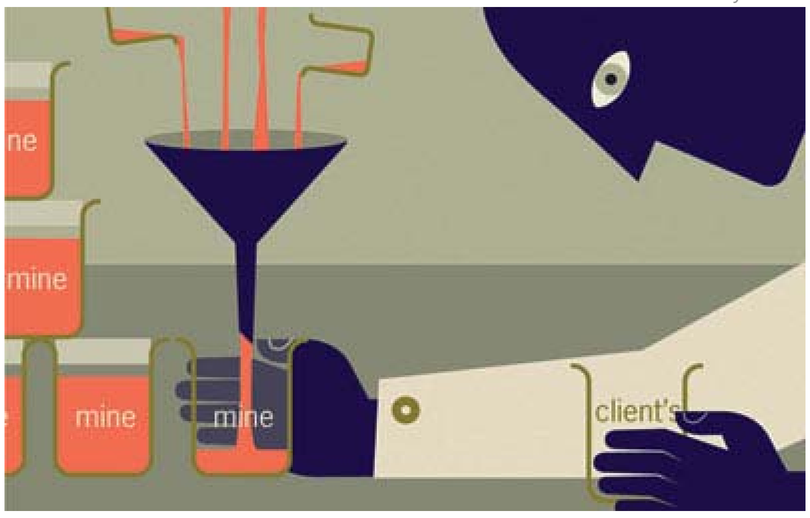
For the past 12 years, Britain has been fighting to get the European court to overturn a similar ruling in the case of Chahal, a Sikh activist living in Britain, who was suspected of terrorism in his native India. Claiming that he posed a national security risk in Britain too, Britain sought to send him back to India. He said he risked torture there. Ruling in his favour, the court said the absolute ban on torture extended to deportation cases “however undesirable or dangerous” the individual involved.

John Reid, a former British home secretary, later described that ruling as “outrageously unbalanced”, famously adding that the European judges “just don't get it”. The rights of the individual had to be balanced against the security interests of the host state, he argued. In this week's ruling the judges have retorted that they did “get it”, and that their opinion remains the same. Although the danger of terrorist violence facing many states could not be underestimated, they said, that should not call into question the absolute nature of the ban on torture under Article 3 of the European Convention.

Money for old hope

Feb 28th 2008
From The Economist print edition

Andy Baker



The fund-management industry has done very well—but mainly for itself, says Philip Coggan (interviewed here)

IMAGINE a business in which other people hand you their money to look after and pay you handsomely for doing so. Even better, your fees go up every year, even if you are hopeless at the job. It sounds perfect.

That business exists. It is called fund management. Charley Ellis, a veteran observer, explains that fees in the industry tend to grow at around 15% a year because markets rise by an average of 8% and savings grow by 5-6%. This growth is being maintained despite the industry's vast size. According to a report by Watson Wyatt, a consultancy, the value of all professionally managed assets at the end of 2006 was $64 trillion (see chart 1).

Under the normal rules of capitalism, any industry that can produce double-digit annual growth should soon be swamped by eager competitors until returns are driven down. But in fund management that does not seem to be happening. The average profit margin of the fund managers that took part in a survey by Boston Consulting Group was a staggering 42%. In part, this is because most fund managers do not compete on price. Instead, they persuade their clients to select their funds on the basis of past performance, even though there is little evidence to show that this is a good predictor of future success. Nor can investors be sure that the intermediaries who sell the funds—brokers, advisers and bankers—will steer them in the right direction. These middlemen often get a cut of the fund managers' fees, so they have little interest in recommending low-cost alternatives.

Hence the clients get engaged in a costly game of chasing the best performers, even though by definition they are bound, on average, to lose it: after costs, the average manager inevitably underperforms the market. Figures from John Bogle of Vanguard, an American fund-management group, neatly illustrate the point. Over the 25 years from 1980 to 2005, the S&P 500 index returned an average of 12.3% a year. Over the same period, the average equity mutual fund returned 10% and the average mutual-fund investor (thanks to his regrettable tendency to buy the hottest funds at the top of the market) earned just 7.3%, five percentage points below the index.

But whereas the clients have not always done particularly well out of the industry, the providers have prospered. In recent years the growth of private equity and hedge funds has led to more widespread use of performance fees, creating a new class of billionaires. The balance between the industry and its clients will not be redressed until investors learn that higher fees do not guarantee higher returns. “There's a huge amount left to do in order to provide a reasonable proposition to the client,” admits Alan Brown, chief investment officer of Schroders, a British fund-management firm.

Even so, fund management is undergoing a revolution of sorts. “The industry is in the process of more change than I've seen in the 30-plus years that I've been in the business,” says Mr Brown. In part, this reflects the lessons of the 2000-02 equity bear market. Pension funds had been heavily exposed to equities in the 1990s, which allowed the sponsoring companies to take contribution holidays. But when share prices fell, pension funds went into the red, raising doubts over whether equities were the right match for the long-term liability of paying out retirement benefits. Some pension funds switched to bonds; others demanded products that delivered positive returns, regardless of the performance of the equity index. That opened the door to hedge funds, private equity and a whole school of investing known as alternative assets.

The market for retail investors is also changing. These days most fund managers do not deal directly with such clients, but sell their funds to third parties such as brokers, advisers, private banks and pooled portfolios called funds-of-funds. This saves fund managers a lot of marketing expenditure, but it also leaves them at the mercy of the middlemen. They can no longer rely on the inertia of clients who stay with a firm for most of their lives; instead, holdings are churned as the intermediaries seek to generate the highest possible returns and justify their fees.

Call me unpredictable

One of the industry's biggest problems is the markets themselves. Not only do whole asset classes go through dismal periods, but investing styles too go in and out of fashion. A technology manager with a shining reputation in 1999 may have found that by 2002, 90% of his fund value had vanished. Even Bill Miller, the star manager at Legg Mason who beat the S&P 500 index 15 years in a row, has just suffered two years of poor returns. The latest event to ruin fund managers' performance numbers has been the credit crunch.

A second problem is that, in fund management, size is not necessarily an advantage. True, it can bring an improvement in margins; managing $2 billion does not cost twice as much as managing $1 billion. It also gives managers the marketing clout to build a brand name. Yet size can also be the enemy of investment performance. If a fund becomes too large, trading moves prices against the manager, or the fund starts to resemble the overall market. And star managers may be driven away by bureaucracy or lack of freedom.

So far, fund managers have been remarkably successful in maintaining their high fees, even in the face of lower investment returns in recent years. For more than three decades they have been fighting the challenge from “passive” rivals, which simply track the market through an index such as the S&P 500 or the FTSE 100. But now there are passive versions of other fund-management styles too, even high-charging hedge funds. Asset managers, for so long the Bloomingdales and Harrods of finance, are facing competition from the sector's Wal-Mart in the form of exchange-traded funds (ETFs), a flexible vehicle that gives investors exposure to almost any asset class at low cost.

Yet the industry is also being presented with two great long-term opportunities. In the developed world, populations are ageing and the burden of retirement provision is increasingly falling on the individual. In some countries the state pension offers little more than a subsistence income, and companies are increasingly retreating from the expensive final-salary pension promises that they made in the 1970s and 1980s. This gives the asset-management industry an opportunity to step into the breach.

In the developing world, meanwhile, rapid economic growth is creating an immense amount of new wealth. Energy billionaires in Russia and sovereign-wealth funds in China and the Middle East may turn to the asset-management industry to guide their investment decisions.

Although those two huge opportunities are likely to ensure that the industry will survive and prosper, the future of individual companies is far more difficult to predict. Only ten years ago the British pension-fund industry was dominated by four big names; Mercury, Phillips & Drew, Gartmore and Schroders. But competition has blown that cosy oligopoly apart: the first two names on that list no longer exist as separate companies.

Individual managers are having to make a series of choices. Do they emphasise their skill ("alpha" in the jargon) or head down the passive ("beta") route? Do they stick to traditional asset classes, such as equities and bonds, or branch out into alternative areas such as hedge funds and commodities? Do they stay small, aiming for boutique status and putting the emphasis on performance? Or do they aim big, covering as many areas as possible, and protect themselves against the vicissitudes of the markets? Even more drastically, do they give up the business of investing altogether and concentrate on the relationship with individual clients, selling them other people's investment products? That, in effect, is what Merrill Lynch did, selling its fund-management business to BlackRock. Citigroup made a similar deal with Legg Mason.

In response, a host of different models is emerging, from tiny specialists with a few hundred million dollars of assets to retail giants such as Fidelity or hybrids such as the Bank of New York Mellon, which has more than $1 trillion of assets spread among a collection of boutique managers. This special report will explain how fund managers make these choices and what is best for the most important people: the individuals who entrust their savings to the fund-management industry.

The top 20 2

Asset managers, December 2006

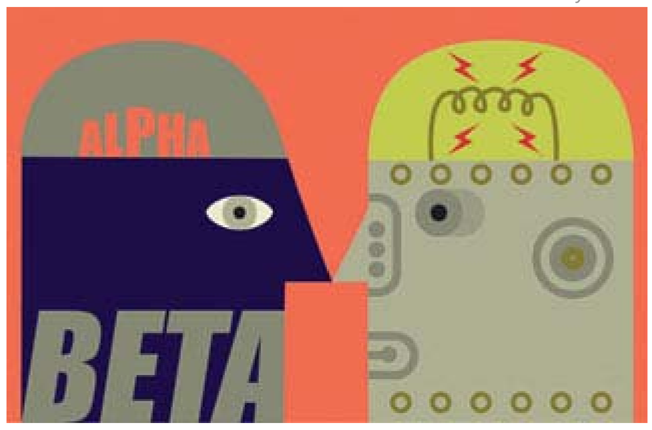
Manager	Total assets $trn
UBS (Switzerland)	2.45
Barclays Global Investors (Britain)	1.81
State Street Global (United States)	1.75
AXA (France)	1.74
Allianz (Germany)	1.71
Fidelity Investments (United States)	1.64
Capital Group (United States)	1.40
Deutsche Group AG (Germany)	1.27
Vanguard Group (United States)	1.17
BlackRock Group (United States)	1.12
Credit Suisse (Switzerland)	1.09
JPMorgan Chase (United States)	1.01
Mellon Financial* (United States)	1.00
Legg Mason (United States)	0.96
BNP Paribas (France)	0.82
ING (Netherlands)	0.79
Natixis (France)	0.77
AIG Global Investment (United States)	0.73
Crédit Agricole (France)	0.70
Aviva (Britain)	0.70

Source: *Pensions & Investments*/Watson Wyatt *Now Bank of NY Mellon

Better than beta?

Feb 28th 2008
From The Economist print edition

Andy Baker



Managers' superior skills are becoming harder to prove

WHAT exactly are fund managers selling? At heart, they are offering exclusivity. In the complex world of financial markets, the client wants the best brains to look after his money. Picking the right fund manager is like shopping at Saks Fifth Avenue or having your shoes made by Manolo Blahnik. But unlike a posh retailer, a fund manager cannot guarantee to provide a superior service year after year. Indeed, he cannot even be sure of offering a positive real return. All too often, clients hand over their money to managers that have performed well in the past, hoping that this superior record was down to skill rather than luck and that it can be replicated in the future.

Historically, fund managers' appeal has been due to two things: risk reduction through diversification, and an ability to pick the right assets. Think back to the 19th century. Victorian investors faced specific risk because they usually held only a handful of securities in their portfolios. To avoid this risk, they often sought the help of their accountants or solicitors. Those professionals soon found themselves with a lucrative sideline in investment advice. Investment trusts (which still exist today) were set up because it was more efficient to bundle together clients' assets into pooled portfolios. Mutual funds were built on similar principles; by agglomerating the assets of a whole range of clients, it was possible vastly to reduce specific risk.

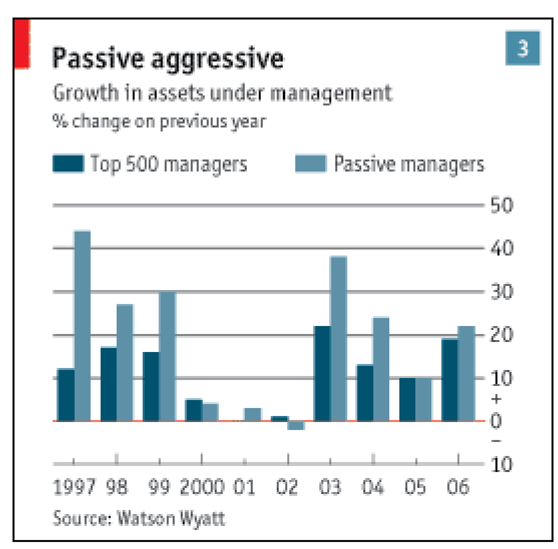
But since the development of index-tracking funds in the 1970s, the business of diversification has become commoditised. Clients can get access to a broad portfolio, such as the shares in the S&P 500 index, for fees of a fraction of a percentage point of the assets a year. Indeed, the widespread use of indices has dramatically changed the fund-management business.

Originally, indices were devised (often by newspapers) as a means of assessing the stockmarket's mood. Then it occurred to investors that they could use the indices as a means of judging whether their fund manager was doing a good job. As they became more sophisticated, they realised that fund managers would be able to beat the index, in the long run, by taking more risks, and started to move to risk-adjusted performance measures that combined returns with volatility. These led to the development of alpha, a measure of a fund manager's skill, defined as the ability to produce superior risk-adjusted returns.

It's all Greek

In recent years there has been a move to separate the effect of alpha from that of beta, which is the portion of an investor's return that comes straight from the market. Thus, if the S&P 500 index rises 8% and an American equity-fund manager delivers a 10% return, the investor gets eight percentage points of beta and two of alpha. Arguably, the client should pay top dollar only for the two additional points, not the eight he could have received even from a low-cost index-tracking fund.

But alpha is quite hard to define. As Andrew Lo of the Massachusetts Institute of Technology points out, to primitive people, everyday technology like cars and televisions can seem like magic. Alpha is a bit like that: it is the part of investment returns that we do not understand.



Investors' attempts to isolate alpha from beta have taken several forms. One is the “core-satellite” approach: the bulk of the money is placed in index-tracking funds and the rest allocated to managers with a proven record of outperforming the market. Often the index-tracking money is invested mainly in developed markets and the satellite money goes to areas such as emerging markets, where an active manager is more likely to be able to outperform the index.

Consultants argue that in the past clients devoted too much of their “risk budget” to equities, in the belief that they would beat bonds over time (the so-called equity-risk premium). Instead, they should have concentrated more on alpha because the returns earned from it are more likely to be uncorrelated than market returns, offering a better combination of risk and reward.

Another approach to finding alpha is to give managers more latitude to stray from the index; in the jargon, to be “benchmark-agnostic”. The idea is that managers should pick the best shares regardless of their weighting in the index. This should produce better returns in the long run, even if it sometimes causes them to lag the index in the short run.

As John Brennan of Vanguard (which, as it happens, is one of the largest index-tracking managers) says, “if you're going to have an active fund, make it take active bets.” As well as its well-known mutual funds (including one $122 billion behemoth that tracks the S&P 500 index), Vanguard offers a range of actively managed funds which it contracts out to other managers. “When we hire someone with an active mandate, we want them to take risk,” Mr Brennan continues. “Me-too stuff will get you nowhere.”

In a way, this change has been good for the fund-management industry, in that it has given individual fund managers more creative freedom. No longer are they forced to buy shares in a company they dislike simply because it has a 5% weight in the index. There has been a fashion in the mutual-fund industry for “focus funds” that own only 20-30 stocks rather than the hundreds needed to track the market. As Jim Connor of Morse, a consultancy, puts it, “the industry has gone from a manufactured model to more like the music industry where it looks for talent that can produce hits.”

But betting on alpha really puts the onus on the fund manager to do better than the market. That explains the increasingly widespread use of performance fees. The idea is that the manager should receive only a modest base fee to help cover his fixed costs, but should take a bigger share of the gains when he succeeds in delivering alpha.

Unfortunately for clients, the alpha delivered by the average fund manager is negative. That is because the performance of the average investor mirrors that of a broadly based index, before allowing for costs. Since costs are often sizeable, the average fund manager is doomed to underperformance.

Even when a fund manager can beat the index, his problems are not over. Just as beta has been commoditised, so, in a way, has alpha as academics have started to break down its components. Most stockmarket indices are dominated by larger companies, which means that active managers' best chance of outperforming lies in buying the shares of smaller businesses. Another tried-and-trusted route to outperformance is to take a “value” approach: buying the shares of companies that look cheap on some valuation measure, such as the ratio of the share price to profits. The rationale is that investors can become overpessimistic about the prospects of struggling companies.

The increased sophistication of indices means that investors can get access to factors like value and small-cap stocks at low cost; they have become betas. So fund managers who outperform with the benefit of these factors are not really demonstrating alpha at all.

Indeed, there are now very few markets that investors cannot access cheaply, thanks to the explosive growth of a vehicle known as exchange-traded funds (ETFs). These are quoted stockmarket vehicles that hold baskets of shares designed to track a benchmark. The first one was launched in 1993. By 2000, ETFs had just $74 billion in assets. But by June last year there were more than 1,000 products with just over $700 billion in assets, estimates Morgan Stanley, an investment bank. By 2011, the bank forecasts, the sector will have $2 trillion under its belt.

Exchange-traded Lego

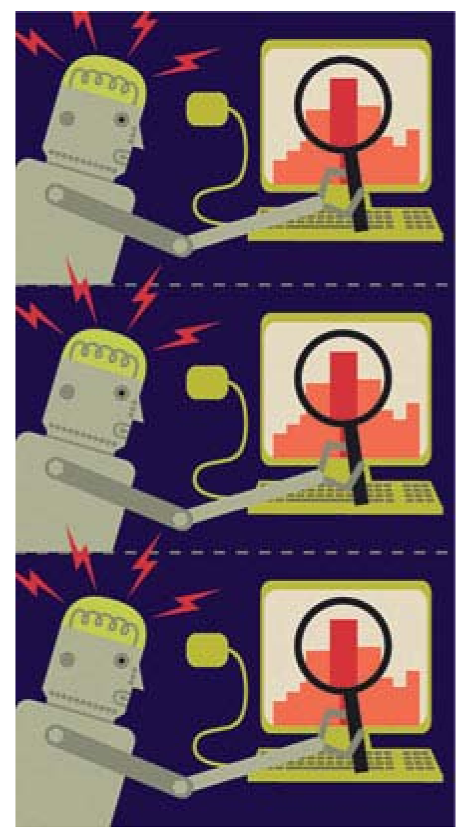
What makes ETFs so attractive is their flexibility. Funds have been established to cover almost any asset class, from Asian property to oil. That has given retail investors an easy way of getting exposure to assets they might previously have been able to access only in a more costly, or roundabout, fashion. Those who foresaw gold's surge to a record high, for example, have been able to buy an ETF that tracks the metal's price instead of paying a mark-up for gold coins or buying shares in a mining company and taking a bet on the management's competence.

Paradoxically, the biggest advantage of ETFs—their cheapness—also turns out to be the biggest barrier to their acceptance by retail investors. The low fees leave no margin to pay commission to intermediaries, who therefore have little incentive to sell them. ETFs have been a success in the American market, which is more attuned to fee-based rather than commission-based financial advice; in other markets it is up to small investors to discover the benefits of ETFs for themselves.

But ETFs have also been bought by institutional investors such as pension funds and even by those modern-day masters of the universe, hedge-fund managers. One reason is that an ETF represents a quick and easy way for investors to take a view on an asset class. Say a hedge-fund manager believes that the Japanese market is set to surge. If he were to assemble a portfolio of stocks, he would have to do a lot of research and might choose the wrong ones. Instead, he can simply buy an ETF linked to a broadly based benchmark such as the MSCI Japan index.

So ETFs could be viewed as a set of Lego bricks from which an investor can assemble a do-it-yourself portfolio. They can also be used to replicate the style biases that, some would argue, have often been mistaken for fund-manager alpha.

Andy Baker



One example is WisdomTree, an American company set up with the help of Michael Steinhardt, a hedge-fund legend, and with the intellectual backing of Jeremy Siegel, a noted academic. It runs ETFs that are weighted on the basis of the cash dividend paid, rather than the market value of the company concerned. The total expenses of its domestic funds amount to a quarter to a third of a percentage point, a small fraction of the costs of a traditional mutual fund. And yet over the ten years to March 30th 2007 its approach would have returned 11.2% a year in the American market, around two-and-a-half percentage points more than the broadly based Wilshire 5000 index. Other companies have come up with similar ideas. Research Affiliates has an index that uses four “fundamental measures” relating to sales, profits, dividends and asset, or book, value.

These ideas have their critics. Some argue that such “active ETFs” are contaminating the purity of the sector's appeal and increasing the costs paid by the investor (because the components of the index have to be changed more frequently). Others would say there is nothing new about the techniques; they are merely value investing in a new guise. Even if that is so, they still pose a considerable threat to traditional fund-management houses. The value school is one of the most respected approaches to investing. If its returns can be matched by funds that mechanically use a few ratios, why pay the fees demanded by active fund managers?

Even hedge funds are seeing their territory invaded. Its managers are the high priests of alpha. Clients have so much faith in their skills that they are willing to pay 2% annually (as well as a 20% performance fee) for the privilege of having their money managed by them. One particular hedge fund was recently able to charge 5% a year and 44% of performance.

But how much of what hedge funds are delivering is really alpha rather than beta? Research suggests that the correlation between hedge-fund returns and the S&P 500 index is already high and getting higher. Worse still, hedge funds are becoming more strongly correlated with each other. Although the hedge-fund industry is very diverse, there have been times in recent years when nearly all the sectors have fallen in unison. This suggests that all of them may be exposed to some common underlying factor.

Grow your own hedge

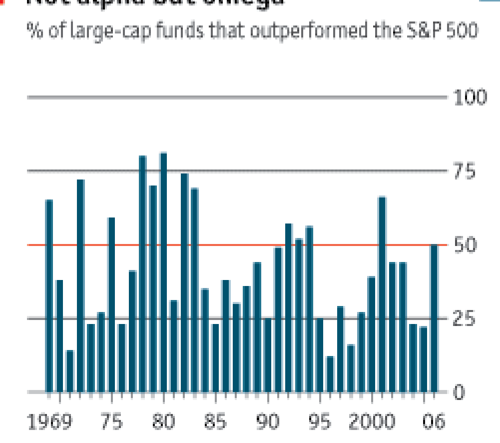
Bill Fung and Narayan Naik at the London Business School have analysed the performance of the hedge-fund industry over a decade and identified seven or eight factors that seem to be responsible for the bulk of its returns. All these factors, the two academics claim, can be replicated at low cost in the market, capturing most of the benefits. So it is possible to set up a fund that offers returns akin to those in the hedge-fund industry but is able to charge much lower fees.

Investment banks have (slightly surprisingly, given their close links with the hedge-fund industry) piled in, producing funds that clone individual hedge-fund strategies. Naturally, many hedge-fund managers are scathing about the banks' efforts. A cloned portfolio is necessarily backward-looking, they say, so investors will be buying what hedge funds used to own, not what they are about to buy. Furthermore, clones will capture the entire beta but none of the alpha of the industry—and it is the alpha that makes hedge funds worth buying. Messrs Fung and Naik accept that hedge-fund managers display skill, but would argue that most of the time this alpha is absorbed by their fees.

Returning to Professor Lo's definition of alpha as the portion of investment returns that we do not understand, it seems possible that as more and more analysis is undertaken, this portion will become smaller and smaller. The “magic” may turn out to be sleight of hand, or it may be random. Some fund managers will always outperform the market, but there is little hope of identifying them in advance.

Cloning represents a particular threat to the quantitative school of fund management. The quants, as they are known, use computer models to identify patterns and relationships in the markets that have been profitable in the past. They are often staffed by the brightest academic minds in mathematics and physics. Quants generally have no interest in visiting a company, sampling its products or meeting its management. Whereas traditional fund managers look at the fundamentals, such as the quality of a company's business model or the nature of its competitors, the quants try to take the subjectivity out of fund management by concentrating on the numbers alone.

Not alpha but omega



Source: John C. Bogle: “The Little Book of Common Sense Investing”

Some quants have a long-term perspective, but many take advantage of the liquidity of modern financial markets to trade very frequently indeed; companies such as AQR, D.E. Shaw, Highbridge and Renaissance often form a substantial portion of daily trading on the New York Stock Exchange. They may aim to conduct their trades in a matter of milliseconds as they try to exploit fleeting anomalies. Some funds put their computer servers very close to stock exchanges for a minuscule reduction in the time it takes for data to be transmitted down the wires.

Quants have been remarkably successful over the past decade, but in August last year something went badly wrong: within the space of a week many of their models ceased to work. The quants thought they had built diversified portfolios by selecting stocks on the basis of a host of different criteria that had previously had low correlations with each other, but suddenly a lot of the factors started to move in the same direction. Some funds put in a dreadful performance; for example, Goldman Sachs's Global Alpha fund lost 38% on the year.

The problem seemed to be that if you set computers to analyse the same set of data, they are likely to come up with similar investment strategies. As positions became crowded, returns started to fall, prompting the quants to use more borrowed money to improve them. When the credit crunch hit, one fund was forced into cutting its positions, bringing down the prices of stocks held by all its rivals and setting off a downward spiral.

Reinventing quants

This does not mean the end of quant investing. “To believe the quant game is over you'd have to think reasonably priced, reasonable growth stocks will underperform,” says Gus Sauter of Vanguard, which runs quant-based funds. But it does mean that in future quant managers may have to reconsider how much leverage to build into their funds, and will have to try even harder to find factors that their rivals are not exploiting. Mike O'Brien of Barclays Global Investors (BGI) says the sector needs to move away from “data mining” and adopt a scientific approach, using quant techniques to provide a sound basis for original investment thinking. Instead of letting the data generate the ideas, BGI now tries to turn the process on its head, coming up with ideas first and then testing them on the data.

But the quant funds may face a challenge from the clones, which use computers to identify a series of factors that produce attractive investment returns. On the face of it, that does not look very different from what the quant funds do. Quant managers may come up with a lot more factors than the clones, but in practice just a few of them account for most of the returns. And the more mechanical and replicable the process of investment gets, the harder it becomes to justify high fees.

Plenty of alternatives

Feb 28th 2008
From The Economist print edition

But hedge funds and private equity have their limits

THE stockmarket is a hard taskmaster. Beating the indices on a regular basis is difficult, and low-fee rivals are competing ever more vigorously. But the fund-management industry has found a new wonder weapon: alternative assets. What makes these special, the industry claims, is that they are not correlated with the stockmarket. They are also difficult to understand, so they require greater skills to manage—which have to be properly rewarded.

That explains why, even as ETFs are driving fees on big stockmarket funds down to a few basis points a year, the managers of the main alternative-asset categories—hedge funds and private equity—are able to charge two percentage points a year, with a performance fee on top. And clients are queuing up to pay them.

Why are they so enthusiastic? The reason goes back to mistakes made in the 1990s. The long bull market encouraged the belief that share prices could move only upwards, and investors who did not have a big allocation to equities looked foolish. Corporate-pension sponsors were able to put 80-90% of their portfolios into shares and then stop making contributions to the fund, on the assumption that juicy returns would continue.

The 2000-02 bear market revealed what an unwise bet that had been. To compound the problems of pension funds as their assets fell with the stockmarket, their liabilities rose because of the drop in bond yields, which made it much more expensive to purchase the income needed to pay pensioners. So the pension funds (and their advisers) decided to broaden their bets and reduce their risks.

One big change was to put more emphasis on alpha, the skill of the manager (see article). But funds also started to widen their range of assets, in the hope of earning a more stable return. The models for this were the university endowments of Yale and Harvard, which started moving into alternative assets in the 1970s and 1980s and have enjoyed considerable success with them. Morse's Mr Connor sees this as an extension of his music analogy: “The industry has expanded from having a limited number of genres into a wide range, from hip hop to garage, thrash metal and the rest.”

However, the move has not been without controversy. It seems plausible that emerging-market debt, property and commodities are genuine alternatives to the traditional staples of developed-market equities and government bonds. But are private equity and hedge funds really in the same category?

Private equity and its close cousin, venture capital (which concentrates on start-ups), invest in businesses that are not quoted on the stockmarket. The idea is that companies will be able to produce better returns if they are protected from the glare of constant public scrutiny and if the managers are given suitable incentives. This usually means offering them share options and loading the company up with debt, forcing managers to pay meticulous attention to their cashflow. These takeovers, also known as leveraged buy-outs, have become a big influence on stockmarkets. But is private equity really an alternative source of return? After all, most of the factors that affect quoted companies—the health of the economy, interest rates—affect private companies as well.

This is also true of hedge funds. These private pools of capital may be run in a different way from traditional funds—for example, they can go short (bet on falling prices) and use borrowed money to enhance returns. But hedge funds still mostly invest in the same types of assets—equities and bonds—as traditional fund managers.

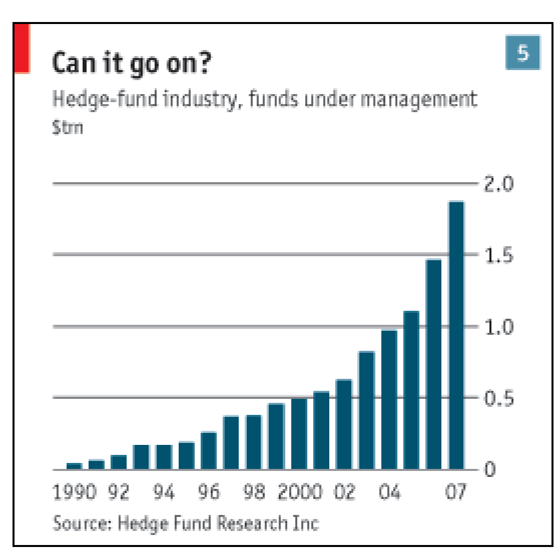
Most hedge funds are alternative only in the way they are managed, rather than where they invest. Because of their methods, they claim to produce “absolute return”—in other words, a nominal gain regardless of market conditions. By contrast, traditional fund managers might think they have done well if they lose 17% when the index has dropped by 20%.

The short answer

Hedge funds can pull off this trick thanks to their greater flexibility, in particular their ability to go short. The worst year for the industry was 2002, when the Hedge Fund Research Index lost just 1.5% (although these indices may flatter, thanks to survivorship bias). Enthusiasts would also argue that if you believe in managers' skill, you should give them as much freedom as possible. Most companies have a tiny weighting in the index. A traditional manager who takes a dislike to a stock can only give it a zero weighting, which will make virtually no difference to performance. But a hedge-fund manager can make a much bigger bet by selling the stock short.

It sounds good in theory, but in practice shorting is very difficult. A long position that goes wrong becomes a smaller part of the portfolio; a short position becomes larger. And where hedge-fund managers use borrowed money, bad bets can be disastrous, as shown by the closure of Amaranth, an energy-trading fund, in 2006 and two Bear Stearns credit funds in 2007.

Even if some hedge-fund managers have special skills, can the industry continue to deliver exceptional returns as it gets bigger? Its assets increased from $39 billion in 1990 to $1.9 trillion by the end of last year (see chart 5). Allowing for the use of borrowed money, McKinsey estimates that total assets under management may be $6 trillion. If the skill of hedge-fund managers consists of exploiting market anomalies, there must surely be fewer anomalies to go around now. The result may be high fees for hedge-fund managers but modest returns for clients, or worse. “Hedge funds are rapidly deteriorating in quality. There is a nasty accident waiting to happen,” says Jeremy Grantham of GMO, a fund-management group.



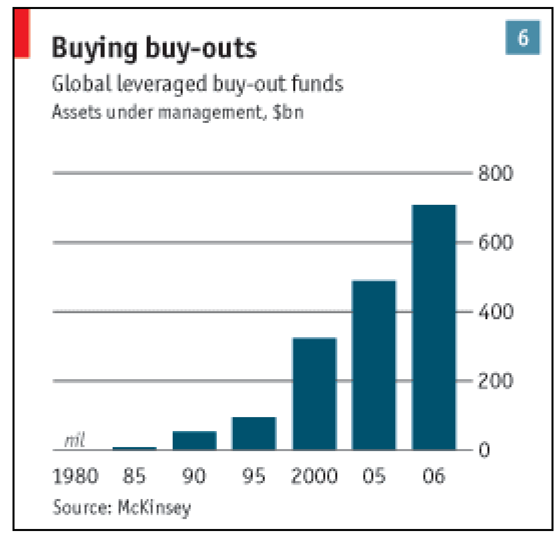
The same arguments can be applied to private equity. If lots of people are competing to do private deals, that is likely to force up the price of deals and cut the level of future returns. According to McKinsey, the amount of private-equity capital increased by 120% between 2000 and the end of 2006 (see chart 6); including venture capital, the sector's total assets add up to over $1 trillion. “So much money has flowed into private equity, venture capital and hedge funds that it has swamped the available talent,” says Mr Grantham.

McKinsey reckons that 62% of American private-equity assets in 2006 were in the hands of the top 20 firms. This is not surprising: the top 25% of funds seem consistently to beat the rest. If anything, it is surprising there has not been more consolidation, given the lacklustre performance of the rest of the industry. The average investor in private equity has not seen particularly attractive returns compared with those available in the public market.

And those returns may be about to deteriorate. The most recent leveraged-buy-out boom ended with many firms collapsing in the early 1990s recession. Mr Grantham fears history may repeat itself. “Private equity has a long tradition of adding value, but there is one issue they have all missed,” he says. “Not a single firm has in its spreadsheet the expectation that profit margins have to come down.”

The move into both hedge funds and private equity involves a paradox. For an asset class to be a true diversifier, it needs to be small; but if it is small, then few investors can be exposed to it. When lots of capital flows into an asset class, it starts to behave like other markets. The recent problems in the British commercial-property market are a good example. Retail investors flocked into the sector as a diversifier from equities, and in the ten years to 2006 it performed brilliantly. But property is an illiquid asset. When prices started to fall last year, investors rushed to redeem their holdings. But it was impossible for the funds to realise on their properties in such short order, so many of them have been forced to suspend dealings in their shares and units. The asset class was simply not liquid enough to be a real diversifier for so many investors.

That has not stopped investors from looking for diversified returns elsewhere. In the second half of 2007 the truly hot areas were "frontier markets", or what might be called the "emerging emerging markets". The hope is that countries such as Kazakhstan and Vietnam will eventually achieve the same sort of growth rates as India and China.



Fund managers are also offering even more esoteric bets, known as "exotic beta". Assets in this class include weather derivatives, distressed power stations and even footballers' contracts. The attraction is twofold. First, these asset classes are so remote from the forces that drive the S&P 500 index that any correlation is unlikely. Second, prices in this market may be set inefficiently, offering scope for astute fund managers to make money. At least that is what exotic-beta fund managers tell their clients to justify their fees.

In the spotlight

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From The Economist print edition

Andy Baker

Fund managers are having to polish their image

WHEN industries become rich and powerful, they inevitably attract attention—and criticism. Fund managers are often reluctant to embrace the spotlight, but are now being forced to do so. Whether it is private-equity groups accused of firing lowly workers, hedge funds under attack for destabilising the financial system or institutions being berated for holding shares in “unethical” companies, the public scrutiny is unrelenting.

Henry Kravis, one of the doyens of the private-equity industry, has found himself the subject of a film, “The War on Greed”, as well as of a protest outside his ritzy Manhattan apartment. In Britain a trade union paraded a camel outside a church attended by Damon Buffini, another private-equity titan, to remind him of the biblical story about the entry restrictions to heaven imposed on rich men.

Such attention has forced the industry to consider whether earning the highest possible returns should be its sole concern. Fund managers have taken to trumpeting the benefits they bring to the economy (by directing capital to where it will be most useful and helping to create employment) and to society at large (by making it easier for individuals to plan for their old age).

Perhaps the unwelcome publicity was inevitable once fund managers started to become rich and appear in the gossip columns. Only 30 years ago fund management was a bit of a backwater, just the thing for those who were not quite bright enough to get into investment banking. “At the very first meeting I went to, a rival told me I had joined the most boring industry in the world,” recalls Patrick Disney of SEI, a firm that advises on selecting the best fund managers.

But thanks to the rise of private equity and hedge funds, these days fund management is a fast route to billionaire status. Buoyant markets and generous performance fees mean that managers who get it right become very rich very quickly. A survey by *Alpha* magazine found that the top 25 hedge-fund managers between them took home $14 billion in 2006. And many of them like to splash their money around, with Steve Cohen of SAC Capital Advisers becoming a prominent art collector and Daniel Loeb of Third Point reportedly paying $45m for a Manhattan apartment.

Fund managers have become the latest group of rich people to incur public displeasure, reinforced by a feeling that they do not perform a socially useful function but merely speculate with other people's money. Some of the criticism is deserved.

Private equity owes some of its success to anomalies in the tax system. For example, when it buys a company it often loads it up with debt and claims tax relief on the interest paid. In an ideal system the tax treatment of debt and equity should be the same. Private-equity executives have also benefited by having a large part of their earnings classed as capital gains, which in most countries are subject to a less severe tax regime than income.

Hedge-fund managers have benefited from light regulation that has given them advantages over their traditional fund-management rivals—such as being allowed to keep the details of their holdings secret, for example, or being able to benefit from falling, as well as rising, prices.

As yet, governments have made little coherent attempt to crack down on these tax and regulatory privileges, mainly because capital is so mobile these days and countries such as Britain and America do not want to drive away rich residents or antagonise the financial community. That may change if an economic downturn prompts voters to demand action.

What about the workers?

Perhaps the most potent attack was launched by Franz Müntefering, a prominent German Social Democrat politician who in 2005 described the hedge-fund industry as “locusts”. He gave voice to the widely held view that both hedge funds and private-equity firms were interested only in short-term profits and catered exclusively to the needs of shareholders rather than employees, customers or the wider community.

This view was taken up by trade unions in Britain, particularly in the early months of 2007 when a new private-equity-funded takeover deal seemed to be announced every week. Calls for the government to change the rules, particularly on tax privileges, resulted in a botched reform of the British capital-gains-tax regime that penalised small businesses far more than private-equity bosses.

The private-equity industry, surprised by the intensity of the criticism, duly supported the creation of voluntary codes committing firms to greater transparency. In Britain at least, the hedge-fund sector took similar steps. Both industries can afford a high-powered lobbying machine. Private-equity firms cited academic studies that appeared to show that, far from destroying jobs, the industry was a net creator of them.

The industry also argued that its model was superior to that of the traditional public company because the interests of managers and investors were more closely aligned, high debt required managers to focus on cash generation, keeping them honest, and managers found it easier to take tough long-term decisions away from the glare of media attention. The debate was still continuing when, in the middle of the year, the credit crunch hit home and the private-equity funds suddenly found it far more difficult to raise money. That seems to have shifted attention to a different type of investor, the sovereign-wealth funds. These funds, particularly those set up by governments in Asia and the Middle East, were prominent among those helping to bail out the American banking sector in the aftermath of the credit crunch.

Hedge funds have also slipped out of the limelight somewhat since last summer. But although unlike private-equity groups they rarely launch takeovers on their own, they can still wield a lot of influence. They frequently lobby for executives to realise value for shareholders by returning cash, selling off unprofitable subsidiaries or agreeing to bids from larger groups. Such “activist” hedge funds usually try to recruit other institutions to their cause. They then organise a shareholder vote, campaign in the media or attempt to enlist outside bidders to get the company's board to change tack.

One of the best-known activists is the Children's Investment Fund (TCI), a European hedge fund. It successfully blocked Deutsche Börse's attempt to take over the London Stock Exchange and then, with a stake of just 1%, set the scene for ABN AMRO, a Dutch bank, to become the target of a bidding war between Barclays and the Royal Bank of Scotland. More recently, hedge funds attempted (unsuccessfully) to control the terms of the rescue of Northern Rock, a struggling British bank.

Such activism has not made them popular, either with the public or with company boards. In the days of autocratic chief executives, fund managers, like small children, were expected to be seen and not heard. Even today, rules at many American companies make it difficult for investors to unseat the management. If investors do not like the way a company is being run, they are expected to shut up and sell the shares. European companies can also be sniffy when investors speak up. And in Japan they hardly ever do.

Gradually, however, activists are becoming more widely accepted. “Even in France and Germany, governments are gradually coming to the conclusion that activism is an acceptable instrument of corporate governance," says Michael Treichel of Audley Capital, an activist fund. Besides, now that markets are global, it is very hard to keep the activists out without driving away the international capital most companies want to attract.

However, hedge funds are not the only activist shareholders. Other fund managers, often reflecting the views of their pension-fund clients, have pushed for companies to pass ethical and corporate-governance tests, such as decent treatment of workers in the developing world or the separation of the jobs of chairman and chief executive. This could leave companies open to attack on both sides. Even as activist funds might be asking them to cut costs and lay off employees, ethical investors could be urging them to think about their workers.

To make things more difficult, the ethical camp is itself split. Old-school ethical investors, often guided by religious principles, did not want their money to be used in businesses they disapproved of, from alcohol and arms manufacturing to gambling and tobacco. In recent years, thanks to the Middle East's increasing wealth, there has been rapid growth in financial products compliant with *sharia* law, aimed at Islamic investors.

Do the right thing, but which?

Another ethical trend, supported by those of a leftish (in America, liberal) persuasion, has been for socially responsible investing (SRI), although the term has been interpreted in a variety of ways. "Social responsibility is in the eye of the beholder," says Ed Bernard of T. Rowe Price, an American fund-management group. But in general, socially responsible investors try to avoid companies that exploit workers (for example, by using child labour in poor countries), cause pollution, add to global warming or operate in countries with dubious human-rights records.

A third school adds some hard-headed calculations to elements of both the ethical and the social-responsibility approaches. Believers in sustainable investing think that picking out the best companies on non-financial criteria will ultimately lead to higher returns. David Blood used to work in the money machine that is Goldman Sachs. Together with Al Gore, a former American vice-president, he set up Generation Investment Management, a firm that specialises in sustainable investment. Firms that treat workers or the environment badly, he says, will eventually face lawsuits or a backlash from consumers or regulators, so a narrow focus on the balance sheet does not make sense in the longer term.

Cynics claim this preoccupation with corporate governance encourages a "box-ticking" mentality; companies will simply meet the minimum standards and cheer up the annual report with some feelgood pictures of racially diverse groups of workers, fetching children or leafy glades. Bozena Jankowska, head of sustainability research at RCM (part of Allianz Global Investors), agrees that "questionnaires are a waste of time" and adds that it is important to talk to companies face to face: "If they are not telling the truth about social responsibility and sustainability, they are probably not telling the truth about the rest of the business either."

Some see socially responsible or sustainable investing as a backward step that will tie down fund managers just as they are escaping the shackles of the index. "The world is moving towards unconstrained investing, but SRI is moving in the opposite direction," says Mr Connor of Morse. Still, as long as some clients care as much about where their money is invested as about how much they earn, SRI is not going to go away.

All things to all men

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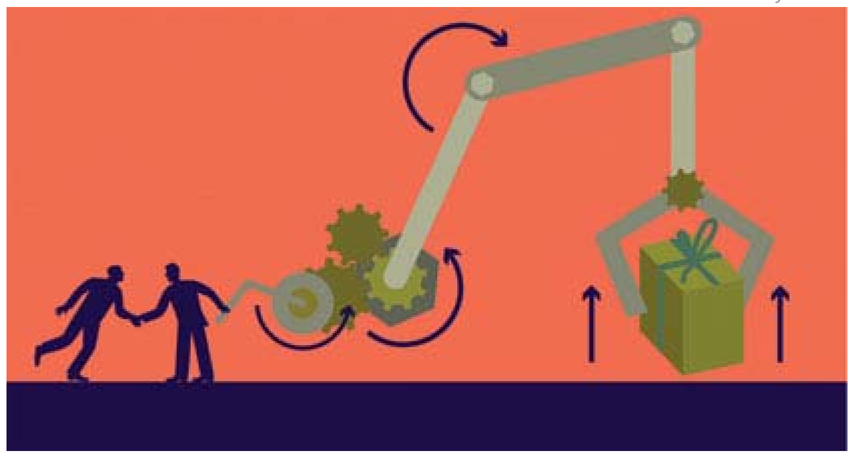
From The Economist print edition

Andy Baker



The industry is becoming more diversified

ASK management consultants to review any sector, and the chances are they will forecast that a few big groups will come to dominate it, with a few niche businesses at the tail end.

The remarkable thing about the fund-management industry is how little it has consolidated. Much of that is due to the random influence of markets. A struggling fund-management group can have its fortunes transformed by hiring one star manager or perhaps having a lucky year. Henderson, a British fund-management group, is exactly the kind of mid-sized business that the management consultants would have expected to disappear, but in recent years it has been very successful in selling international funds to American investors.

In most industries, companies can hope to thrive by following the Wal-Mart model. Economies of scale will allow them to become more efficient, reduce prices and attract more customers. But in the fund-management industry that strategy works only in index-tracking, or passive management. This is a commodity business. Some technical expertise is needed to ensure that the benchmark is tracked accurately, but the business is mainly about price. Large companies are able to spread their fixed costs, allowing them to charge lower fees. Sure enough, two giants, Barclays Global Investors and State Street, dominate the industry.

When it comes to active management, there is a big debate over whether size is a help or a hindrance. The “small is beautiful” school points out that some of the best hedge funds were started by two men and a spreadsheet. “Total assets under management is a relatively poor explanatory variable of success,” says David Hunt of McKinsey. “Scale in many styles works against performance.”

Sandy Nairn has worked at both Templeton and Scottish Widows Investment Partnership (part of the Lloyds TSB banking group). He now runs his own boutique business, Edinburgh Partners, with just £3 billion ($6 billion) under management. “Often in firms, there are three key people who make all the difference,” he says. “There is a limited number of very good people so the bigger the firm, the smaller the proportion of top talent.” Mr Nairn adds that “the bigger you are, the more sales-oriented you become because you are tapping into the mass market. Fund managers become less important than the marketing and compliance people.”

Mr Nairn may be biased, but he raises a fundamental dilemma for the industry. Charles Ellis, an industry veteran, describes it as the difference between professional-led and business-led companies. In the first sort, the fund managers are in charge. The second kind are in danger of becoming too preoccupied with short-term profit, increasing the proportion of assets under management and running the risk of damaging the culture and long-term reputation of the firm. For example, marketing people may persuade firms to launch funds in hot areas (such as technology in 1999-2000) even when investors think the top of the market may be in sight.

“When I started in the industry in 1972,” says Ed Haldeman of Putnam, a Boston-based fund-management group, “all asset-management companies were led by investment people. Being good at investment didn't necessarily make them good at leading the firm. Eventually, the business and marketing people came to lead. The risk was that they ran the company on the basis of what was best in the short term. Now we are trying to find a balance between the two.”

What are the problems of scale in the fund-management industry? The first is the culture it can create. Most people agree that you have to be clever to be a successful fund manager, and also a bit of a contrarian: there is no point in buying what everyone else is buying. The danger in a large company is that individual managers will be second-guessed by strategy committees or risk managers or simply intimidated into going along with the rest of their colleagues. “Fund management requires talent, just like being a concert pianist. Industrialising the process really doesn't work,” says Nigel Blanshard of Culross, a hedge-fund group.

Not everybody sees control systems as a disadvantage. Rogue fund managers have ruined the reputations of plenty of businesses, and clearly there is a need for some sort of oversight. But even if a manager is given his head and becomes a star, the company may not reap the success it expects. It is all too easy for a star manager to be lured away by a rival and take his clients with him.

A lot of fund managers, particularly those that deal with institutional clients, emphasise the “process”—the systematic approach they take to beating the markets. In some firms, such as Capital International, this is driven by teams of analysts rather than by fund managers; the hope is that even if the star is run over by a bus, the firm will still perform well.

But scale affects other aspects of the business too. For example, if a fund has hundreds of billions of dollars of assets under management, it may not find it worth its while buying stakes in smaller companies. If it does, it risks becoming the dominant shareholder. Robert Harris of Majedie, a specialist British equity manager, illustrates the maths. “How much of a company with a £2 billion market value does a fund manager need to hold to have a 2% position across his portfolios?” he asks rhetorically. “If the manager has £5 billion of assets, it needs to own just 5% of that company. If it has £20 billion of assets, it needs to own 20%.” It may be possible to assemble that kind of stake, but it will not be easy to sell it quickly.

Another problem for large fund managers is that the act of buying and selling can move prices against them. The big groups do their best to reduce this problem by setting up specialist trading desks, splitting their orders among brokers and keeping their plans to themselves, but it is hard to escape the issue entirely. “If you start to move share prices when you have assets over a certain size, that must affect performance,” says Mr Nairn. Some managers close their funds or discourage new investors if they think that further growth may affect their performance. For managers motivated by performance fees, this will usually make financial sense, because the loss of performance fees would outweigh the extra fees from managing more assets.

But a deliberate strategy of staying small also has its problems. If the business specialises in just one product area, a couple of bad years in that speciality can be fatal. Similarly, the business may remain sound only for as long as the founders are willing to stay on; if they get bored or complacent, it may not survive. “It's a one-generation business,” admits Mr Nairn. “But everyone pretends it's a two-generation business so they can sell out.”

Convergence and divergence

So an odd combination of trends is at work. The clients are moving away from investing in a limited number of asset classes to a much broader range. In response, the specialists in the fund-management industry are venturing into new areas; for example, hedge funds are going into private equity and vice versa. Client strategies are diverging whereas fund-management firms' strategies are converging on a broadly based model.

Reach for the stars
Asset managers, fastest-growing firms
% increase of assets under management, 2001-2006
Source: Watson Wyatt

For the firms, this means diversification. For example, in the hedge-fund industry, managers who used to concentrate on one particular product line, such as arbitrage, in recent years have added other strings to their bow and become multi-strategy firms. Others have taken the diversification several steps further, adding long-only funds or moving into other operations, such as private equity, direct lending or market-making. That should provide them with better protection against a freak bad year. It should also allow them to keep those of their clients who are now haring off in different directions, looking for returns from asset classes such as commodities and private equity.

Traditional firms have set up their own hedge-fund operations or established hybrid funds that offer a watered-down version of hedge-fund strategies. “Big firms were never going to miss out on hedge funds. They weren't going to let their staff be lured away or miss out on the fees,” says Rob Fairbairn of the BlackRock Group. Investment banks, too, have taken control of, or stakes in, hedge-funds groups; it was through this route that Vikram Pandit became chief executive of Citigroup.

In a few years' time there may no longer be such a thing as a hedge-fund group, only groups that offer a range of ways of managing money. Clients will be able to choose from their menu of long-only or long-short, rather like diners in a restaurant can order their eggs scrambled or sunny side up.

By diversifying, fund managers also hope to avoid some of the old traps of scale. Firms pride themselves on being a “collection of boutiques”. Sometimes the groups try to create these boutiques internally; more often they go out and buy them. That allows the founders of smaller fund-management groups to cash in on some of the value they have created and to take advantage of the larger group's marketing clout.

Yet when boutiques become part of a larger business, they risk losing the spark that made them successful in the first place. Horacio Valeiras now works for Nicholas-Applegate, a small and midcap manager that is part of Allianz Global Investors. He was reluctant to join a larger group after an unhappy experience when a previous employer was taken over by Morgan Stanley. “We wanted to maintain our philosophy and control our own destiny,” he recalls. He talked to Allianz in Germany and they convinced him they would allow him autonomy. “I confess they have given me more freedom than I expected,” he says.

So the integration of boutiques needs careful handling. “It is possible for a fund-management company to have a large number of funds and run them well,” says Ed Haldeman of Putnam. “But we believe it needs distinct teams as opposed to being all controlled from the top.” Having such teams, or internal boutiques, means the individual fund manager can feel responsible for his own operation. Incentives can be set at the level of the individual unit. “The worry in big groups is that some guy in another part of the group has lost your bonus,” says Jonathan Little of Bank of New York Mellon.

Boutique-style giants

Mr Little's group now has $1.1 trillion of assets under its wing, with 13 brand names including Dreyfus (an American mutual-fund arm), Newton (a London-based equity manager with a thematic approach) and EACM (an American fund-of-hedge-funds manager). Ronald O'Hanley, the group's chief executive, says this diversity is an advantage. “We have three global bond products, so depending on the clients' attitude towards, say, credit, we can steer them in the direction of the appropriate fund manager,” he says.

Another group that is unashamedly aiming for scale is BlackRock. At the end of its latest financial year the company had some $1.4 trillion of assets, thanks to the purchase of the old Merrill Lynch Investment Management (MLIM) business and of Quellos, a hedge-fund group. According to Mr Fairbairn of the group's London office, the “merger between MLIM and BlackRock was driven by a real opportunity to build strength across equities, fixed-income and alternative assets to get a greater share of the wallet.”

BlackRock also has ambitions to expand outside the fund-management area. It is one of the pioneers of “fiduciary mandates” where the manager takes total charge of a pension fund, dealing with issues like asset allocation and administration as well as stock selection. The company also has a business called BlackRock Solutions that allows it to model portfolios and assess risk; the system is sold to both clients and competitors. In the thick of the credit crunch, the company was called in by the state of Florida to advise on the handling of a money-market fund with exposure to subprime-related securities.

In these examples, fund managers are moving into business areas previously occupied by actuaries and consultants. Fund managers are trying to exploit their size without running into the diseconomies of scale peculiar to the industry. Such diversification brings potential conflicts of interest; for instance, firms might favour their hedge-fund clients, who pay higher fees, over their traditional clients. Nevertheless, the business opportunities are too attractive for fund managers to pass up.

Besides, nobody wants to be seen as a big monolithic group that might produce mediocre results. Until recently, that was a danger facing Fidelity, arguably the best brand name in global fund management; at the start of this decade, its funds were perceived as too large and unwieldy to generate exciting returns and it developed a reputation for chasing asset growth. However, Fidelity has recently turned its investment performance around.

In 2005 it installed Harry Lange as the new manager at Magellan, which for many years had been Fidelity's flagship fund. Mr Lange made some daring but successful bets in 2007, as a result of which, for the first time since 1997, Magellan has just been opened to new money. Insiders point to the extra money that the company's chairman and key shareholder, Ned Johnson, has devoted to research over the past couple of years. But the company has also seen some reorganisation under Rodger Lawson, whom Mr Johnson recently installed as president, in an attempt to sharpen its focus and to ensure that the business is run efficiently.

We make, you sell

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From The Economist print edition

Sometimes it's better to concentrate on one thing

IF FUND management is such an attractive business, why would large banks such as Citigroup and Merrill Lynch want to give it up? After all, with both groups facing write-offs related to the credit crunch, the steady revenue from asset management would have been a comfortable cushion.

But there is one big problem with being a fund manager: you have to beat the market. If you don't, intermediaries such as brokers and private banks will not select your funds. And regulators, at least in America and Britain, will get upset if they think you are stuffing your poorly performing funds down your clients' throats.

This has prompted a move in the Anglo-Saxon markets to separate the jobs of "manufacturing" (managing portfolios) and "distribution" (selling them to clients). In continental Europe and Asia fund management is still dominated by the big banks and insurance companies. In Italy, for example, 92% of assets are gathered directly by salesmen tied to, or employed by, the fund-management group; in Britain the proportion is just 14%.

Manufacturing may sound like the more attractive part of the business. Provided the company gets its performance right, its profits will go up exponentially: it costs little more to manage $2 billion than $1 billion. But firms that act as distributors still earn fees from fund management, by charging investors for the oversight of their portfolios or by taking commission on the funds they sell. At the same time they cut out much of the cost.

There are three main kinds of distribution. The first is simply to sell products managed by your own firm. The second is "open architecture". This allows the client access to almost any fund manager on the market, or at least to all the managers who are willing to allow their funds to be offered on such a platform. For various reasons, some are not. For example, they may want to control the type of clients that own their funds, or limit the size of funds under management to avoid their performance being diluted. Or they may object to handing over part of the annual management fee to the distributor. "Some of the really interesting boutiques don't want to be on platforms and give away half their fees," says Alan Bartlett of WestLB Mellon AM, a firm that specialises in identifying skilled fund managers.

Decisions, decisions

Another problem of open architecture is the so-called paradox of choice. Retail investors can feel overwhelmed by the thousands of funds on offer, so they are inclined to choose names they recognise. This favours funds that spend a lot on marketing and advertising. As a result, clients may not choose the best (and almost certainly not the cheapest) funds. But there is nobody to steer them in the right direction, because giving clients individual advice is too difficult and too expensive.

The third sort of distribution is "guided architecture". In this model, a distributor offers the funds of a restricted number of firms that it has pre-selected as being suitable for clients. This narrows down the choice for investors and offers a degree of stability to the fund managers involved.

The effect of the manufacturing-distribution split is that the retail market is becoming almost as institutionalised as the pension-fund market. Just as a pension-fund manager's ability to get business usually depends on winning over a handful of consultants, attracting money from the "high net worth" market (ie, the rich) depends on a manager's ability to convince an elite group of private banks. That gives the managers plenty of scope to bandy about terms like alpha and beta in their presentations. "At least this means we can talk at the level we're accustomed to," says one manager.

This opens up opportunities for boutique-style firms. "Groups like Citigroup and Merrill Lynch have got out of asset management and moved to open architecture; we, as an independent asset manager, are just what they are looking for," says Jim Kennedy of T. Rowe Price. Outsourcing distribution allows fund managers to specialise in their area of expertise.

But there is a price to pay. Depending on outside distributors means the fund manager loses direct contact with the client. One industry veteran recalls how his firm used to maintain a department to deal with the letters from investors; now the correspondence has slowed to a trickle. The result may be less hassle but also a reduction in customer loyalty. There is a lot more "churn" (turnover of customer accounts) than there used to be. "These people [the distributors] have to do something to justify their fees," laments one fund manager, and that something usually means switching to a new fund as soon as one appears to falter.

The recent decline in the fortunes of New Star, a British fund-management group, illustrates the danger. New Star was founded by John Duffield, formerly of Jupiter Asset Management, with the explicit aim of recruiting well-known individual fund managers. Its funds were popular with both retail investors and distributors such as financial advisers and private banks. But in 2007 performance faltered as the company became overexposed to the British property market. In the second half of the year fickle investors left in droves, withdrawing almost £2 billion from the group's funds. The company cut its dividend in the expectation of further withdrawals this year. In response, its shares fell by nearly a third. If you live by short-term performance, you can die by it too.

Jam today, jam tomorrow

Feb 28th 2008
From The Economist print edition

Why the industry will still be thriving in ten years' time

Andy Baker

THE fund-management industry may have its problems, but it also has two enticing opportunities ahead of it. You could call them the two Es—the emerging and the elderly.

Twenty-five years ago, developed countries in Europe and America started to drop the capital controls they had had in place ever since the second world war. Rational investors took the opportunity to diversify their portfolios. The fund-management industry profited richly as it took a slice of the capital flowing freely between nations.

Now the capital markets are truly global. One of HSBC Global Investment Funds' most successful products in recent years was the sale of a BRICs (Brazil, Russia, India and China) fund through the Italian post office. Here was a London-based manager selling the shares of Russian oil firms and Brazilian coffee companies to Italian pensioners, neatly demonstrating that finance has become borderless.

Not that globalisation is a new phenomenon. Before the first world war, British investors were funding the development of Argentina's railways and French ones were buying Tsarist bonds issued by the Russian government. But now the capital is coming back the other way, most obviously in the form of the sovereign-wealth funds that have been every bank's favourite sugar daddy over the past 12 months. The deals that hit the headlines are the direct investments, but sovereign-wealth funds are also likely to spread their portfolios more widely. That will not only diversify their risk but may also avoid a lot of political hassle. The fund-management industry will benefit from the opportunity to offer a range of investments to the new centres of financial power.

And it is not just the sovereign funds that will be accumulating assets. As individuals in emerging markets become wealthier, they will start to build up their own savings. Foreign fund-management groups will compete for the chance to tap into this fast-growing pool of capital.

Just as in the West, the market will probably split into three. Institutions are already looking abroad for international equity exposure. Rich individuals will also be potential targets as they look for more sophisticated products such as hedge funds. The mass market will be harder to break into. In some countries, such as China, the best route will be to link up with a domestic partner.

McKinsey reckons that the best opportunity for growth is not, in fact, in any of the emerging markets but in Japan, which already has personal financial assets totalling $13 trillion, against China's $2 trillion. In the past a lot of that money has been locked up in low-yielding deposits. Less than 3% of household assets are in mutual funds, against nearly 20% in America.

Fund managers are even more excited about the Middle East, with plenty of wealth being generated by high oil prices and looking for a home. Some of this is going into local stockmarkets which are now enjoying another boom, not long after the previous one fizzled out in 2006. But some of it is also being grabbed by American and British fund managers. As one of them says, “the great thing about these accounts is that if you win one, it can easily be worth $500m.” Flights from Heathrow to Dubai are packed with managers chasing the Arab dollar.

The region is also developing its own fund-management community. Investcorp was founded in 1982 and sells a range of alternative investments to local investors, from hedge funds through private equity to real estate. Assets under management are growing fast, reaching $15 billion earlier this year, and the group now has a significant presence in the fund-of-hedge-funds market.

Between them, the growth of Asian and Middle Eastern markets may represent as great an opportunity for the fund-management industry as the rise of corporate-pension plans in the 1970s and 1980s or the love affair between baby-boomers and mutual funds in the 1980s and 1990s. But there is also much to do for the industry nearer home.

An age-old problem

In the core European Union countries, the old-age dependency rate (the number of people above retirement age as a proportion of the working-age population) is set to rise from 21% today to 50% in 2050, according to Elizabeth Corley of Allianz Global Investors. Responsibility for funding retirement income is increasingly switching from the state and the corporate sector to the individual.

But a lot of people have no interest in, or understanding of, the pensions market. They underestimate the amount of capital they will need to live on in retirement. And they can be overwhelmed by the task of deciding what to do with their pension savings. “It is asking a lot of uninformed individuals to handle the responsibility for asset allocation for their retirement,” says Jeff Knight of Putnam, a Boston-based fund-management group.

Andy Baker

The “cafeteria” model of pension provision, in which employees are invited to choose from a vast range of funds, leads investors to worry about the wrong things. “People are focusing too much on which funds to choose and not enough on the total amount of their contributions and whether that will provide a decent return,” says Alan Brown of Schroders.

The privatisation of the Swedish social-security system provides a useful case study. Swedes were encouraged to pick their own funds, with 456 to choose from at the launch in 2000, according to a 2004 paper by two academics at the University of Chicago, Henrik Cronqvist and Richard Thaler. But despite the large choice, most participants put their money into funds with an alluring recent record. The favourite fund at launch, specialising in technology and health care, had risen 534% in the five preceding years. Over the next three years, however, it lost 70% of its value. Oddly, once having made their choice, participants slumped into inertia; fewer than 4% changed their portfolio each year.

Chastened perhaps by their experience, over 90% of Swedes now choose the default option (the one that scheme members are assigned to if they do not want to make their own choice). Similar figures have been observed in America and Britain. This suggests that particular care needs to be taken in designing the default fund so that it offers a broadly based mix of assets.

There are three possible ways of achieving this, each of which would have different implications for the fund-management industry. The first is to use index funds to get exposure to the main assets of equities and government bonds. That would be the cheapest option and would provide plenty of business for passive specialists such as Barclays Global Investors and Vanguard, but the rest of the industry would not get a look-in.

The second route would be for one fund manager to run the entire fund; that would be a great business opportunity for one of the big groups, such as Fidelity or BlackRock. The third option would be for a fund-of-funds group to select the portfolio, choosing funds that specialise in areas like emerging markets, property and so on. This would be good for the boutiques, which might otherwise be shut out of the pension-fund industry.

But offering the right pension funds is only one of the industry's preoccupations. It will also need to cater for the fact that as Western populations age, they are likely to stop building up assets and start running them down—or, as the management consultants like to put it, from the accumulation phase into the decumulation phase. Investors will no longer be looking for capital gains but for income.

The trouble is that fund managers do not provide clients with the information they need to make sensible plans. People thinking about their retirement are not really interested in whether their portfolio has beaten the S&P 500 index or outperformed its peers in the global-equity-funds sector. What they want to know is how much income they can expect and how much spending power it will command.

People in traditional defined-benefit pension schemes have a rough idea of the answer. Provided they stick with their employer, they know what proportion of their final salary they will draw in retirement, so they can prepare for it. But those who are relying on a defined-contribution, or money-purchase, scheme are completely in the dark. They can be given illustrations of the sort of income that different rates of return will produce, but there is no guarantee that those returns will be achieved, and the effect of inflation can be hard to understand.

The sort of product that most people want is probably something that requires them to pay in a given sum a month for the rest of their working lives in return for a given annual income, or some proportion of their final salary, for the whole of their post-retirement lives. Anyone who could offer them something along those lines would crack the market.

Yet fund-management companies find it very difficult to make that kind of promise. The only investment that can offer a guaranteed inflation-linked return is index-linked government bonds, which offer very low real yields. Add in a fund manager's fees, and the client would have to save a huge amount to get the income he wants. That explains the prevalence of the current system: the client saves less and the funds invest in equities in the hope of earning good returns, but they do not offer a guarantee.

Why don't fund managers take advantage of the fact that equities nearly always outperform bonds and cash in the long term? They could offer their own guarantee and rely on the stockmarket to do its bit. After all, this is what final-salary pension schemes have traditionally done. The problem is that regulators would not allow managers to make such an unfunded commitment because things might just go wrong. Instead, they would ask the funds to put up an enormous amount of capital to back such a guarantee.

This has put the onus on fund managers to come up with products that deal with some of people's retirement worries, but without offering guarantees. Among the most popular are lifestyle funds, which switch investments from equities to bonds as retirement approaches. The idea is to prevent disaster in the form of a stockmarket crash hitting the fund just before retirement. Similarly, so-called target retirement funds allow investors to choose the year of their planned retirement so that the manager can adjust the asset allocation accordingly.

Then there are variable annuities, which tend to be offered by insurance companies. In return for a fee, these allow investors to lock in the value of the fund (and the expected income) on a regular basis; this gives investors the security they crave but still allows them to benefit from a rise in the market. But ultimately the guarantee is only as strong as the insurer's hedging strategy and balance sheet.

Other options include guaranteed funds that offer investors, say, 90% of the rise in an equity market over the following five years, but with the promise that capital will be returned if the market falls. These products appeal to first-time investors who want to get some exposure to stockmarkets but are nervous about the risks. Lastly, there are products that seek to use most people's biggest pool of savings, their homes, allowing them to convert capital into income.

These outcome-oriented products, as they have become known, are likely to increase in popularity. McKinsey reckons that between 1994 and 2005 such products grew at 28% a year, compared with 13% for the conventional mutual-fund industry; and that by 2010 perhaps 25-30% of the earnings of leading asset-management firms will come from products not yet on offer today.

Guaranteed uncertainty

Indeed, one of the few sure predictions that can be made about the fund-management industry is that in ten years' time it will have changed drastically. Leaving aside the havoc that turbulent markets can wreak, some managers will have taken advantage of the rise of the developing world and the ageing of Western populations, and some will have failed miserably. Some will have built a franchise in the complex world of alternative assets and some will have suffered embarrassing losses. Fund management will still be a great business in aggregate, but there will have been plenty of scope for individual firms to make a complete hash of it.

But whatever happens to the industry, it would do its reputation a power of good if over the next ten years its activities were adjusted to benefit its clients a little more and its managers rather less.

Sources and acknowledgments

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Offer to readers

Feb 28th 2008
From The Economist print edition

Business and the environment

From geeks to greens

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From The Economist print edition

Executives are switching in droves from the computer industry to clean-technology firms. Do they have what it takes to succeed?

PA - Landov

WHEN Shai Agassi, long the heir apparent at SAP, was told in March 2007 that he would not become chief executive for at least another two years, he quit. And when the German software giant then tried to change his mind by offering to make him boss right away, he realised he was "much more excited" about the new chance that his unexpected freedom would grant him. In January Mr Agassi's new start-up, Better Place, announced its first deal, in partnership with Renault, a carmaker, and the government of Israel: to "get an entire country off its addiction to gasoline" by switching to electric cars.

Though Mr Agassi is the most senior executive so far to quit a mainstream information-technology firm for clean tech, he is far from alone. Mr Agassi (pictured right, above) joins Elon Musk (pictured left), a co-founder of PayPal who is now chairman of Tesla Motors, an electric-car start-up, and Vinod Khosla (pictured centre), a legendary venture capitalist who has switched his focus from dotcommery to greenery, among many others. "There is an unbelievable migration of talent from traditional technology to clean technology," says Adam Grosser, a partner at Foundation Capital, a big Silicon Valley venture firm. "They have had their social conscience energised, and they believe there is a lot of money to be made. So you get to exercise your capitalist desires while feeling self-righteous at the same time."

Many of these techies are being recruited by the same Silicon Valley venture firms that were behind successive generations of tech companies, from PC-makers to software companies to two waves of internet firms. Along with Foundation Capital, several of the leading venture firms, including Kleiner Perkins and Khosla Ventures, are now betting big on green.

The multi-billion-dollar question is whether the skills that make somebody a successful executive, entrepreneur or investor in digital technology also work with green technology. What does a software guru bring to biofuels? Can you build an electric car in a garage? The answers may have huge implications for the planet.

Mr Khosla, who made his fortune as a co-founder of Sun Microsystems, a computer-maker, has no doubt that the Silicon Valley model can succeed in this new field. Partly, that is because he believes that dramatic change can best be achieved by entrepreneurial start-ups, which are not lumbered with the incremental outlook of what, in the early days of the internet, were called "big dumb companies".

With market risk declining fast, as even the American government mandates big increases in renewable energy and energy efficiency, much of the job is coming down to backing the right technology. Mr Khosla believes that venture capitalists are good at understanding and managing technology risks, in whatever industry they are in. Traditional energy companies understand and take on exploration risk, say, but do not feel comfortable investing in a new fuel technology with a similar level of risk, he says. "People in venture and IT are used to operating in a context when you don't know if a technology will work, and we start building before the design is finalised and fix it as we go along," he says. They are also used to a high failure rate, which they balance against the prospect of rich rewards when things go well.

"What really differentiates the Silicon Valley community is its ability to work with entrepreneurs in all sectors and shape early-stage businesses," says Bill Ford of General Atlantic, a private-equity firm that is investing heavily in greenery. "Over my career in Silicon Valley, I have learnt how to create and grow technology-based companies," says David Cope, chief executive of Purfresh, a company that focuses on purifying water and food without using nasty chemicals. He previously worked for a string of tech companies, from IBM to BizGenics, a software firm.

The internet is so passé

Mr Agassi says that what he brings from SAP is an ability to think systematically about solving problems. "I learnt how to understand a big problem, break it into small pieces, solve every one of these pieces and to reintegrate them back into a system," he says, noting that previous attempts to introduce electric cars have failed because of a lack of systemic thinking. His solution brings together four pieces: Renault, which will build the cars; Better Place, which will provide the infrastructure that allows consumers to recharge the cars easily; investors to finance the infrastructure; and a government ready to offer a large tax break to anyone ready to buy a zero-emissions car—Israel has guaranteed its tax break until 2019.

In some cases, the leap from computing to greenery may not be all that big. Most geeks already have a science background (though Mr Musk abandoned his physics doctorate after two days). Building solar panels has much in common with building microchips. "It is all about miniaturisation and the use of silicon," says Mr Ford. If he is right to expect a "Moore's Law for solar", the effectiveness of the technology will increase at a predictable rate. One of the early successes in the green boom is SunPower, a solar-energy firm spun out of Cypress Semiconductor, which now has a stockmarket value of nearly $6 billion.

Similarly, energy firms operate huge distribution networks—another area in which geeks feel at home. "When I joined from Perot Systems in 2004, the last-mile technology for energy utilities had not been invented, and I saw a huge opportunity to help utilities connect more efficiently with their customers," says Scott Lang, the chief executive of Silver Spring Networks. His firm applies internet technology to utilities' networks to improve energy efficiency and manage demand. "This is classic IT," he says. He reckons that nearly half of the demand for new generation capacity around the world over the next 15 years could be met instead through greater efficiency.

One danger for tech executives who go green is that "they may expect things to happen too quickly," says Mr Lang. "They are used to overnight change, but this is going to take time." Another, at least for some green start-ups, is the amount of capital that has to be laid out at an early stage.

"The amounts of money on the line are radically different from traditional technology start-ups," says Mitch Mandich, a 25-year veteran of Silicon Valley technology firms, including Apple, who runs Range Fuels, which is building America's first cellulosic-ethanol plant in Georgia. (The idea is that turning plant material such as switchgrass, wood or agricultural waste into biofuel will overcome the drawbacks of corn-based ethanol, which is inefficient and drives up food prices.) He has had to learn to raise money from New York investment banks and hedge funds, as well as from his venture-capital backers. Clean-tech start-ups very quickly leave the $5m-10m range, he says, and go to $50m and $100m fundraising rounds. "The stakes get very high much earlier."

For this reason, Foundation Capital is focusing on firms that improve energy use. Attempts to design clean fuels are "not capital efficient", says Mr Grosser, noting that "building plants costs hundreds of millions, and the margins may be low." Mr Khosla, an investor in Range Fuels and other clean-fuel firms, disagrees. He thinks the huge market opportunity in "replacing coal and oil" justifies the huge risks.

Then there is the need to focus on government policy. When it comes to green investing, public-policy risk may matter at least as much as technology risk. Even though the three main remaining candidates for the White House all say they will introduce a mandatory federal cap-and-trade scheme to limit America's carbon-dioxide emissions, the details have yet to be agreed on and the votes cast. "Managing public-policy risk is not something traditional technology executives have had to do, so there will be a steep learning curve," says Diana Glassman, an environmental-business banker at Credit Suisse.

Still, they are off to a promising start. Mr Khosla is fast building a reputation as a wily Washington wheeler-dealer. Range Fuels has won a $76m grant for its Georgia plant from the Department of Energy. And having bonded successfully with Shimon Peres and Ehud Olmert in Israel, Mr Agassi confidently predicts another deal between Better Place and a national government "within 100 days".

Health care

The bleeding edge

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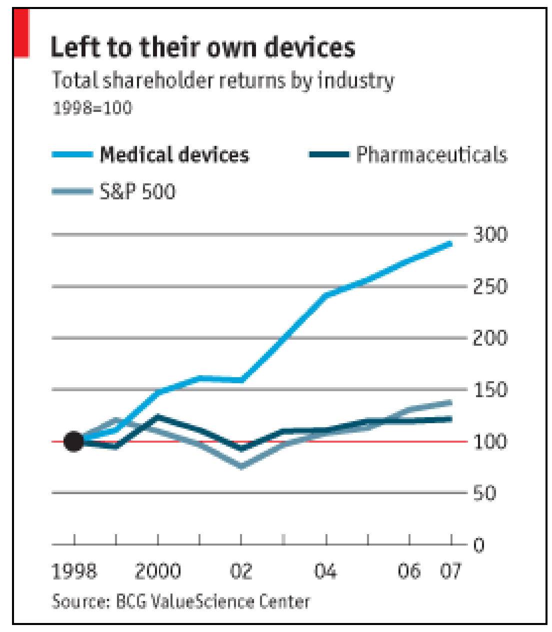
The drugs giants are in trouble, but medical devices are booming



A GOLDEN age of medical innovation could be at hand—but only if the lawyers get out of the way. That, at least, is what champions of medical-devices firms argue. The industry has certainly been doing well lately. Thanks to the success of insulin pumps, heart stents and laparoscopic surgical tools, the industry's total shareholder returns have far outpaced those of the large drug companies—and, indeed, most other industries (see chart).

Proponents of medical devices point to such promising upstarts as Apollo Endosurgery, an American firm developing “natural orifice” surgical products that leave no scars. This approach, which involves inserting sophisticated surgical devices through orifices such as the mouth or anus, rather than slicing patients open, has already been shown to work in removing gall bladders. Apollo is convinced it can be adapted even to heart surgery.

But there is a snag. Santiago Horgan, a surgeon at the University of California in San Diego who advises Apollo, explains it is much easier to find suitable patients in his native Argentina than in hyper-litigious California. “I've turned down some ideal candidates, because I discovered they were lawyers,” he says.

Apollo's concerns about litigation echo those of other small device-makers in America. Even if their products have been deemed safe by the Food and Drug Administration (FDA), they have long faced the threat of liability lawsuits in state courts. Peter Lawyer of the Boston Consulting Group, a consultancy, has scrutinised the share valuations of firms in this field, and he reckons that those with stockmarket values of less than $2 billion are being penalised by investors, who seem them as riskier. “The big multinationals are big enough to survive losing one of those liability suits, but the smaller innovators would be wiped out altogether,” he says.

But now, after a landmark ruling by the American Supreme Court, the spectre of a blunderbuss of liability suits may have receded. On February 20th the court ruled that if a device's design has been ruled safe and effective by the FDA, then juries cannot say otherwise based on state law. A spokesman for AdvaMed, the devices-industry lobby group, cheered the decision as a sensible one that will prevent such lawsuits from “disassembling the innovation cycle” with contradictory rulings.

James Ralston of Smith & Nephew, a British device-maker, even argues that it will help America's regulators catch up with their counterparts across the Atlantic. Perhaps surprisingly, considering the grousing usually heard from drugs giants about European regulators, his firm has often found it faster and easier to launch new products in the Europe than in America.

If the ruling stands (and there are some rumblings among Democrats in Congress about overriding it), then the industry's boom seems likely to continue. Medical devices have already seen an influx of private-equity funds and venture-capital firms. Mr Lawyer also points to the “gathering wave” in Asia, including an unexpectedly strong cluster in Pakistan. FDA data on new-device applications shows that these low-cost innovators are rapidly evolving from making cheap tools to more sophisticated devices.

The long-term trends also look promising as the confluence of genomics, nanotechnology and high-speed computing make possible more elaborate devices. Futurologists at Deloitte, a consultancy, reckon the “medical home”, chock full of new medical devices, will be a reality within five years. James Tobin, chief executive of Boston Scientific, an American devices giant, points to an ageing population, the proliferation of diseases, the demand for medical technology and the growing appetite for medical technology in emerging nations and insists “we're just beginning to scratch the surface.”

It all sounds great—provided nobody asks who is paying for all of this. America's Congressional Budget Office recently released a study arguing that “the emergence, adoption and widespread diffusion of new medical technologies and services” were to blame for fully half of America's health inflation. Unlike in other industries, where new technology often leads to productivity gains as inefficient older equipment is junked, new medical gadgets (such as MRI scanners) tend to be used in addition to today's technologies (such as X-ray machines). The industry may have the Supreme Court on its side, but it will now be watching carefully to see who wins the White House.

Video games

Attempted carjack

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Electronic Arts bids for the bad boy of video gaming

“WATCH drunk fat old men throw sharp instruments around a crowded room...get loaded and phone up your ex-girlfriend and call her a whore...warm beer and misogyny, does it get any better?” asks a trailer for “Grand Theft Auto IV”, the latest instalment of a bestselling series of video games set in the criminal underworld. Evidently not, in the view of Electronic Arts (EA), an American video-game giant. On February 24th it announced that it had made a hostile bid of $2 billion for Take-Two, owner of the series. Take-Two immediately rejected EA's bid as an opportunistic attempt to take advantage of the new game's release on April 29th. Nonetheless, most analysts reckon that EA will end up behind the wheel.

EA's immediate motivation appears to be reactive. In December last year two rival video-game firms, Activision and Vivendi Games, decided to merge, dethroning Electronic Arts as the industry leader by revenues. Buying Take-Two would put it back on top. A deal would make strategic sense too. EA is not particularly known for creativity; it churns out reliably profitable sports games, movie tie-ins and lots of sequels but has tended to buy independents to generate ideas for new games. Acquiring Take-Two would bring it Rockstar Games, home to Sam and Dan Houser, the talented brothers behind the “Grand Theft Auto” series. Another motivation for EA may be to stop Take-Two competing with it in sports games. That would mean worse products for gamers, says Sam Kennedy of 1UP, a gaming website.

Take-Two, for its part, might benefit from a bit more stability. Its management has been chaotic, and its current chairman, Strauss Zelnick, was installed by large shareholders in March 2007 after a stock-options scandal. Indeed, EA would have found it easier to buy Take-Two early last year, when it was still in turmoil, but discussions came to nothing. Nevertheless, John Riccitiello, EA's chief executive, argues that Take-Two is just too small to compete in a market where size is increasingly important: scale helps firms spread costs and risk as games become more elaborate and expensive to develop.

One reason to expect a deal soon is that Take-Two's board of directors recently approved a series of changes to the company's agreement with ZelnickMedia Corp, an investment firm that runs Take-Two. These will boost its compensation and include an award of shares which vest if Take-Two is acquired. Corporate-governance experts have questioned the timing of the move, which came immediately after EA made an initial (private) bid, earlier in February. Mr Zelnick, the founder of ZelnickMedia Corp, said that the timing had nothing to do with EA's offer. But everything is in place for an acquisition.

If it goes ahead, how will EA handle Take-Two? In the past EA has deliberately kept away from the most controversial areas of video gaming. Now it is trying to buy the maker of “Manhunt 2”, a particularly violent game that was recently banned in Britain but is on sale in America. Take-Two has only recently arrived at a preliminary settlement of up to $2.75m for all consumer class-action lawsuits in America relating to the “Hot Coffee” modification, which allowed people to access sexually explicit content in an earlier “Grand Theft Auto” game. The new game, which features drink-driving and strip clubs, will doubtless spark more outrage.

If EA does not give Rockstar free rein, its games might lose their appeal. This week Mr Riccitiello expressed admiration for Rockstar and made reassuring noises about how EA gives its labels lots of freedom. “I take him at his word on that,” says Mr Zelnick, but he points out that some of EA's past acquisitions have not worked out well. Some people reckon that the Houser brothers may leave—either because they do not want to work for EA, or for their own reasons. The Rockstar team's contract is up for renewal in February 2009. “They may have accomplished what they set out to do with Grand Theft Auto,” says Mr Kennedy, “and the fourth instalment could be their last.” For EA, buying Take-Two could prove to be just as risky as cruising the streets at Wanted Level six.

Business in China

On the fake take

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A Chinese gang is charged with printing $147 billion in fake receipts

THE sums are impressive by any standards. Had it been uncovered five years ago, the scam would have amounted to nearly 10% of China's GDP at the time. It is equal in value to Google's stockmarket capitalisation today. In what is being described as the biggest scandal of its kind since 1949, four men pleaded guilty in a court in Yunnan on February 22nd to producing bogus receipts valued at 1.05 trillion yuan ($147 billion). These could have denied the tax authorities more than 75 billion yuan in revenues. A fifth suspect will stand trial in a separate case.

The scam, operating in nine provinces, was based in Guizhou. In all, more than 1m fake receipts were found, ready for shipping to Kunming, Yunnan's capital, where they were to have been distributed and sold in China's larger cities. Two lorries were needed to carry them away. According to the tax authorities, the fake receipts were indistinguishable from the real thing.

The business was discovered by accident last August when police searched a bus and found 128,300 fake receipts worth 18.7m yuan. Investigations over the next few days led them to a factory where they found a further 400,000 receipts worth over 600 billion yuan, as well as various computers and scanners. Over the following six months they arrested suspects in several other provinces. Between them they were found to have almost another 200 billion yuan in copied sales slips in their possession.

Although this is a particularly large haul, the practice of printing fake invoices and receipts is widespread in China. Indeed, it is one of the country's boom industries. In 2007 almost 3,000 cases were uncovered, involving more than 10m fake receipts and at least 100 printing facilities. In January the government ordered a crackdown. The State Administration of Taxation has since been issuing public warnings through state broadcasters and via mobile-phone text messages.

Companies buy the receipts to offset their tax bills. Individuals buy them to fake their expense claims. But such practices are not just about cutting tax bills or fleecing employers. Bogus certificates, business letters, receipts and invoices allow companies and individuals to produce fake business accounts or make a wide range of other false claims.

Four men also appeared in a Shenzhen court this week charged with using forged documents in an attempt to withdraw 80m yuan from Shanghai Pudong Development Bank. Similarly, in Fujian the boss of Aoxing Biotech was arrested this week for creating a company that he had claimed was listed on the NASDAQ exchange in New York and had 50m yuan in assets. The true value of the business appears to have been only 500,000 yuan. But through the alleged hoax, he successfully managed to extract more than 3m yuan from 100 investors.

It is well known that Chinese companies often keep several sets of books. Yet the creation of entirely fictitious transactions, which can fool even the careful eyes of auditors and tax officials, suggests that investors need to be especially wary about where they put their money. Buyer—and tax man—beware.

Fashion in New Zealand

Kiwis on the catwalk

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The unlikely rise of New Zealand's fashion industry

WHEN it comes to fashion sense, New Zealand has a reputation—but not in a good way. For years Kiwi backpackers recognised each other around the world from their unofficial uniform of black tracksuit-trousers, bush shirts and sneakers. Visiting diplomats have remarked upon the penchant among New Zealand women for short haircuts, backpacks and sensible shoes. One ambassador accused them of dressing like soldiers; another said they looked as though they were going to a funeral.

Icebreaker

Made in New Zealand

But things are changing. New Zealand is now home to a vibrant and steadily expanding fashion industry, with some 50 established labels, up from a handful ten years ago, half of which sell abroad. The World Trade Organisation says clothes exports were worth NZ$315m ($216m) in the year to June 2007, up from NZ$194m a decade earlier. The largest market is Australia, followed by America, Britain, Hong Kong and Japan.

Karen Walker, one of New Zealand's leading designers, showed a collection at New York's Fashion Week in February. Trelise Cooper's designs are sold in fancy American shops, including Saks Fifth Avenue and Fred Segal. And Pumpkin Patch, a childrenswear and maternity-clothes chain, moved into the British and American markets in 2006, and its success is prompting it to open more shops in American this spring.

What does New Zealand have to offer? Charles Haddrell of New Zealand Trade and Enterprise, an economic-development agency, says it benefits from the combination of Pacific and urban cultures, an emphasis on natural fibres that appeal to environmentally conscious buyers, and a fresh and quirky approach. Icebreaker, a maker of outdoor clothing, does well abroad with its use of pure merino in striking colours and shapes (pictured above). Ms Cooper adds that because New Zealanders are geographically remote and have little exposure to mass labels, like Gucci and the Gap, designers ignore the rules. “This produces a different, quite edgy style,” she says.

Marketing campaigns that trade on the country's unspoilt scenery and laid-back culture also help. Bobux, which sells its pliable leather baby-shoes in 18 countries, boasts that they are “Born in New Zealand”. Swanndri, a cult maker of outdoor wear, shows rugged farmers in its brochures to emphasise the durability of its clothes. “We have to make a good garment. Most of our customers have guns,” runs one of its slogans.

The Southern Trust id Dunedin Fashion Week, which shows new and emerging designers and is now in its ninth year, opened on February 26th. But there are clouds on the horizon. As firms outsource manufacturing to Asia, they face a backlash from their loyal domestic customers. And the weak economy is hurting clothes retailers in America, which may not be such an attractive export market for the next couple of years.

Business in France

Not so exceptional

Feb 28th 2008
From The Economist print edition

French industry is taking on more Anglo-Saxon characteristics

FRANCE has always fancied itself as a bit of an exception. Occasionally there are fleeting signs that it may be right. Compare, for instance, the economic gloom sweeping America and other places with the stellar profits of big French companies. In recent weeks leading companies such as ArcelorMittal, Total, L'Oréal, Suez and PSA Peugeot Citroën have all reported huge profits for 2007 and a cheerful outlook for this year. But what has boosted their profits? Despite France's reputation for insularity and protectionism, it is the enthusiasm of its companies for globalisation. Their international scope protects them from downturns in some markets.

Some French firms now want to curtail production at home and switch to cheaper manufacturing abroad. Michelin (profits up 35%) and ArcelorMittal (up 30%) both plan to close French factories to improve their international competitive positions. Lakshmi Mittal, boss of ArcelorMittal, has refused government aid to keep a factory in the Moselle region open: he wants to close a plant that is no longer economic, aid or no aid. Similarly, Michelin, a global brand as well as a French star, is consolidating the smallest of its 32 factories in Western Europe (16 of them in France) for economies of scale. But it plans to expand production in Mexico, Brazil, India and China by 60% in the next few years.

This pains politicians with local elections looming, especially as the popularity of President Nicolas Sarkozy wanes. He has been whizzing round the country making protectionist noises. He popped up at the Alstom factory in La Rochelle last month to unveil a new high-speed train and to remind people that its maker is only around today because he bailed it out four years ago. He visited the Michelin site to talk up (prematurely) plans for a Suez tyre-recycling plant that could save some of the manufacturing jobs lost in tyremaking.

Ever since the glory days of Gaullist *dirigisme*, French presidents and prime ministers have loved to intervene in industry. President Sarkozy is even meddling in the Société Générale affair, hinting again this week that the chairman, Daniel Bouton, should go. If it wants to do more than talk, the retention of stakes in privatised companies and the creeping privatisation of Gaz de France (GDF) give the government plenty of industrial levers to pull.

But the pressures of globalisation seem to have trumped old-style intervention. The head of the employers' federation, Laurence Parisot, told Mr Sarkozy that Mr Bouton's career was none of his business. Proposals to bolt together two defence groups (Thales and Safran), and two power companies (Alstom, a turbine-maker and Areva, a nuclear group), have been shelved; this week Areva's boss, Anne Lauvergeon, repeated her opposition to any forced merger. The president's industrial achievements are limited to bashing heads to good effect at Airbus and advancing the privatisation of GDF. This week talk of a bail-out of Alcatel-Lucent, a struggling Franco-American maker of telecoms gear, was denied by the finance ministry.

As *le Meccano industriel* has gone out of fashion, activist investors, led by firms such as Wendel (a listed, family-controlled investment firm) and AXA, an insurance group, have been championing a more Anglo-Saxon style of French capitalism. Both are involved in a simmering row at Saint-Gobain, a building-materials firm. Wendel has taken an 18% stake, thinks the firm's assets could be sweated harder, and is demanding seats on the board.

But Jean-Louis Beffa, the veteran chairman of Saint-Gobain, wants to cancel the double-voting rights of long-term shareholders to stop Wendel taking control. Saint-Gobain's employee shareholders support him because they fear tougher management. For the first time, French managers are under pressure from stable shareholders who want them to improve returns—not just shelter from hostile bids. The coming months will show how this more global capitalism fares as the economic pressure grows.

Coal mining in Germany

Small earthquake in Saarland...

Feb 28th 2008 | FRANKFURT
From The Economist print edition

...not many dead. But the industry itself could be a casualty

EPA

The miners hang up their hats

AN EARTHQUAKE of magnitude 4.0 rocked the Saarland on February 23rd, triggered by mine workings. Bits fell off a church steeple and a few houses were cracked. But the real damage was to the local coal-mining industry: work has been suspended pending investigation. If Peter Müller, the state's premier, has his way, it will provide an excuse to close the mine for good, six years ahead of schedule.

The Saar and Ruhr are Germany's two historic mining areas—mining in Saarland dates back to 1429. But their production has long been uncompetitive and devours subsidies of around €2.5 billion ($3.7 billion) a year. In 2007 the industry and government struck a deal: mining would be phased out by 2014, or 2018 at the latest, unless a review in 2012 showed that the economics had suddenly changed for the better. So the miners of the Saar already looked doomed. They have dwindled from 60,000 in their heyday, producing 17m tonnes a year, to a mere 3,600 producing 3.6m tonnes from one mine at Ensdorf. But sudden closure would still be a shock.

Dietmar Geuskens, the local boss of IG BCE, the energy workers' union, hopes a safe way will be found to resume mining. The Saarland workings are in sandstone, which crumbles and cracks, causing frequent tremors and subsidence. RAG Deutsche Steinkohle, the firm that runs the mine, reports that 34 tremors were recorded in 2008 before this week's big one, and 53 in 2007.

Closure would affect the entire Saarland economy. It is the smallest German state and has an unemployment rate of 8.2%. Suppliers to the mining industry have already made some of their workers part-time, says Mr Geuskens. Ancillary workers, such as cleaners, are being laid off too. The local power station will have to decide soon whether to convert its furnaces to burn imported coal. Just two months ago the villagers of Ensdorf blocked plans by RWE, a power giant, to build a new 1,600MW coal-fired power station nearby. Perhaps they had an inkling that the end of coal was nigh.

Face value

The figures man

Feb 28th 2008
From The Economist print edition

Bill Ruprecht rescued Sotheby's after a price-fixing scandal. Now he faces a new test

Sotheby's

“WE WERE looking at an abyss of uncertainty, embarrassment and debt,” says Bill Ruprecht, recalling 2000 when he took over as boss of Sotheby's, one of the two leading fine-art auction houses. Sotheby's had just been accused of conspiring to fix prices with Christie's, its rival and the other member of the duopoly at the top of the art-auction world. Diana Brooks, Mr Ruprecht's predecessor, and Alfred Taubman, the retail tycoon who was Sotheby's chairman until the scandal became public, risked going to prison as co-conspirators in the alleged scam. Sotheby's faced financial ruin and its reputation was in tatters. “I didn't want the job,” says Mr Ruprecht.

But eight years on he is glad that he was talked into taking it. On February 26th Sotheby's reported record sales of $6.2 billion for 2007, up 51% from 2006. This included a record 748 works sold at auction for more than $1m. In May last year Sotheby's auctioned off “White Centre (Yellow, Pink and Lavender on Rose)” by Mark Rothko for a stupendous $72.84m, three times the highest price previously paid at auction for the artist. Including the Rothko, Sotheby's sold four of the five most expensive pictures in 2007. It was the best year in its 264-year history.

Not bad for someone who was once snootily dismissed by a department head at Christie's as a mere “figures man”. Mr Ruprecht, who grew up in Missouri, explains that his mother was a painter and his father the boss of various public companies, so he can draw upon his parents' artistic and business qualities. He graduated from the University of Vermont in 1980, having gone back to finish his degree after dropping out for three years to make furniture. He joined Sotheby's oriental-carpet department the same year, and had worked his way up to become head of its American business when the scandal hit and the board asked him to take over as chief executive. “The first thing I had to do was to reassure staff and to keep them from jumping ship,” he says. He rallied the staff at a general meeting, promised a new beginning and then convinced the board to pony up for “golden handcuffs” for top specialists. All of them stayed put.

Mr Ruprecht then spent the first four years of his tenure sorting out the firm's legal and financial problems. Sued by their clients in a class-action lawsuit, Christie's and Sotheby's agreed to pay $256m apiece to compensate customers for illegally co-ordinating the commissions they charged on sales. Mr Taubman, who owned a controlling stake in Sotheby's at the time, paid $156m of its bill; the firm paid $100m. Sotheby's was also fined $45m by America's antitrust regulators and $20m by the European Commission. Christie's won exemption from these fines because Christopher Davidge, its former boss, had spilt the beans about the price-fixing conspiracy to the authorities.

The struggling company cut operating costs, chopped staff and even sold its grand Manhattan headquarters for $175m in 2003, leasing the building back for 40 years. (It repurchased it this year for $370m.) Sotheby's also abandoned its partnership with eBay, the leading internet auction-site, losing a total of $100m on its various online efforts. “Selling top art over the net doesn't work,” says Mr Ruprecht. By 2004 the business had been “resized”, he says, and in the second half of that year the art market reignited, leading to the bull run of the past few years.

The main driver of the boom is the new wealth of emerging economies. Today punters from 58 countries will buy pieces worth more than $500,000. That compares with 36 countries five years ago, says Mr Ruprecht. At the recent Sotheby's evening sale of Modern and Impressionist paintings in London, newly rich Russians snapped up Franz Marc's “Weidende Pferde III” for a record £12.3m ($24.3m) and “Schokko mit Tellerhut”, by Alexej von Jawlensky, another German Expressionist, for £9.4m, double the price of the picture's last sale at auction in 2003.

Relations between the top houses remain far from cordial. Sotheby's is still smarting from what it considers to be unfair treatment in the clean-up of the price-fixing scandal. Mr Davidge secured an amnesty, but Mr Taubman went to jail for more than nine months and Ms Brooks spent six months under house arrest. The disparity between the two firms' punishments meant that “at times it seemed as if Sotheby's had been price-fixing with itself,” says a Sotheby's employee, who insists that none of her colleagues knew about the practice.

Quality, not quantity

The two firms are now competing hard for leadership, but with very different strategies. Christie's says that it is “the world's leading art business” measured by sales, profitability and the quality of works offered. Under Mr Ruprecht, Sotheby's says its goal is to be the best, not the biggest, by focusing on the high end of the market. Christie's sells items worth anything from $200 to over $80m; at Sotheby's the price floor is $5,000. Tellingly, the two firms had almost identical turnover last year, but Sotheby's sold 42% fewer lots than Christie's did. Yet Mr Ruprecht still has work to do to establish Sotheby's as the industry's top dog. Maria-Christina Sayn-Wittgenstein, an art dealer in New York, says that in Old Masters Christie's and Sotheby's are equally strong, though in 19th-century pictures Sotheby's wins hands down. Another expert says Christie's has a stronger brand and a firm grip on China and other emerging markets.

An old adage has it that at Sotheby's businessmen are pretending to be gentlemen, and at Christie's gentlemen are pretending to be businessmen. Both companies' reputations as gentlemen have taken a hit, but business is booming once again. “I can't say I did it,” says Mr Ruprecht, who credits his colleagues, as well as the remarkable art boom, for the turnaround. A downturn will present him with a new test. Mr Ruprecht admits that his business “is not recession-proof”. But he is betting that Sotheby's will benefit from a flight to quality in harder times.

Business in South-East Asia

The tigers that lost their roar

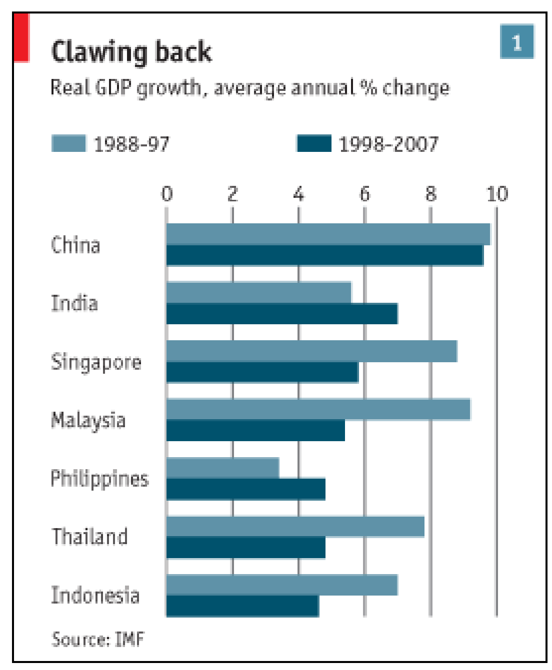
Feb 28th 2008 | BANGKOK AND KUALA LUMPUR
From The Economist print edition

Illustration by James Fryer

Other emerging economies are producing world-class companies by the dozen. Why aren't the countries of South-East Asia?

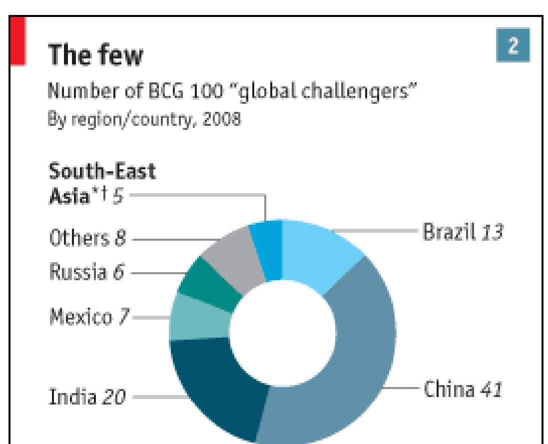
IT IS easy to forget, now that China and India are all the rage, that until ten years ago South-East Asia was the world's fastest-developing region, winning the sort of investor attention and breathless column inches that the two new giants now enjoy. The region has, slowly, recovered from the blight of 1997-98. It has recently had several years of strong growth (see chart 1) and its governments' finances have been greatly improved. Even so, after all this time the region's five main economies—Indonesia, Malaysia, the Philippines, Singapore and Thailand—are still notable for the near-absence of companies that could truly be called world-class.

The region has 570m people and had a head start in economic development over much of the rest of Asia. So why does it still have no global consumer brands of the stature of South Korea's Samsung and LG? Where are its rising technology leaders, like Taiwan's AU Optronics and Taiwan Semiconductor? Where are its equivalents of India's world-conquering Tata Steel, Ranbaxy and Wipro? Or China's market-devouring Huawei and Lenovo? Ask an investor in London or New York to name globally respected South-East Asian firms and the answer is unlikely to consist of much more than Singapore Airlines.



In a recent book, "Asian Godfathers", Joe Studwell, a journalist, examines this failure in stark terms. The region's business scene, he says, remains dominated by old-fashioned, mediocre, sprawling conglomerates, run at the whims of ageing patriarchal owners. These firms' core competence, such as it is, is exploiting their cosy connections with governing elites. Their profits come from rent-seeking: being handed generous state contracts and concessions, or using their sway with officialdom to keep potential competitors out. If they need technology, they buy it from abroad. As a result, Mr Studwell says, the region has "no indigenous, large-scale companies producing world-class products and services."

Similar things were once said of much of the rest of Asia—and sometimes still are. But somehow other countries' top businesses, even in India, the home of the licence Raj, have escaped this mediocrity trap. Whereas the export-led growth of South Korea and Taiwan comes mainly from indigenous firms making globally competitive goods with their own technology, much of South-East Asia's high-value exports are made by foreign companies. Thailand has built a successful motor industry by attracting multinationals. But it will constantly suffer the risk that these will move to somewhere like China, with lower costs and a bigger home market.



Company	Country	Main business
Indofood Sukses Makmur	Indonesia	Food & drink
Malaysia International Shipping Co	Malaysia	Shipping
Petronas	Malaysia	Fossil fuels
Charoen Pokphand Foods	Thailand	Food & drink
Thai Union Frozen Products	Thailand	Food & drink

Look under the bonnet of what seems to be a well managed, local industrial firm in South-East Asia, such as Astra, an Indonesian carmaker, and you find that it is assembling Japanese cars under licence and is controlled by a Hong Kong group. Not many have got far beyond serving the home market. A recent study by the Boston Consulting Group (BCG) of the 100 largest multinationals from emerging economies (a category that excludes Singapore) contained only five from the whole region. By contrast there were 13 just from Brazil, which has only a third of South-East Asia's population and which until about a decade ago had no genuinely global firms to speak of (see chart 2).

Class distinctions

To be counted as world-class, a firm needs to be more than just well run and large. It should have a globally valued brand, or its own leading-edge technology, or a genuinely innovative and admired business method. These are demanding standards: even some of those in BCG's top 100 are really just plain big. In South-East Asia few companies meet them. Some come close, especially in Singapore, the region's most advanced country. Singapore Airlines is the world's fourth-largest international carrier and is perhaps the region's best-known brand around the world. Keppel and SembCorp, the world's two largest makers of offshore oil drilling-rigs, dominate their industry.

However, some of Singapore's tech stars are showing signs of fading, worries Garry Evans, an equity strategist at HSBC. Chartered Semiconductor and Creative, for example, are slipping behind rivals in places like Taiwan, which now has "a critical mass in technology and a very entrepreneurial culture," he says.

In banking, the region has some impressive contenders, like Singapore's OCBC and Malaysia's Public Bank, which are expanding beyond their borders. But now these must contend with China's huge and increasingly muscle-flexing banks as well as Western ones with deep roots in the region, such as HSBC and Standard Chartered. As in other types of business, the region's local champions lack scale in a world where critical mass seems to matter ever more.

Admittedly, the region has some natural handicaps. The ten members of the Association of South-East Asian Nations (ASEAN) have a huge variety of languages, religions, political systems and histories. Even the most populous member, Indonesia, with 230m people, is itself enormously diverse, being made up of 17,000 islands and a rainbow assortment of cultural and religious traditions. By comparison, Brazilians may dance the *forró* in the north and the samba in the south, but theirs is a pretty homogeneous and monolingual country of 190m, all on one land mass.

That said, ASEAN's leaders could do much more to keep their lofty promises of European-style economic integration, to give local companies a sizeable home market from which to build world-beating businesses. Their failure to construct a genuine single market is shown up by the fact that ASEAN's members still do three times as much trade with non-members as they do among themselves. Internal tariffs have been cut, but as McKinsey, a management consultancy, noted in a report in 2004, product standards and other non-tariff barriers often differ among ASEAN countries, forcing manufacturers to make small production runs for each country.

All this lowers the competitiveness of local firms, as well as multinational companies operating in the region. Corruption is another great burden on business. That is true elsewhere in Asia too, but several South-East Asian countries—notably Indonesia—are afflicted by corrupt and unreliable judicial systems, making it difficult to enforce contracts.

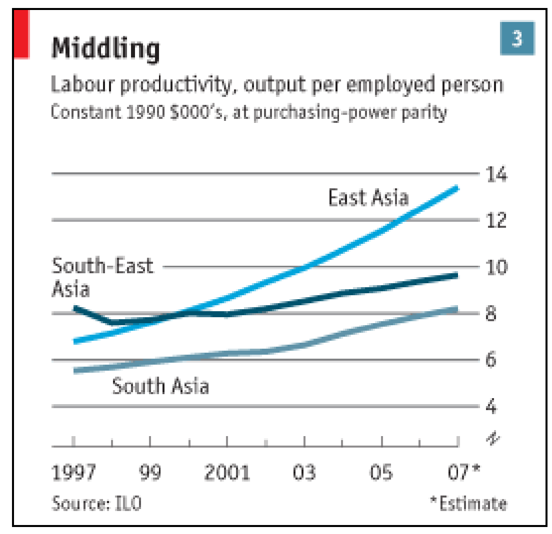
Dicing with relegation

Although it is hard to generalise across Asia, another obstacle to developing world-class businesses is that the five main South-East Asian economies do worse than might be expected—that is, relative to their national incomes—in promoting technology and higher education. Tony Fernandes, the boss of AirAsia, a fast-expanding Malaysian airline and a contender for the "world-class" label, laments how South Korea, where the government has pumped money into research and training, has left his country trailing in so many ways. "We used to beat them at football—not now," he groans.

Malaysia has also spent heavily on universities and the promotion of technology but its efforts have been stymied by the country's messy racial politics (including preferential university places for the Malay majority) and by the handing of state contracts and concessions to undeserving government cronies. Both the lack of fair competition between businesses and the failure to widen access to education may have a common underlying cause: that South-East Asian countries remain in the grip of narrow elites.

The problem betrays itself not just in the region's relative lack of memorable business names but in its basic economic statistics—in particular, labour productivity, the key to long-term growth. Productivity in China and India is growing much faster than South-East Asia's is. East Asia overtook the region in output per worker by 2000 and has continued to power ahead. Now South Asia is closing the gap (see chart 3). Not even hosting the factories of so many sophisticated multinationals seems to have made much difference to South-East Asia. With all those Indian and Chinese pairs of hands joining the global workforce, the region has no option but to seek to move beyond simply offering low wage costs and produce better-educated workers and more innovation.

It is not all the fault of governments. The region's unwieldy conglomerates could do more to help themselves achieve global scale by concentrating on fewer businesses. Some are doing so, but others still seem unable to resist poking their fingers into another pie. The food-and-drink arm of Charoen Pokphand, a Thai conglomerate, is in BCG's top 100; but the group is an unspectacular contender in industries from telecoms to convenience stores and is now moving into carmaking. San Miguel of the Philippines, a big beer-to-food conglomerate, recently talked of trying its hand at generating electricity. Synergy Drive, the absurdly named merger of three underperforming plantation firms controlled by the Malaysian government, is taking a stake in the giant Bakun hydro-dam in Borneo.



This dilettantism was once summed up damningly by Michael Porter, of Harvard Business School: "These companies don't have strategies, they do deals." Gerry Ambrose in the Kuala Lumpur office of Aberdeen Asset Management laments that it is indeed hard to find Malaysian companies with "a business plan that will last ten years". Many firms have improved their profitability since the 1997-98 crisis but that may not guarantee their long-term survival. Because even the best-run firms often have boards and shareholder lists dominated by the founding family and their friends, it is hard to believe that their thinking will change.

Of the "godfatherish" firms profiled in Mr Studwell's book, one that analysts say is among the best performers is YTL, a Malaysian conglomerate. Big in construction, the firm also owns a British water firm, Wessex Water, operates hotels and upmarket shopping malls, runs a high-speed rail link from central Kuala Lumpur to the city's airport and owns a chain of power stations. Its founder, Yeoh Tiong Lay, built a giant construction business with state contracts in the country's early post-independence period. In the 1990s, when his friend Mahathir Mohamad was prime minister, the firm got concessions to generate electricity using subsidised gas from the state oil firm, which the state electricity firm was obliged to buy.

Nice work if you can get it. But the founder's son, Francis Yeoh, who now runs the firm, insists that it has not just rested on its laurels. It has delivered, he argues, "a 55% annual compound growth in profits" since the mid-1980s and it now earns 70% of its revenues outside Malaysia. On February 22nd it declared a profit for the six months to December 31st of 688m ringgit ($202m), 24% more than a year before. The firm does have a core competence, says Mr Yeoh, which is to build and maintain infrastructure assets of first-world quality at third-world prices. Even the group's hotels and shopping malls should be seen as "unregulated infrastructure", he argues, stretching the point somewhat.

As Asia continues to grow vertiginously, it will need a lot more infrastructure, regulated or not, and YTL, says Mr Yeoh, has shown it can provide it. In particular, he foresees juicy contracts from applying Wessex Water's skills at cleaning up rivers to the continent's murky waterways. This indeed sounds like a promising growth business. But there will be others—not least some sizeable Chinese water-treatment firms—which will be after those same contracts. So far Wessex Water is making decent profits in western England, but its potential to become a global leader is untested.

Hitherto, Malaysian companies have had a remarkable record of picking duds when they buy foreign firms. Laura Ashley, a fashion designer; Costain, a builder; Lec, a fridgemaker; and Agusta, a motorbike-maker: all were bought by Malaysian firms with less than glorious outcomes. Even so, if they continue to improve, YTL and the region's other conglomerates may yet break the mould. Other Asian world-beaters also began as divisions of sprawling, family-run groups but eventually escaped their orbit sufficiently to thrive. An executive at India's globally expanding Tata Steel, for instance, says that Tata Sons, from which it sprang, maintains its minority stake in the firm but these days leaves it to be run by professional managers.

Another hopeful sign for South-East Asia's corporate future is that it seems to be getting easier for those outside the closed circle of the politically well-connected to set up new businesses and challenge the incumbents. Mr Fernandes's AirAsia is the prime example. Started only six years ago, the airline now criss-crosses the region with a huge network of low-cost flights. Mr Fernandes, a former music-industry man, is still frantically adding routes: he expects to be allowed to start domestic flights in the Philippines and Vietnam soon. He has started a separate, low-cost, long-haul airline, AirAsiaX, which is flying from Kuala Lumpur to Gold Coast airport in Australia and Hangzhou near Shanghai. Flights to Melbourne, Amritsar and eventually London are on the way.

Though ASEAN has been slow to lower its barriers in some areas, in aviation they are coming down. Singapore and Malaysian Airlines' duopoly on the Kuala Lumpur-Singapore route has just been scrapped and, says Mr Fernandes, incumbent firms across the region are finding that their home governments are no longer protecting them. It could be said that, by linking the region's cities with cheap and frequent flights, Mr Fernandes has done more to turn South-East Asia into an integrated economic block than any ASEAN ministerial summit. In other once-coddled industries, too, governments are starting to dismantle monopolies. YTL's Mr Yeoh says there will soon be "no hiding place" for firms trying to live from old-fashioned rent-seeking.

The rise of China and India, with their huge home markets, may mean that it is too late for South-East Asia to become big in manufacturing. But it does still have the prospect of producing world-leading firms in other areas where it has an edge. Tourism and hospitality are obvious examples, especially as the region's neighbours become richer. South-East Asia could become both "the Mediterranean and the Caribbean of Asia", enthuses YTL's Mr Yeoh.

Playing to your strengths

Apart from YTL, well regarded companies that could use tourism growth as a springboard to global greatness include hotel groups such as Singapore's Banyan Tree, casino operators like Malaysia's Genting and even hospital firms like Thailand's Bumrungrad, a growing competitor in "medical tourism". However, as HSBC's Mr Evans points out, such firms have yet to demonstrate that they can transfer their vaunted "service mentality" to other parts of the world that do not have an abundance of cheap labour.

Natural resources are another promising source of future world-beaters. Following Brazil and, closer to home, Australia, South-East Asia is beginning to build global businesses by making the most of what nature has provided. Palm oil, of which most of the world's supply comes from Malaysia and Indonesia, is one example. Some plantation firms are simply hitching a ride on the boom in prices but IOI, a Malaysian plantation owner, is about 50% more efficient in terms of yield per hectare than its local rivals. If the government could push Synergy Drive, its new behemoth, to the same level of productivity, it would boost the economy.

The region already dominates some types of agricultural produce: Thailand and Vietnam are the world's two largest rice exporters, for example. Since the region has so much coastline and so many rivers, there is much scope for expanding fish-farming and seafood production. Thai Union, a giant tuna-packer, is already in BCG's top 100. Vietnam, the region's rising star, has several big seafood firms which, if they can resist the regionwide scourge of diversification, may one day reach similar heights. But to make the most of its fertile land and waters, the region needs more sophisticated food-processing industries and stronger brands, instead of exporting bulk commodities.

The reasons why South-East Asia has been slower than other regions to produce world-class businesses are complex and open to debate. But they do seem to be linked to the perseverance of narrow elites and to the countries' sluggishness in overcoming old rivalries and building an integrated regional market. As a handful of promising companies are showing, not all is lost. Even in today's fierce jungle, South-East Asia can still breed tigers.

Foreclosures in America

Searching for Plan B

Feb 28th 2008 | WASHINGTON, DC
From The Economist print edition

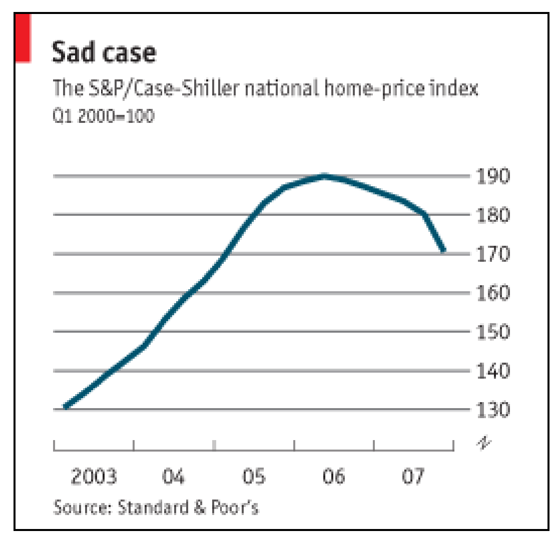
As America's mortgage mess worsens, radical solutions are gaining appeal

Getty Images

WITH brick-fronted townhouses and old-fashioned street lamps, Faulkner's Landing in Ashburn is one of hundreds of new developments that sprouted across the farmlands of northern Virginia during America's housing boom. Less than three years old, these houses originally sold for around $550,000, but are now worth some 40% less that that. Foreclosures are rising. For owners who put little or no money down, points out Danilo Bogdanovic, a local estate agent, it is often not worth paying a mortgage far greater than the value of the house.

As America's house prices slide, fears are growing that more people will post the keys to their lender and walk away. The practice, already common among speculative buyers, has a nickname, “jingle mail”. For a fee, websites such as youwalkaway.com, explain what to do. Laws on repossession differ by state. But thanks to high legal costs, mortgage firms have historically not chased borrowers even when the law allows it.

It is easy to paint grim scenarios. Repossessions are soaring, up 90% from a year ago according to RealtyTrac, a seller of foreclosure statistics. According to the S&P Case-Shiller index, average house prices fell by 9% in 2007 (see chart), and the pace of decline is accelerating. Mark Zandi of Moody's Economy.com reckons that 8.8m mortgage-holders, 17% of the total, have home loans that are greater than the value of the house. If house prices fall by another 10%, as he expects, Mr Zandi expects almost 14m mortgages to be underwater in a year's time.



Given that the typical mortgage is worth $225,000, over $3 trillion of debt would be affected. Since the costs of foreclosure can eat up 25% or more of the value of a loan, the losses could be enormous if a large fraction of these borrowers walk away. Nouriel Roubini, one of Wall Street's most pessimistic seers, worries that the “forthcoming jingle-mail tsunami” could spawn $1 trillion-2 trillion of financial losses, creating a systemic banking crisis.

Experience from previous regional housing busts suggests most people with negative equity do not simply walk away from their houses. But much about today's situation is unprecedented—particularly the high initial loan-to-value ratios. On February 27th Fannie Mae, the government-backed mortgage giant, announced an unexpectedly big loss of $3.55 billion for the fourth quarter of 2007 because of increased foreclosures.

Until recently, Washington's main fear was that foreclosures would soar as the low initial interest rates on some 2m adjustable subprime mortgages reset. In December 2007, to great fanfare, the Bush Treasury cajoled the mortgage industry into promising a (voluntary) temporary rate-freeze for certain groups of borrowers. So far, these efforts have yielded little. But thanks to big rate cuts by the Federal Reserve, resets are becoming less of a problem. One analysis suggests that the typical reset now involves a jump in monthly payments of just over 10%, compared with 25-30% six months ago.

But even as resets become less painful, analysts are realising that they are not the main cause of foreclosure. An influential study from the Federal Reserve Bank of Boston points to falling house prices, and the resultant negative equity, as a far bigger trigger. Stemming foreclosures, points out Paul Willen, an author of the study, will depend on reducing the size of mortgages relative to the value of a house.

One approach under consideration in Congress is to adjust America's personal-bankruptcy law so that judges can “cram down” a mortgage to the market value of a house. Under current law, judges cannot reduce the debt on someone's main residence, though they can do so for holiday homes or investment properties. Proponents of the legislation reckon 600,000 people could avoid foreclosure if the rules were changed.

The mortgage industry is vehemently opposed. And many economists worry that allowing cram-downs will worsen the drought of credit in America's mortgage markets. Chris Mayer of Columbia Business School points out that some $750 billion of annual mortgage lending has dried up as the securitisation of subprime and jumbo loans has collapsed. Changing bankruptcy rules, he argues, would make matters worse by raising the cost and reducing the supply of mortgage credit. Several studies have shown that borrower-friendly laws lead to more restricted credit. However, a new paper by Adam Levitin of Georgetown University Law School and Joshua Goodman of Columbia University finds scant difference in interest rates on mortgages that can already be crammed down (such as holiday homes) and those that cannot.

Unsurprisingly, bankers are lobbying for a different approach, one where the government stems the foreclosure spiral (and limits losses) by buying and refinancing whole swathes of mortgages. One idea, championed by Chris Dodd, the chairman of the Senate Banking Committee, is to recreate a modern version of the Home Owners' Loan Corporation, a Depression-era institution that refinanced mortgages in the mid-1930s when almost half of all home loans were in default. Other proposals have similar aims. A government institution, such as the Federal Housing Administration (FHA), would buy mortgages at a discount and refinance them into new loans with a government guarantee. Credit risk for the refinanced mortgages would shift to Uncle Sam.

How much of a “bail-out” this implies depends on the discount at which the mortgages are bought and on their subsequent performance. Most proposals suggest using the market price; Mr Zandi wants the government to buy mortgages by auction. Some plans are ambitious: Alan Blinder of Princeton University foresees an institution that takes over between 1m and 2m loans, worth $200 billion-$400 billion. Other schemes are narrower. Democratic congressmen talk of an initial capitalisation of around $20 billion.

Another complementary idea, touted by the Office of Thrift Supervision (OTS), is to give mortgage lenders a share of the upside if properties appreciate. Under this scheme, the FHA would insure a new mortgage at a house's current value. The existing lender would get a “negative equity” claim for the difference between that and the original loan, which could be exercised if the house later sold at a higher price. Some proponents of bankruptcy reform want to attach similar provisions to the cram-down. But the details of any “shared appreciation” devices are tricky. If homeowners have little hope of building equity in their house, the incentive to default remains.

All told, all the plans are fraught with problems. Bankruptcy reform will help some of today's borrowers while hurting tomorrow's. Government refinancing potentially puts taxpayers' money at risk. For the moment, the Bush administration opposes both and pins its hopes on voluntary loan modifications. Public opinion is also against any “bail-out”. But the climate in Congress is shifting. As the housing market worsens, bigger government intervention is becoming ever more likely.

The Economist's house-price indicators

% change

	Latest	Q4 2006	1997-2007
Singapore	31.2	10.2	na
Hong Kong	24.3	3.6	-29
Australia	12.3	9.7	168
Belgium	11.4	9.3	142
Sweden	11.3	10.5	149
China	10.5	5.3	na
South Africa	9.1	14.8	395
New Zealand	8.9	9.2	124
Canada	6.0	11.5	80
France	5.6	9.9	150
Italy	5.1	6.2	102
Spain	4.8	9.1	190
Britain	4.2	9.4	210
Netherlands	3.8	4.7	102
Denmark	2.1	14.9	129
Switzerland	2.0	1.8	19
United States (OFHEO)	0.8	5.9	94
Japan	-0.7	-2.8	-32
Germany	-2.7	-1.1	na
Ireland	-7.3	13.1	227
United States (Case-Shiller national index)	-8.9	0.2	104
United States (Case-Shiller ten-city index)	-9.8	8.7	156

Sources: ABSA; ESRI; Hypoport; Japan Real Estate Institute; Nationwide; Nomisma; NVM; OFHEO; Quotable Value; Stadim; Swiss National Bank; Standard & Poor's; government offices

Monetary policy

Oceans apart

Feb 28th 2008
From The Economist print edition

The ECB and the Fed diverge over inflation. Hence the surging euro

Get article background

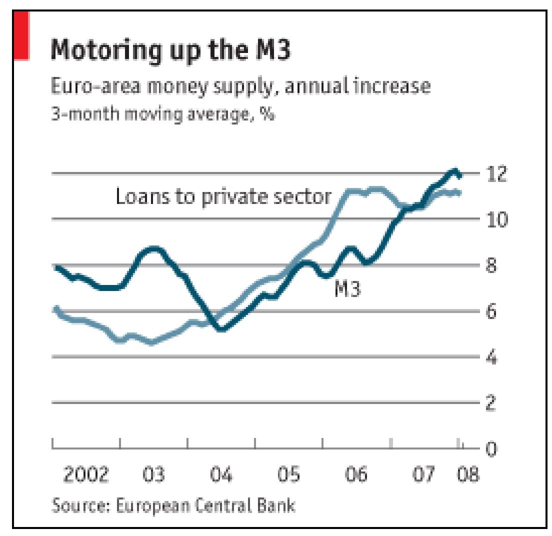
FOR such a young institution, the European Central Bank (ECB) has some old-fashioned ideas. Unlike the Federal Reserve, its older American cousin, it still collects and publishes estimates of M3, a broad measure of the money supply. The ECB pays heed to these statistics too—or at least to the matching figures on credit growth. This ritual nod to the idea that inflation is caused by too much money seems more quaint than it should, but nevertheless adds to the bank's prim image.

The ECB is stuck in its ways on other matters too. At its next policy meeting on March 6th the bank is very likely to keep its benchmark interest rate at 4%, where it has been lodged since the credit crisis began last August. Contrast this with the hyperactive Fed, which has already slashed its key interest rate from 5.25% to 3% and is expected to cut again at its next scheduled meeting on March 18th.

The ECB is reluctant to offer the same insurance against faltering demand. This is partly because the threat to the euro-area economy is less immediate and alarming. But it is also because the bank is more anxious about inflation. Consumer prices in the euro area rose by 3.2% in the year to January, well above the 2% limit of the central bank's target range. The ECB fears that today's high inflation, bolstered by fresh increases in oil and commodity prices, will alter expectations about future inflation and that firms and workers will bump up their prices and wage claims to match.

The money-supply figures published on February 27th lend support to the ECB's more cautious stance. M3 rose by 11.5% in the year to January, nearly three times as fast as the 4% or so rate of nominal GDP growth that is consistent with 2% inflation. This is less worrying than it might seem. Much of the build up in money represents savings rather than funds for spending. The M3 measure includes interest-bearing deposits that cannot be withdrawn quickly and these are booming as investors opt for safer and more liquid assets.

A new working paper from the ECB concludes that portfolio shifts of this kind have made M3 a poor guide to even medium-term inflation. The bank's rate-setters have in any case placed greater emphasis on the strong expansion of credit that goes with buoyant deposits. Private-sector credit is growing at a double-digit rate (see chart), even if banks are tightening their lending terms. Loan growth to non-financial firms picked up to 14.6% in January, a sign that the credit crunch so far has not hurt borrowing for investment.



Recent surveys confirm that firms are not yet feeling the pinch. The purchasing-managers' index for February, which combines provisional readings from manufacturing and service industries, picked up from 51.8 to 52.7. Business confidence in Germany has risen for a second consecutive month, according to Ifo, a Munich-based research institute.

These more upbeat indicators will probably harden the ECB's view that it does not need to act soon to prop up the economy and is right to be vigilant on inflation. The Fed, on the other hand, has more to worry about. The headline inflation rate in America rose to 4.3% in January, far higher than in the euro area. Yet the Fed seems preoccupied with arresting the economy's downturn.

Frederic Mishkin, a member of the Fed's rate-setting committee, argued this week that fighting recession and curbing inflation are not conflicting objectives. When (as now) global prices of food and energy are rising rapidly even as spending at home weakens, the Fed can still safely set rates to support the economy. As long as inflation expectations are stable, says Mr Mishkin, these external price pressures are likely to prove only temporary.

This approach relies heavily on trust in the Fed to keep inflation under control. But there are signs that the policy of rapid rate cuts is undermining that trust. The yield gap between conventional and index-linked Treasuries, a measure of inflation expectations, has risen by more than 0.3 percentage points this year. The Fed's own forecasts suggest that the short-term trade-off between growth and inflation is worsening. It recently revised up its inflation forecast for the fourth quarter of 2008 by 0.3 percentage points, even as it downgraded its GDP growth projection for this year, from 1.8-2.5% to 1.3-2%. In his twice-yearly testimony to Congress on February 27th Ben Bernanke, the Fed chairman, conceded that the risks to inflation had increased since these forecasts were finalised at the end of January, because of the run-up in commodity prices. Even so, Mr Bernanke did little to challenge the widespread belief that the Fed is primed to cut rates again soon.

That assumption combined with gloomy figures on America's economy and more encouraging signs of life in the Europe has helped drive the euro above $1.50 for the first time. A weaker dollar will only compound the risks to inflation, which may have helped propel the price of gold, a traditional hedge against inflation and a falling currency, to a high of $965 per ounce this week.

The ECB too is set to downgrade its GDP growth forecasts and to revise up its inflation projections. That is unwelcome for any central bank. But its policymakers can at least console themselves that their hair-shirt approach is gaining some admirers in the currency markets.

Buttonwood

Structural fault

Feb 28th 2008
From The Economist print edition

Why debt markets and shares have parted company

IF BOND and stockmarkets are driven by the economy, they should tell similar stories. American two-year government bonds are yielding around 2%, suggesting a dismal economic outlook. Similarly, corporate bonds are trading as if many of them are expected to default. So why are global stockmarkets, after a wobbly January, acting as if they had barely heard of the credit crunch?

The disconnect is not total. Over the past week better news about the health of America's “monoline” bond insurers caused stockmarkets to rally and bond spreads to fall. Nevertheless, there is an impression that, as Charles MacKinnon of Thurleigh Investment Managers puts it, the credit markets are pointing to the beginning of a savage recession but the stockmarkets are suggesting that companies, if you overlook the crisis-ridden banks, are in fine fettle.

The most plausible reason for the different moods lies in the structure of the world of credit. The debt markets, as everyone knows, indulged in a lending spree in recent years. Investors, desperate to earn higher returns, were happy to buy complex (and often risky) products. Those bets are now unwinding and, as a result, the credit markets have become trapped in a negative spiral. The need to reduce risk forces investors to sell assets into an illiquid market. Those firesales drive down prices which, in turn, prompts more investors to reduce risk.

A good example is a mischievous security called a constant-proportion debt obligation, or CPDO. These ungainly contraptions played on the fact that investment-grade bonds had historically offered returns that more than compensated for the risk of default. The CPDOs took advantage of this spread by using borrowed money (up to 15 times leverage) to sell default protection against a basket of such bonds. But the leverage proved to be a curse when spreads widened rapidly.

According to Jonny Goulden of JPMorgan, by late February the prices of some CPDOs had fallen so far (to 30% of the original net asset value) that they forced managers to buy insurance against further falls. This required them to buy about $30 billion of protection against an index of credit-default swaps. That pushed up the cost of such insurance, and thus made it appear more likely that corporate bonds would default. In turn, this forced down the prices of the bonds themselves.

This deleveraging is the classic response of investors when they become risk averse. But it is being made worse by the turmoil among banks. Before the subprime crisis, it was widely thought banks had succeeded in dispersing risk. Now the risk has come back to haunt them.

Take the leveraged loans that private-equity groups are hoping to use to finance takeovers of quoted companies. With many existing loans trading at less than 90% of their face value, banks are regretting their willingness to back them. According to Linda Huber, chief financial officer of Moody's, a rating agency, “Banks are now considering whether it is worth paying a break-up fee of up to $200m on some multi-billion leveraged-loan commitments rather than funding the loan and taking a loss.”

Credit markets need a longer period of good news to stop these kind of negative spirals from taking hold. The modern financial system lacks any obvious buyer of last resort, perhaps because so many investors have to mark their losses to market. Hedge funds, too, depend on the banks for financing. Sovereign-wealth funds have been willing to supply the banks with capital (which does help) but have not yet braved the wilder fringes of the credit markets.

In contrast, stockmarkets seem to be counting on a combination of Federal Reserve rate reductions and tax cuts to rescue the economy; even the announcement on February 26th of plunging consumer confidence, falling house prices and rising producer prices failed to dent Wall Street's sangfroid.

It is not unknown for credit and share markets to part company. Mike Thompson of Thomson Financial says that, since 1991, the correlation between the performance of high-yield bonds and the S&P 500 index has been pretty low—less than 20%. In the late 1990s, for example, companies were being forced to pay higher borrowing costs while stockmarkets were enjoying the dotcom boom.

But there is an industry where the markets move as one. The credit crunch has caused the cost of insuring against bank defaults to rocket. Since the start of August, the banks have underperformed the global stockmarket by 12%. Everyone agrees that the fortunes of the banks will decide the length and depth of the crisis.

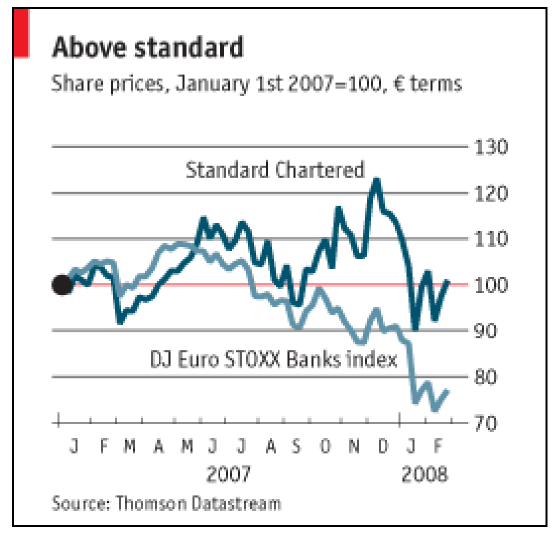
Economist.com FINANCE & ECONOMICS

Standard Chartered

The decoupled bank

Feb 28th 2008
From The Economist print edition

A rare bright spot in a troubled banking sector



THERE was a whiff of nostalgia about the unveiling, on February 26th, of the full-year results of Standard Chartered. Here was a bank that had not forgotten how to make money: revenue bounced by 28% last year, to $11.1 billion; earnings jumped by a similar amount, to just over $4 billion. Here too were shareholders with reasons to celebrate: the bank's share price has risen by 13% over the past 12 months. It could almost have been 2006.

In fact, Standard Chartered's unusual success reflects a profile tailor-made for 2008. Though headquartered in London, the bank concentrates on bubbly emerging markets in Asia, Africa and the Middle East. Profits at the consumer business in Hong Kong, the bank's single biggest unit, grew by more than 20% last year. Even that looked piffling compared with a 91% rise in profits at its Indian wholesale arm. South Korea alone yielded weak results.

The bank also has a relatively low exposure to the sorts of instruments that have tripped up its peers: investments in asset-backed securities, most of which were in any case not originated in America, are under 2% of its assets. Its capital base is strong, its liquidity profile healthy. And it already boasts two of the more transparent sovereign-wealth funds—Istithmar of Dubai and Temasek of Singapore—as long-standing shareholders. (Indeed, Temasek, which earlier this year inched up its stake to 19%, may be coming a little too close for comfort.)

Clouds do exist. Whistlejacket, a structured-investment vehicle managed by the bank, is being wound up after efforts to bail it out foundered. The financial hit to Standard Chartered is small (some $116m, out of total write-downs of $300m) but the dents to its reputation are harder to quantify. “Some of our clients have taken losses, as we have,” says Peter Sands, the bank's chief executive. “We are disappointed with the outcome.”

More worrying is the potential impact of an American recession on emerging markets. Standard Chartered's wholesale division posted record results for January. But the bank's top executives do not expect to escape events in the developed world unscathed. In preparation for an American slowdown, it began tightening up credit terms for export-dependent sectors as long ago as early 2007.

Such foresight may reflect the fact that emerging markets have dished out some hard lessons in the recent past—classes that many banks in developed markets have been able to skip. Without deep capital markets to supply funds, the bank has not taken liquidity for granted: its ratio of customer loans to deposits is a mere 86%. Nor did it bank on house-price appreciation: memories of the downturn in Hong Kong's property market in the late 1990s and the early part of this decade are fresh enough to feature in Standard Chartered's stress tests. May the bank now be tempted to apply such risk-management skills in developed markets? Unlikely. Mr Sands feels he must focus on the bank's main markets: another lesson being painfully learned elsewhere in the industry.

Bank of Japan

Mood swings over Muto

Feb 28th 2008 | TOKYO
From The Economist print edition

A ruffled succession at the central bank risks unnerving markets

THE governor of the Bank of Japan (BoJ), Toshihiko Fukui, stands down on March 19th, and his successor had long been a given: Toshiro Muto, Mr Fukui's able deputy. Yet for weeks, the government of Prime Minister Yasuo Fukuda has put off an announcement of Mr Muto's nomination, since resistance to him has grown within the opposition Democratic Party of Japan (DPJ), which controls the upper house of the Diet (parliament). The succession has come down disturbingly close to the wire.

Within the DPJ, grounds for opposing Mr Muto vary. Some members dislike how the ruling Liberal Democratic Party (LDP) came up with its candidate the usual way—behind closed doors—and want a more transparent process. Others weigh Mr Muto's five years at the central bank against his 37 years at the overbearing Ministry of Finance, and fear for the bank's new-won independence.

Meanwhile, a political debate about monetary policy is also growing. After years of interest rates at zero to counter deflation, Mr Fukui had hoped to leave office having “normalised” monetary policy—that is, to bring rates up to Japan's nominal growth rate of 1.5-2%. But he moved too late, having raised rates only to 0.5% before America's credit bust and signs of a cyclical slowdown in Japan made further hikes politically objectionable. Most bank-watchers assume that the BoJ will not be able to raise rates again until the Federal Reserve next tightens, an event that is not in the foreseeable future. In the meantime, some within the LDP call for rates to be cut to zero again.

Curiously, opposition voices, backed by some economists, argue loudest for continued normalisation. Japan's low interest rates, they say, have not boosted the economy. In particular, savers have earned poor returns, so depressing consumption. Raising rates, by contrast, would put money in people's pockets, while also breaking Japan's deflationary mindset. In that context some favour Yutaka Yamaguchi, a former BoJ deputy governor who now advises investment banks. Mr Yamaguchi is thought by his promoters to favour faster normalisation. Kazuo Ueda, an academic and former member of the BoJ's policy board, has supporters in both camps, as does Haruhiko Kuroda, head of the Asian Development Bank. For the moment, Mr Muto remains the likeliest candidate. Still, that others are even in the running at this late stage is a measure of Japan's political confusion.

Risk management

Next year's model?

Feb 28th 2008 | NEW YORK
From The Economist print edition

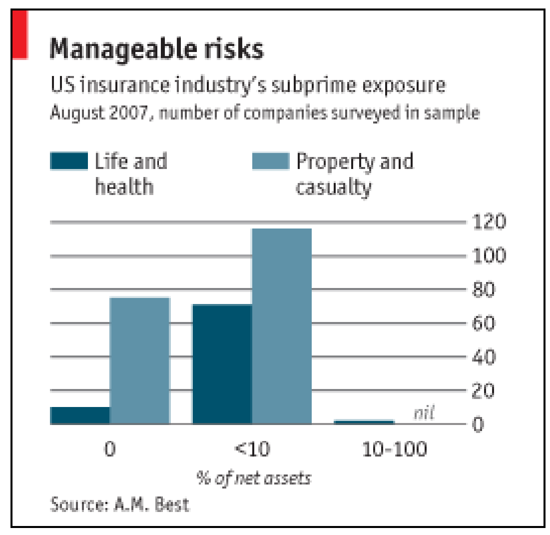
Some insurers reckon they can teach investment bankers a thing or two about handling risk

WITH their snappy name and flashy mathematical formulae, “quants” were the stars of the finance show before the credit crisis erupted. Now the complex models of risk that they developed are accused of misleading banks about the safety of subprime-laced securities. Small wonder that investment bankers are working overtime to fix what went wrong.

One source of wisdom they may overlook is the staid world of insurance. After all, what could the green-eyeshade brigade of actuaries possibly teach the wizards of Wall Street? Several important lessons, reckon some insurers, who point out that much of their industry has thus far avoided the worst of the credit crisis.

Although a few firms—including Swiss Re, a big reinsurer due to report its 2007 results after *The Economist* went to press—face billions of dollars of write-downs on ill-judged involvement in America's mortgage crisis, much of the European industry has so far come out relatively unscathed. Announcing a record profit for 2007 on February 25th, Munich Re, another big reinsurer, boasted it had just €340m ($514m) of subprime-related exposure, or less than 0.2% of its investments.

American insurers have a slightly bigger slug of subprime holdings than the Europeans (see chart), but analysts are sanguine. Fitch, a rating agency, notes that America's life-insurance industry could probably weather $7 billion-8 billion of unrealised losses, though damage on such a scale would harm some firms.



This is a very different story from the bursting of the dotcom bubble. Back then, returns on insurers' equity portfolios plunged just as liabilities on everything from life policies with guaranteed pay-outs to directors-and-officers (D&O) insurance soared, almost bringing the industry to its knees. Banks fared far better.

So what can banks learn from the insurers now the boot is on the other foot? Raj Singh, a former investment banker who recently became chief risk officer of Swiss Re, points out that the banks' risk models, which try to put a value on how much they should realistically expect to lose in the 99% of the time that passes for normality, draw on reams of historical data. But this can produce a false sense of security.

Insurers looking at, say, catastrophe risks have relatively few data points and thus tend to have a healthy scepticism of models. They more often brainstorm their own scenarios. “In insurance, we have to think the unthinkable all the time,” says Mr Singh, pointing out that the industry came up with a scenario of a multiple plane crash above a metropolitan area well before the attacks on New York's World Trade Centre in 2001.

Scenario-building usually involves insurers' senior managers, whereas in many banks the “stress testing” of risk models is the preserve of quants. Moreover, in banks different teams often track different risks, masking potentially catastrophic correlations between them. Smart insurers are increasingly aware of the way in which life, property, business interruption and other risks interact—a portfolio risk-management approach encouraged by both regulators and investors.

Insurers have a list of other things banks can learn too, including the idea that getting a customer to retain a part of a risk reduces moral hazard—something investment banks' pass-the-risk-parcel approach to securitisation blithely ignored. Swiss Re's Mr Singh notes that insurers have a respect for risk that is reflected in the status of the chief risk officer, who is treated as an equal partner in senior management. In investment banking, he claims, such people tend to get sidelined when the good times roll—though big investment banks such as Merrill Lynch and Morgan Stanley have belatedly rejigged their risk set-ups.

Pots and kettles

Yet, the insurers should not get carried away. Although many have performed better than the banks, some of them have tripped up nonetheless. Worst-hit are America's bond insurers which, lemming-like, rushed into guaranteeing dodgy asset-backed securities that eventually threatened a further meltdown in credit markets. Such fears were partially assuaged this week when Moody's and Standard & Poor's (S&P), two credit-rating agencies, affirmed the top-notch ratings of MBIA, one of the biggest bond insurers. S&P also affirmed its AAA rating on Ambac, another big insurer that is trying to raise billions of dollars of capital from a group of banks.

Then there are the mortgage insurers, another obscure corner of the industry that is a financial black hole. Big mortgage underwriters such as MGIC and PMI Group may well see their credit ratings cut soon. MGIC recently revealed that it lost almost $1.5 billion in the last quarter of 2007 alone, as mortgage defaults soared.

Such problems will seep into the mainstream industry via reinsurers such as Swiss Re and XL Capital, which underwrote some of the specialists' risks. Red lights are also flashing in the D&O market because of an expected flood of litigation linked to the credit crunch. On February 24th HSH Nordbank, a German lender, sued UBS to recover millions of dollars of losses it incurred on a portfolio of credit derivatives sold to it by the Swiss bank. Bear Stearns reckons liability insurers could lose up to $8 billion-9 billion on claims related to such lawsuits. That is a big number—until you compare it with the banks' total subprime write-downs, already well above $100 billion.

But the biggest losers are those who tried hardest to behave like banks and sought to jettison their industry's plodding image. A case in point is American Insurance Group (AIG), the world's largest insurance company, which recently had to write down $4.9 billion of swaps related to collateralised-debt obligations. Swiss Re has already written down $1 billion or so on two related credit-default swaps. Such mishaps suggest insurers, too, need to remember that modelling risks is not necessarily the same thing as managing them.

Economics focus

In the stocks

Feb 28th 2008
From The Economist print edition

Shame fills a vacuum in China's financial law enforcement

THE vast gaps in the regulations governing China's financial markets are no secret. The risks are spelled out in mind-numbing detail in every Chinese share prospectus issued to Western investors. They run the gamut from the possibility of full-blown Communist expropriation to bad accounting, insider trading, market manipulation and fraud.

There are enough prosecutions to indicate that mischief-making goes on, but not enough to make enforcement appear credible. Even when there are rules, the line between acceptable and unacceptable conduct is often unclear, and some actions are patently unfair. There is, for example, no "full" disclosure law, no match of regulation FD in America. Companies frequently meet investors selectively. The information that emerges can include changes in senior management—and hence strategy—and be of extraordinary value. In more developed markets, aggrieved shareholders kept in the dark could fire off private lawsuits; but private litigation in China is allowed only after the state has determined malfeasance.

Given these shortcomings, China might well be shunned by investors, but it is not. Its Shanghai and Shenzhen stockmarkets—though falling sharply this year—were together capitalised at $3.9 trillion at the end of January, more than in any country in the world except America and Japan. Despite their size, the markets are not efficient, however. Share-price movements, according to several studies, do not fit as closely with financial results as in other large markets. That is not only bad for investors; it also undermines the stockmarket's broader economic job of channelling capital to where it can best be used.

Name and shame

Plenty of studies demonstrate the role of a good legal environment to financial markets. But Benjamin Liebman and Curtis Milhaupt, two professors at Columbia Law School, argue in a forthcoming paper* that, whatever the limitations of the scope and enforcement of China's laws, another form of regulation has quietly emerged. Drawing on China's traditions, the authorities now also discipline wrongdoers using public criticism.

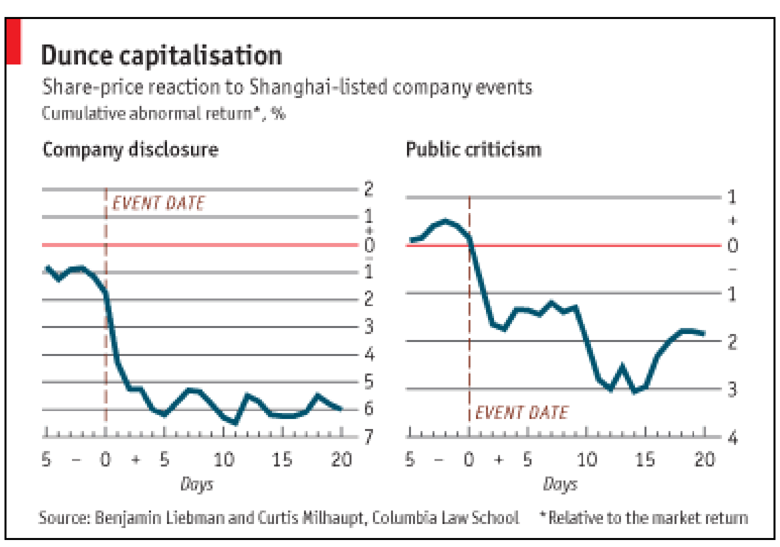
Financial markets are usually regulated through well enforced securities laws, like the ones America introduced during the Depression; or through self-regulation, as in America before the Depression and in London's Alternative Investment Market today. For many years academics focused more on laws, believing that exchanges pursued members' interests rather than those of investors. But a landmark study by Paul Mahoney, of the University of Virginia, a decade ago began to shift support towards self-regulation. Privately run markets have an interest in safeguarding investors, because that is the best means of increasing listing and trading volumes and thus of generating more fees. When exchanges were run by the state, it was not clear whether the self-interest worked in that way.

When China's two stock exchanges were created in 1990, the chief goal was to use private savings to restructure state-owned firms. Investors received only minority stakes and limited sway over corporate governance. Equally important, both exchanges were run by bureaucrats, so there were fewer incentives to increase their value by attracting companies and punters. There was little effective competition between them.

Over the past 18 years, China has introduced rules against market manipulation, fraud and insider dealing, but enforcement remains patchy. The China Securities Regulatory Commission seems competent but overwhelmed. Sometimes it takes years to issue penalties after lengthy investigations—and along the way cases lose relevance.

In the meantime, the exchanges have quietly begun to acquire authority. The power that they wield appears flimsy—the most serious penalty they can levy is a rebuke to firms and individuals through public notices. But it is remarkably effective in a country with a long history of punishment by humiliation—think of the *cangue*, a rectangular slab around the neck, in pre-Communist times and dunce caps in the Cultural Revolution.

Messrs Liebman and Milhaupt write that between 2001 and 2006 the exchanges publicly criticised 205 companies and almost 1,700 people. They looked at the share prices of the targeted firms both when they disclosed the conduct for which they were being criticised and when the criticism was published. The admissions typically preceded the rebukes, and in the few weeks that followed the firms' share prices underperformed the Shanghai stockmarket by an average of up to 6% (see left-hand chart). After the criticism, there was a further lag of up to 3% on average (see right-hand chart).



Dunce capitalisation
Share-price reaction to Shanghai-listed company events
Cumulative abnormal return*, %
Source: Benjamin Liebman and Curtis Milhaupt, Columbia Law School *Relative to the market return

Using evidence from extensive interviews, Messrs Liebman and Milhaupt point to other damage too. Raising money through equity markets and banks became more costly, and sometimes impossible, for companies that had been criticised. Suppliers and customers also took a tougher line. Some people lost the right to be a director or senior manager, and suffered from pariah status in a country where there is little pity for failure. The criticisms were sometimes even a prelude to formal investigations by the regulatory authorities.

Criticism may count for a couple of reasons, the authors suggest. Amid the vacuum of information in China, any hint of bad news is likely to be seized upon. And, in a state-run economy, it is never good to be unpopular with the authorities.

From an academic point of view, more intriguing is that the exchanges have begun to regulate themselves even though they are not private. This suggests that there is room, even in countries with authoritarian governments, for new forms of governance to emerge when laws fail. It is quite conceivable that the exchanges may become better regulators than the official ones.

* "Reputational Sanctions in China's Securities Market", to be published in the *Columbia Law Review*.

Antidepressants

Hope from a pill

Feb 28th 2008 | NEW YORK
From The Economist print edition

Photofusion

Disagreements over whether drugs to combat depression are worth taking

ANTIDEPRESSANTS have long been the source of controversy. Amphetamines were widely used as an antidote to neurotic depression into the 1960s, until such “pep pills” came to be seen as doing more harm than good. Similar worries are now engulfing today's antidepressants, like Prozac and Paxil, which are among the most widely prescribed drugs in the world. Two new studies have stirred things up: one warning that antidepressants do not help most people very much, and the other gushing that they are a marvellously cheap way to save lives.

Most antidepression pills prescribed today are selective serotonin reuptake inhibitors (SSRIs), a type of drug that boosts the amount of serotonin hanging around in the brain. Serotonin is a brain chemical closely associated with mood. Boosting its level this way might therefore improve a person's mood. Earlier versions were less effective than modern pills, which have fewer side effects and are less toxic in overdose. The use of SSRIs worldwide has shot up from below 3 billion doses in 1995 to over 10 billion in 2004.

Is all the pill popping doing any good? There is recent evidence that it can lead young people to act on suicidal thoughts, prompting America's Food and Drug Administration (FDA) to insist on warnings. SSRIs have generally been seen as a way to ease depression in adults without killing them. Derek Summerfield argued in the *Journal of the Royal Society of Medicine* that, although there is no epidemic of depression, “the case for an epidemic of antidepressant prescribing is now cast iron.”

A study published in this week's *Public Library of Science (PLoS) Medicine*, an open-access scientific journal, raises doubts about dispensing such drugs so freely. Irving Kirsch, of the University of Hull, and his colleagues scrutinised the clinical trials for several new antidepressants, taking care to include those never published (but which, by law, have to be reported to the FDA). They found that SSRIs did not help the vast majority of depressed people much more than placebos did. The net benefits over placebos did not usually reach the level considered big enough to be of clinical significance by Britain's National Institute for Health and Clinical Excellence (NICE).

This study points to two factors that bedevil proponents of SSRIs: publication bias and the power of placebos. Dr Kirsch believes published data “give an exaggerated view of a drug's benefit.” People with very severe depression did see benefits above the NICE threshold, but even that was not a ringing endorsement. Dr Kirsch explains that this was not because SSRIs worked much better in the very seriously depressed, but rather that the effectiveness of placebos dropped off sharply in such people, making the drug look better.

There are two sorts of criticism of the idea that SSRIs are mostly a waste of money. One comes from those who say the study itself is rubbish. David Nutt, of the University of Bristol, says failed drug trials often remain unpublished because their design is shoddy or their results uninteresting. He criticises the PLoS paper as a “mishmash of quality trials and lousy trials leading to a false criticism of these drugs”, which he maintains do help those with depression even if their effectiveness falls below the NICE's “arbitrary” threshold. Dr Nutt thinks it is misleading to compare these drugs with placebos, since what matters is that they work when compared with some alternatives, such as “talk therapy”, for which he believes there is even less evidence of effectiveness.

Good-news potions

Yet there is reason to think that unpublished studies do reveal some important and rather unflattering details about antidepressants. A well-designed study published in January in the *New England Journal of Medicine* looked at a larger group of antidepressants and concluded there was indeed “a bias toward the publication of positive results”: 94% of the published trials were positive, whereas only about half of the unpublished ones were.

That bolsters the PLoS paper, but there is another sort of critique that challenges its conclusions. A recent study published by America's National Bureau of Economic Research (NBER) analysed data from 26 countries over several decades to determine what effect SSRIs have had on suicides. Its authors argue that antidepressants are in fact “a very cost-effective means for saving lives”.

Countries with both high and low initial rates of antidepressant use saw similar trends in suicides until SSRIs were introduced. Jens Ludwig, of the University of Chicago, argues that countries that took to the new drugs saw a relative decline in suicides. After controlling for many variables, his NBER team reaches the cheerful conclusion that an increase in sales of one pill per person per year (about a 12% increase over the level in 2000) leads to a decline in suicide mortality of about 5%.

So are SSRIs to be shunned or saluted? The controversy will rage on, but Erick Turner, of the Portland VA Medical Centre in Oregon, suggests a third way. As one of the authors of the *New England Journal of Medicine* paper, he says the study confirms that most antidepressants do not work as well as published reports claim. That suggests many people, especially children, should be more careful about using them. But that does not mean they are pointless. He speculates that, if other therapies fail, “maybe all you need is a minor or mediocre effect in order to reduce suicides overall.” That may be particularly true for those who are closest to the edge of darkness.

Diagnostics

Winds of change

Feb 28th 2008
From The Economist print edition

A new kind of breathalyser

JUST over 50 years ago Robert Borkenstein, then a little-known forensic scientist, invented the breathalyser, allowing instant analysis of alcohol levels in the blood from a sample of breath. It turns out, though, that a person's breath may reveal a great deal more about him than simply whether or not he is fit to drive. It could also help doctors diagnose illnesses.

Every breath that is exhaled contains trace amounts of at least 1,000 compounds. Yet mass spectrometry, electronic noses and the other ways of detecting these compounds tend to be too slow or too imprecise. Mass spectrometry, for example, can have difficulty identifying a single component from within a mixture of many molecules.

Michael Thorpe and his colleagues at the National Institute of Standards and Technology, and the University of Colorado, both in Boulder, have been looking for something better. This month in an online journal called *Optics Express*, they demonstrate a technique that may simultaneously—and quickly—identify tiny amounts of many different substances in the breath.

They use something called an optical “frequency comb”, which is a precise tool for measuring different frequencies of light—made possible by advances in ultra-fast lasers. The frequency comb is generated by a laser that produces a series of very short, equally spaced pulses of light (like the teeth of a comb) across a broad spectrum of frequencies.

The team “combed” breath samples from volunteers with the light pulses. Each molecule has its own light-absorption spectrum, so by analysing which colours of light were absorbed, and in what amounts, the team could work out which chemicals were present and in what concentrations. The breath of one student smoker, for example, contained a level of carbon monoxide five times greater than the breath of the non-smokers.

Some diseases and conditions can cause small changes to the breath. Excess methylamine can, for example, signal liver and kidney disease. Ammonia may be a sign of renal failure and elevated acetone levels can indicate diabetes. Nitric oxide is a sign of asthma and other lung diseases, such as chronic obstructive pulmonary disease, cystic fibrosis and bronchiectasis (the abnormal widening of airways). However, simultaneously monitoring nitric oxide, carbon monoxide, hydro-peroxides, nitrites, nitrates, pentane and ethane in the breath, would allow a much more definitive diagnosis of asthma.

The technique is a long way from the doctor's surgery—it has not yet been through clinical trials. But as a new kind of breathalyser, more selective and sensitive than any existing device, it promises to become a fast, cheap screening tool. In addition, lots more markers of disease in the breath no doubt remain to be discovered.

What the researchers delicately forget to mention is that the breath is not the only source of biological aromas suitable for chemical analysis. Perhaps not what Borkenstein had in mind when he created the breathalyser, but another way of sniffing out the truth.

Forensic science

Telltale hairs

Feb 28th 2008
From The Economist print edition

You can tell where someone has been from his hair

POLICE now have a new test to help catch criminals and verify alibis. By analysing the chemical composition of human hair, researchers can determine the source of the water someone has been drinking in recent months. And that can indicate where he has been.

The technique depends upon studying isotopes. These are naturally occurring variants of elements, which share the same chemical properties but have different weights because their nuclei contain different numbers of neutrons. James Ehleringer and Thure Cerling, at the University of Utah in Salt Lake City, and their colleagues collected human hair from barbers' shops in 65 American towns. They report in the *Proceedings of the National Academy of Sciences* that isotopes in hair closely match the hydrogen- and oxygen-isotope ratios found in the local water.

This research has obvious implications for law enforcement and is being used by Salt Lake county sheriffs to help identify a murdered woman. Isotope analysis of her hair revealed that she spent the years before she died in America's western mountains, which helps detectives concentrate their search. The new method may also help anthropologists understand more about the history and migration of ancient humans at sites where bits of hair are preserved.

The technique works because when water evaporates at sea, a combination of hydrogen and oxygen isotopes rise to form a cloud, which then releases rain when it moves inland. Heavier isotopes tend to fall sooner. So those living close to the sea, or in corridors suffering frequent storms, will tend to absorb more of the heavy isotopes in their hair.

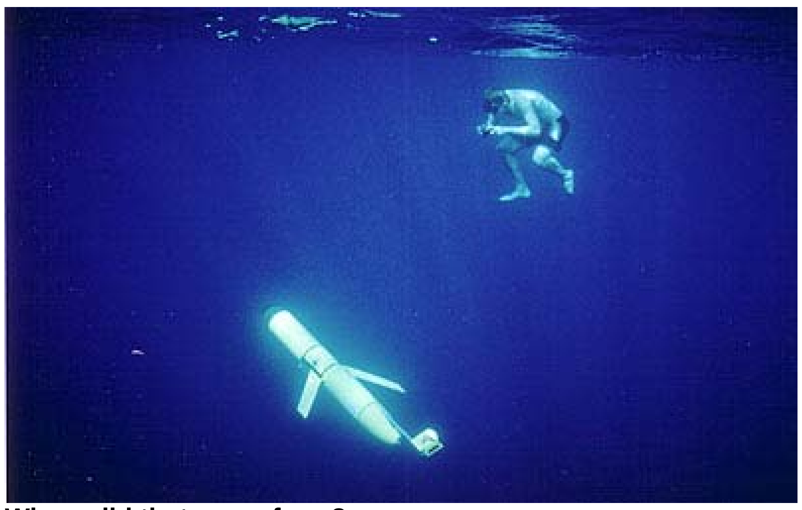
For that reason, however, it is not perfect. In America, storms can come from the Pacific or the Atlantic. This creates regions with geographically similar isotope values. So, if a murder took place in Los Angeles and a suspect claimed to have been in San Diego all the time, hair analysis could not help, because the cities have similar isotope signatures. But if the suspect were in Las Vegas, which has a different signature, he could find himself nicked.

Sea gliders

Run silent, run green

Feb 28th 2008
From The Economist print edition

John Lund



Where did that come from?

By harvesting its energy directly from the sea, a new underwater robot could cruise the oceans for years

SOMETHING unusual is swimming in the sea near the United States Virgin Islands. It has been there since December, slowly criss-crossing the 65km between St Croix and St Thomas, periodically surfacing and then diving back down again to depths of 4,000 metres. It is likely to keep this up for another three or four months. It is not some strange aquatic creature, but a new robotic underwater vehicle that could revolutionise the way oceans are studied.

Various sorts of remotely controlled machines already explore the sea. Most use electrically driven propellers or thrusters to manoeuvre. Some are tethered to ships, whereas others are cast free to operate like miniature submarines, although these too need the services of a support vessel. Using underwater vehicles can be an expensive business: research ships cost tens of thousands of dollars a day to run, and because the ocean is such a vast place they need to remain at sea for long periods to collect data. The robots also have to keep returning to the ships to have their batteries replaced or recharged.

Some oceanographers have started to use another sort of underwater vehicle that is capable of much greater endurance. These can dive for days or even weeks before having to be recovered. They still rely on batteries for propulsion, but are extremely stingy in their power demands because most of the time they “glide” through the water. These sea gliders do not have an engine and instead manoeuvre vertically by changing their buoyancy while relying on a pair of short, stubby wings to glide forwards.

The gliders use electrical power to operate pumps and valves to transfer oil back and forth between a bladder that is contained inside their torpedo-shaped pressure hull and another bladder that is outside (usually in a flooded part of the hull). To dive, oil is transferred from the external bladder to the internal one. This does not change the craft's mass but decreases its volume, which lowers its buoyancy and makes it slowly sink. To surface, the oil is pumped back outside.

To move forward, the pitch of the craft is changed. This is done by pumping fluid towards the bow, which pitches it down for a dive, or sending it towards the stern to point the nose up when ascending. In some gliders small electric motors also slide the batteries backwards and forwards to adjust the pitch. The angle helps the craft's wings to provide a lifting force and translate some of the vertical motion into forward motion.

Sea gliders move slowly, at around 1kph, tracing a saw-tooth pattern through the water as they constantly ascend and descend. When they reach the surface they communicate by satellite, transmitting any data they have collected, like temperatures and salinity. Before diving again, they take a GPS bearing, which an on-board computer uses to navigate by. The computer steers a rudder, which is usually the only external moving part.

Dive, dive

Sea gliders were conceived in the 1980s by Douglas Webb, a former researcher at the Woods Hole Oceanographic Institution. Only in recent years, though, have they become fully operational and more capable. Some are called “Slocums”, after Joshua Slocum, who in 1898 was the first person to sail single-handedly around the world. A few have managed to stay at sea for several months. In 2004 a sea glider built by the Scripps Institution of Oceanography in San Diego (and called *Spray* after Slocum's self-steering sailing ship) even managed to cross the strong currents in the Gulf Stream on a voyage to Bermuda.

The craft that is steadily plodding between the Virgin Islands is being operated by a team from Woods Hole and the Webb Research Corporation, founded by Mr Webb. It is a Slocum that has been modified to harvest the energy that it needs to operate its buoyancy-propulsion system from the sea itself. In theory, this sea glider could travel for thousands of kilometres on voyages that could last for years.

The craft uses mechanical energy instead of electricity to move oil. It harvests that energy by exploiting the difference in temperature between the warm surface of the sea and its cold depths. The glider contains two wax-filled tubes which operate like pistons. When it rises towards the warmer surface the wax melts and expands, which compresses a tank of air. This compressed air is used as an energy store to push oil between the bladders.

The experimental craft still uses some battery power, albeit tiny amounts, to open and close valves and for its instruments. But even so, Ben Hodges, a member of the Woods Hole team, thinks the glider could operate for a year or so before having to be recovered.

It may well be possible to use the same mechanical forces that produce compressed air to generate electricity to top up the glider's batteries. It could then sail on almost indefinitely, unless a surface vessel damaged it or caught it in its fishing nets. This rarely happens, but there are other more practical limits to endurance, including the need to reset instruments and to remove the inevitable weed, barnacles and other marine life that would encrust a glider during very long voyages.

Green-energy gliders that stayed at sea for many months could undertake long-term studies of the ocean, particularly into the effects of climate change. Indeed, in a science-fiction article written some 20 years ago the late Henry Stommel, an influential Woods Hole oceanographer, imagined fleets of Slocums cruising the sea to collect scientific data. It would not be the first time that science fiction turned into science fact.

Cultural diplomacy

Soft power and a rapturous ovation

Feb 28th 2008 | PYONGYANG
From The Economist print edition

North Koreans listened to music they had never heard before—Gershwin, Dvorak and the "Star-Spangled Banner"—in an historic first visit by an American orchestra

FOR at least 90 minutes in a theatre in Pyongyang it was possible for those attending a concert by the New York Philharmonic Orchestra to believe that 55 years of cold-war hostility were coming to an end. North Koreans said they were impressed by the music of their foe. Their American guests, astonished to be there at all, spoke of a thaw beginning.

For citizens of a country in economic ruin, hope is readily clutched at. Power shortages mean frequent blackouts. Heating is erratic. Food prices are soaring. Buses carried the American visitors along desolate snow-dusted streets almost devoid of normal life: only a trickle of vehicles, few lights, no crowds of shoppers. The buses drove past a billboard showing a giant fist slamming into the cartoon figure of a little American soldier. On the eve of the orchestra's visit the North Korean media were still warning, as they had done since most of those attending the concert were born, of the immediate danger of an American-provoked war.

But at the East Pyongyang Grand Theatre history was made on February 26th. On either side of the stage the American and North Korean flags were suspended on silver poles. Not since the 1950-53 Korean war has the Stars and Stripes been so publicly displayed in North Korea.

For the first time many in the audience—and nationwide, thanks to a rare live television and radio broadcast—heard America's national anthem, the "Star-Spangled Banner". Lorin Maazel, the orchestra's music director, conducted it right after North Korea's national anthem as the 1,000 people attending stood with arms respectfully to their sides. The foreigners there—among them, the 100-member orchestra, a former American defence secretary, William Perry, and Yoko Nagae Ceschina, the rich Japanese widow of an Italian count, who helped pay for the North Korean visit—included the biggest American contingent to visit Pyongyang since the city was briefly occupied by American forces during the Korean war.

Most of the music was unfamiliar to North Koreans, who would never have been to a performance that did not include some adulatory reference to the Workers' Party, its founder Kim Il Sung and his son and successor as supreme leader, Kim Jong Il. Western classical music is permitted, but in limited doses. The first (and occasionally the fourth) movement from Dmitri Shostakovich's "Leningrad" symphony is a favourite, bundled with North Korean works like "Glory to General Kim Jong Il" and "The Sea of Blood".

The Philharmonic's programme had a propaganda twist to it too. It began on neutral ground with the boisterous prelude to Act III of Richard Wagner's "Lohengrin". Then followed two pieces showcasing America's classical-music heritage: Antonin Dvorak's "New World Symphony" (though a Czech, Dvorak composed it in America and the Philharmonic gave its premiere in 1893) and George Gershwin's "An American in Paris" from 1928. Dvorak's famous (to non-North Koreans at least) cor anglais solo echoed the lugubrious tones of some of North Korea's musical fare, but the cocky jauntiness of the Gershwin bordered on a forbidden realm.

The encores—another novelty in North Korea, where performers stick to the printed programme—began with Georges Bizet's brassy "L'Arlésienne" suite. Next came a favourite routine from the Philharmonic's repertoire. Mr Maazel introduced the composer as his late predecessor, Leonard Bernstein. He then left the stage to let an imaginary Bernstein conduct the piece, the overture to his operetta "Candide". An American critic quipped in reference to North Korea's Kim dynasty that this was perhaps a metaphor for leaders running things long after they have died. North Koreans in the audience (members of the country's elite—the tickets were not for sale) wore metal badges on their chests showing Kim senior's portrait.

The climax was saved for last. As the first notes of "Arirang", a Korean folk song, were played murmurs rippled across the hall. The tune is familiar to Koreans on both sides of the demilitarised zone that divides the peninsula. It has become an undeclared anthem of longing for unification. North Korea stages an "Arirang" festival every year in which 100,000 people perform a series of mass callisthenics.

The orchestra received a rapturous standing ovation. Even North Korea's most senior attendee, Vice-President Yang Hyong Sop, readily got to his feet. The Americans were overjoyed. "To say I am over the moon tonight is an understatement," Zarin Mehta, president of the orchestra, told the players at a celebratory banquet back at the Yanggakdo hotel. Mr Maazel told reporters that the Philharmonic had not been given such an enthusiastic reception in a long time. "They could have played 'Chopsticks' and it wouldn't have mattered," said a Pyongyang-based diplomat in the audience. That it happened at all was what delighted the North Koreans.

The State Department was an enthusiastic backer of the visit. When the orchestra received the invitation by fax from Pyongyang last August, it turned to the government for advice. Christopher Hill, America's top negotiator with North Korea, encouraged the orchestra to accept. Tensions between the two countries over North Korea's nuclear programme were beginning to ease. North Korea had shut down its nuclear reactor in Yongbyon in July. In June Mr Hill had paid the first visit to North Korea by an American official since President Bush had described the country in 2002 as part of an "axis of evil" along with Iran and Iraq.

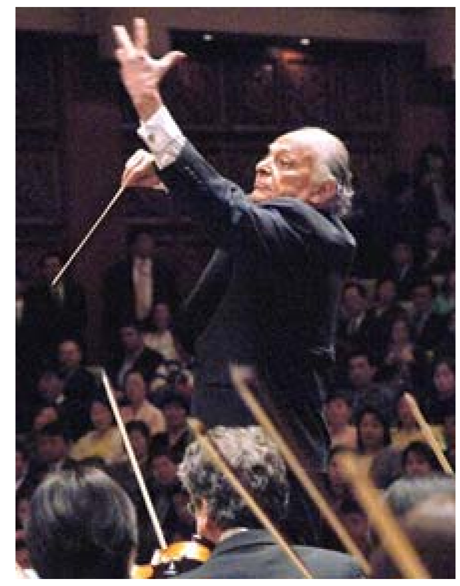
Classical diplomacy

Orchestras have long acted as goodwill ambassadors during political stand-offs. In 1956 the Boston Symphony Orchestra became the first prominent American ensemble to play in the Soviet Union. The Philharmonic itself, then under Bernstein, followed three years later. In 1973 the Philadelphia Orchestra performed in Beijing, an event that symbolised a sea change in America's relations with China following President Nixon's visit there a year earlier. "Our small symphony is a giant leap," said Mr Mehta when he announced the Pyongyang visit last December. "What follows from that is up to the diplomats to deal with. All we can do is show the way that music can unite people."

EPA

Fortunately for the Philharmonic the North Koreans did not say what music they wanted. In official propaganda, Kim Jong Il is portrayed (flatteringly of course) as a musical micro-manager. He set out his principles in a speech to musicians in 1968 at the age of 26. Music must serve the revolution, he said. It must not be based on "uproarious Western music". The great leader (his father), he said, liked "lively and militant marches". Mr Kim said he had initially thought that the song "Kim Il Sung is our Sun" sounded good in D major. But his father had advised E major as better for expressing emotions richly.

Choosing what to play in Pyongyang proved the easy part. Finding a suitable venue and getting the orchestra and instruments there were more difficult. The seat of the State Symphony Orchestra, the Moranbong Theatre (recently refurbished under Kim Jong Il's guidance—“no details escaped him,” gushed the state news agency), was rejected as too small. The East Pyongyang Grand Theatre, though bigger, needed modifications to bring its acoustic qualities up to the Philharmonic's standards (the North Koreans obligingly made the alterations, including building an “acoustic shell”, at their own expense).


Maestro Maazel

Pyongyang's harsh winter and shattered economy were obstacles too. Organisers worried that the instruments would be damaged by temperature variations as they were transported into and around the city. The chandelier-decked foyer of the venue itself was freezing. Mr Mehta held talks at the foreign ministry with an official wearing a thick overcoat in his office. Pyongyang's heating has been so bad this winter that residents complain they cannot remember the last time they were able to have a shower, says a diplomat.

Unable to find any heated trucks in North Korea to carry the instruments, the orchestra arranged for some to drive up from South Korea (South Korea's Asiana Airlines provided a Boeing 747 jet to fly the orchestra itself in and out of Pyongyang). The North Koreans promised good heating at the hotel and venue—and they delivered it. Mr Mehta had to ask for a window in his room to be unsealed so that he could get a bit of cool air.

The authorities spared no effort to isolate the Americans from the reality of life in Pyongyang. Some attempting a morning jog were turned back by guards at the perimeter of their hotel. Officials like to put foreigners there. It is on an island in Pyongyang's Taedong River from which it is difficult to get into the city proper, and there are no taxis available. When they were not rehearsing or performing during their 48-hour stay, the Americans were taken on bus tours of the city's monuments, including a giant bronze statue of the late President Kim—the country's leader during the Korean war.

But will all this bonhomie—both contrived and genuine—really change anything? Donald Gregg, a former American ambassador to South Korea who attended the performance, called it a “16-inch broadside of soft power into the hearts and minds of the [North] Korean people.” But conservative American commentators have attacked it as pandering to a brutal regime. History suggests orchestral diplomacy may be of little real relevance. The Boston Symphony's visit to the Soviet Union was followed soon after by the crushing of the Hungarian uprising. America's relations with China fared better after 1973, but its alignment against the Soviet Union was the critical factor. America has no strategic interests in North Korea beyond stopping it from being a menace.

For all the hoopla, North Korea's main state newspaper, *Rodong Sinmun*, relegated news of the performance to a dry piece at the bottom of page four (a story about flowers sent by Kim Jong Il to Cuba's new president, Raúl Castro, dominated the front page). If nothing else, the impact might simply be cultural. One official brought up on a diet of revolutionary tunes said he knew nothing before about classical music from the West. Emerging from the East Pyongyang Grand Theatre he admitted, “Now I like it.” The Philharmonic did achieve something.

Economist.com BOOKS & ARTS

The human brain

What a piece of work

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From The Economist print edition

WHAT is it that makes Man, in Hamlet's phrase, a “paragon of animals”? The answer: a brain so greedy it gobbles a fifth of his energy; so big his birth was agony for his mother. Adam Zeman draws on literature, the history of science, and his practice as a consultant neurologist to paint a portrait which, like the brain itself, is elegantly arranged. A chapter apiece is devoted to each of the organ's structures, building up from atom to psyche, and rounded off with a chapter on the soul.

Alison is always tired, and when Mr Zeman first meets her he is tired too. A fortnight later he returns from a holiday refreshed—to find Alison comatose in intensive care. His failure to diagnose the muscular weakness that starved her of oxygen leaves him, despite his break, also feeling drained. The tale introduces readers both to the role of oxygen in the brain and to the intertwining fates of body and brain, and the influence of events on both.

When brains go awry, people change and, sometimes, disappear. Dave, a bus driver, must find a new job when his epileptic attacks progress from “ecstatic seizures”—brief, transfiguring moments of bliss—to full-blown fits. He retrains, as a priest. Pete is anxious and preoccupied; rogue proteins have misfolded and taught others in his brain to do so too. By the time he dies of Creutzfeldt-Jakob disease he cannot speak or feed himself, or comprehend what has become of him.

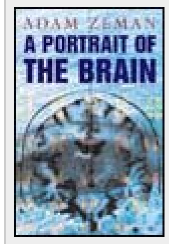
The influence can also work in the other direction. Mr Zeman's last tale is of Jenny, trapped in a loveless marriage, unable to admit her feelings for another woman and finally felled by the discovery that the object of her desire has a lover. She is admitted to hospital suffering from vomiting, blackouts and weakness; tests turn up nothing. It is only when she leaves her husband that she starts to mend.

The final chapter introduces the hardest problem of all: how do events in our brains give rise to mind, consciousness and soul? Mr Zeman thinks the “comforting and tenacious idea” that the body has an imperishable occupant is a “wonderful fiction”, but that as scientists understand the brain's workings better, at least some of the mind's mysteries will yield too.

“It is in the brain that the poppy is red, that the apple is odorous, that the skylark sings,” Oscar Wilde once wrote. Mr Zeman's portrait of the brain is more even than a portrait of Man: it is a portrait of the world he perceives too.

A Portrait of the Brain.
By Adam Zeman.
Yale University Press; 256 pages; £18.99. To be published in America by Yale in April

A Portrait of the Brain
By Adam Zeman



Yale University Press; 256 pages; £18.99. To be published in America by Yale in April

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The Bush legacy

War horse

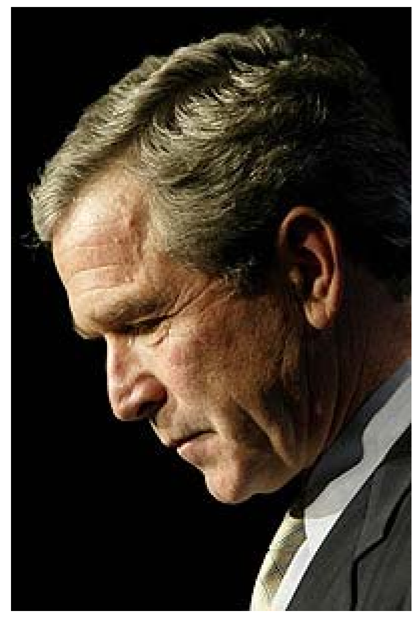
Feb 28th 2008
From The Economist print edition

President Bush's eight years in office will be clouded by the invasion of Iraq

AS GEORGE BUSH'S presidency draws to a close, biographers are scrambling to capture its essence between hard covers. Few will do as good a job as Lou and Carl Cannon. The Cannons are canny, diligent reporters steeped in American politics. Mr Cannon senior has written five books about Ronald Reagan. Carl, his son, was until recently the White House correspondent for the *National Journal*, a weekly magazine for Washington insiders. In “Reagan's Disciple”, they have produced as subtle an account of the past seven years as you could wish for.

The Cannons measure Mr Bush by a yardstick he once set for himself—did he govern as Reagan would have? The short answer is no, but the longer answer is more interesting. Reagan, the authors observe, understood instinctively how Americans felt. “He was less dependent on polls than other politicians, not because he was more principled but because he needed [them] less.” Mr Bush is also scornful of polls, but far less in tune with the popular mood. Hence his belief, after winning 50.7% of the vote in 2004, that he had enough political capital to reform Social Security (public pensions) and immigration law. He did not, and both reforms failed.

Reuters



Toxic Texan

Both Reagan and Mr Bush made a passionate case that people everywhere yearn for freedom. But Reagan understood that democracy cannot easily be spread by force of arms. The Cannons note, for example, that the cautious questions Colin Powell asked before the invasion of Iraq—such as: “[What if we] find no weapons of mass destruction?”—are exactly the kind of questions that Reagan himself asked of his aides when much smaller military ventures were mooted. Despite his gung-ho image, Reagan was reluctant to risk shedding American blood. He cut his losses and ordered American troops out of Lebanon after 241 of them were killed by a suicide-bomber in 1983, and he refused, despite the urging of his advisers, to invade Panama.

It is too early to tell how history will judge Mr Bush. Though currently as unpopular as any president since Jimmy Carter, he sometimes likens himself to Harry Truman, who left office under a cloud because of the Korean war but has since been rehabilitated by many historians.

In the meantime, however, Mr Bush is so toxic that Democrats running for office constantly invoke his name whereas Republicans hardly ever do. This year, every Republican in the race for the White House vowed to be like Reagan, not Mr Bush. As the Cannons argue, it is probably not healthy for a party to be so wedded to the past. The challenges Reagan faced, such as communism and high taxes, are either gone or much diminished. Today's problems, and especially Iraq, will require fresh thinking. On the last day of Reagan's presidency, Mr Powell—who was his national-security adviser before becoming the younger Mr Bush's secretary of state—told him: “The world is quiet today.” It is unlikely that Mr Bush will hear the same words on his last day in office.

Jacob Weisberg's “The Bush Tragedy” is an altogether fluffier work. Mr Weisberg is the editor of *Slate*, an online magazine. He is perhaps best known for collecting Mr Bush's verbal stumbles into books of “Bushisms” which people give to their brothers-in-law for Christmas. In this book, he enlists William Shakespeare's help to psychoanalyse the president.

Mr Bush, he argues, is best understood as being like Henry V. As a young man, he larked about, drank a lot and resented the fact that his father was so accomplished. In mid-life, he quit drinking and, having lowered everyone's expectations of him, easily surpassed them. Like Henry V, he sought glory in war but “seems never to have considered the cost”. It is a fair analogy, but hardly original. Mr Weisberg makes a convincing case that people should read Shakespeare, but not “The Bush Tragedy”.

Craig Unger, meanwhile, is a vivid reporter, but his judgment can be squiffy. The thesis of his new book, “The Fall of the House of Bush”, is that ever since 2000 the American government has been hijacked by a secretive cabal of neoconservatives and Christian fundamentalists. Others might put it differently: that Mr Bush, like all presidents, has advisers, some of whom have given him bad advice.

Mr Unger goes on to argue that neocons and Christian fundamentalists, not militant Islamists, may be “the most powerful enemies of our modern, humanist, post-enlightenment world”. To illustrate this idea, he goes on a tour of the Holy Land with some American evangelicals who believe that the existence of a Jewish state in Palestine is a necessary precondition for the second coming of Christ. Mr Unger's fellow tourists try to picture the river of blood that will flow when Jesus returns and unbelievers are slaughtered, as the Book of Revelation suggests will happen. “They seem to have no problem with the slaughter of billions,” frets Mr Unger.

Evangelical Christians do indeed believe some odd things, but Mr Unger hugely exaggerates the threat this poses. Believing that God will one day smite unbelievers is quite different from believing, as Osama bin Laden does, that God wants the faithful to smite them right now. Granted, evangelicals are influential in America, but no more so than their numbers would imply. And yes, they do tend to support Israel, but so do other Americans. Unlike Mr Bush, America's next president will not be a member of the religious right, but he or she will still consider Israel America's most dependable ally in the Middle East.

Reagan's Disciple: George W. Bush's Troubled Quest for a Presidential Legacy.
By Lou Cannon and Carl M. Cannon.
PublicAffairs; 382 pages; $27.95 and £16.99

The Bush Tragedy.
By Jacob Weisberg.
Random House; 304 pages; $26.
Bloomsbury; £16.99

The Fall of the House of Bush: The Untold Story of How a Band of True Believers Seized the Executive Branch, Started the Iraq War, and Still Imperils America's Future.
By Craig Unger.
Scribner; 436 pages; $27. Simon & Schuster; £17.99

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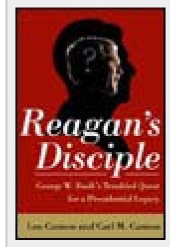

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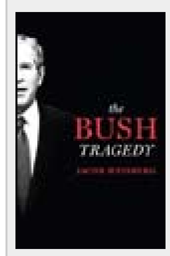

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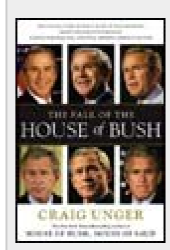

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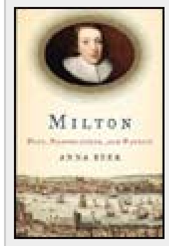
John Milton

Heavenly muse

Feb 28th 2008
From The Economist print edition

PEOPLE quail slightly at the thought of John Milton: the Latin, the theology, the school memories of "Paradise Lost"—there is something inhospitable about it all. A scholar himself, Milton seems to belong to scholars and teachers. Very little is known about his private life. There is a haunting sonnet to a dead wife, but he wrote nothing else about any of his three wives, two of whom died soon after giving birth, nor about his three daughters, nor even about his dead infant son. Anna Beer, in this fair-minded and scholarly biography, cannot disguise her frustration. Could he even have erased them from the record, she wonders, as "beneath his notice"?

Milton: Poet, Pamphleteer, and Patriot
By Anna Beer



Bloomsbury; 458 pages; $34.99 and £20

Buy it at
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Milton, who was born 400 years ago this year, saw himself as a man set apart. Born into an upwardly mobile family, Cambridge educated, trained to dispute in Latin, he seemed cut out for academia, the church or the law. Instead, he saved himself for poetry, with a reading programme and an eye on immortality. He wanted to be the national voice of England, no less. But it wasn't until he was blind and in his 50s that he embarked on "Paradise Lost", his great epic about the fall of man, about good and evil, reason, free will and authority, which would indeed immortalise him.

What happened in between was England's own fall—its descent, in the 1640s, into civil war and a kind of politics driven by just those philosophical and moral questions. This is the heart of Ms Beer's book, the aspect that brings the reader closest to the man. The bitter dispute between king and parliament about the nature of good government exploded in a storm of ephemeral pamphlets furiously arguing and counter-arguing.

With the fate of the nation at stake, this was Milton's moment. He piled in with pamphlets of his own; tracts expressed in a vivid, word-coining, muscular English, at times high-flown, at others colloquial, sometimes downright rude, but always engaged. What fires him is the whole principle of debate, the battle of wits: "Who ever knew Truth put to the worse", he wrote, "in a free and open encounter."

"Thou canst not touch the freedom of my mind," Milton once wrote. It expresses the principle behind his attacks on all the intellectual oppressions of his day, on church dogma, on censorship and monarchical absolutism. And it led, ultimately, to his pamphlet in support of the regicides. Milton was no saintly liberal. His divorce tracts, written when his first wife temporarily left him, are tainted by self-regarding sophistry. He wasn't above working as official censor to the Commonwealth and he failed to question the standard misogyny of the day. Ms Beer makes no apology for him—though she does her best to soften the charge of misogyny in his treatment of Eve in "Paradise Lost".

Ms Beer roots Milton in his period very well, both historically and physically—in the streets of booksellers and printing presses around St Paul's cathedral in London, near where he lived. But with the restoration of King Charles II, he did become a lonely figure: refusing to flee, suffering arrest and imprisonment, and continuing to tackle the grand questions of life and destiny. Despite her frustrations, Ms Beer clearly admires him, and one can't help doing so too.

Milton: Poet, Pamphleteer, and Patriot.
By Anna Beer.
Bloomsbury; 458 pages; $34.99 and £20

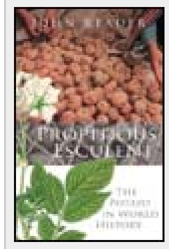
History of the potato

Wonder-food

Feb 28th 2008
From The Economist print edition

ON THE face of it, John Reader's new biography of the potato seems to have a silly title—“propitious esculent” is just a fancy way to say “helpful food”—and an even sillier subtitle. But that is because the virtues of the world's fourth biggest food crop (after maize, wheat and rice) and its influence on world history are easily overlooked. “I used to take potatoes for granted,” the author writes. His aim is to discourage readers from doing likewise.

Propitious Esculent: The Potato in World History
By John Reader



Heinemann; 315 pages; £18.99

Buy it at
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The key to the potato's value lies in its high yield and its almost perfect balance of nutrients. Potatoes can produce more energy per unit area per day than any other crop, and it is possible (though tedious) to subsist on a diet of spuds and very little else.

First domesticated in the Andes, the potato was carried to Europe in the 16th century. At first Europeans were suspicious: the potato was variously thought to be an aphrodisiac, to cause leprosy or to be poisonous. But it slowly caught on as its merits in times of famine and war became apparent (it is more reliable than grain and remains hidden underground until harvested). By the late 18th century it was being hailed as a wonder-food—for the poor, at least. Marie Antoinette promoted potatoes by wearing their flowers in her hair.

People then started to worry that the potato was too popular, and that its abundance was causing an unsustainable increase in population. Exhibit A was Ireland, where the booming population subsisted almost entirely on potatoes. The danger of such dependency was starkly revealed by the Irish potato famine of 1845: at least a million people died, and another million emigrated.

Mr Reader's tale ends with the modern efforts to understand the genetics of the potato, which could lead to more disease-resistant varieties. The propitious esculent, he explains, is likely to feature in the diets of space-farers who will have to grow their own food.

The all-potato diet will not appeal to all readers, but this accessible account embraces the latest scholarship and addresses the failings of previous works on the subject. Indeed the book, like the tuber it describes, fills a void: the spud now has the biography it deserves.

Propitious Esculent: The Potato in World History.
By John Reader.
Heinemann; 315 pages; £18.99

Baba Amte

Feb 28th 2008
From The Economist print edition

Murlidhar Devidas ("Baba") Amte, champion of India's lepers and outcastes, died on February 9th, aged 93

WorldPictureNews

HE HADN'T meant to touch it. As he grubbed in the rain-filled gutter to pick up dog shit, human excrement and blackened, rotten vegetables, stowing them in the basket he carried on his head, he brushed what seemed to be a pile of rags, and it moved a little. The pile was flesh; it was a leper, dying. Eyes, nose, fingers and toes had already gone. Maggots writhed on him. And Murlidhar Devidas Amte, shaking with terror and nausea, stumbled to his feet and ran away.

Most people thought he was crazy to be doing that job anyway. Scavenging was a job for *harijans*, outcastes. But Mr Amte, a handsome man in his 30s, was better known as a big-shot criminal lawyer in Warora, in what is now Maharashtra in central India. He could charge as much as 50 rupees for arguing for 15 minutes. He was a member of the bridge club and the tennis club and vice-president of the Warora municipality, and he kept, outside town, an elegant farmhouse set in lush fields which he had never lifted a finger to cultivate himself. But after living with Mahatma Gandhi in his ashram in the mid-1940s, something had happened to him.

At first he let his hair and fingernails grow long, a holy man's guise that looked odd in a lawyer. After that, when the scavengers came to him with grievances one week, he decided to try their work, scraping out latrines for nine hours a day. His family, landowner Brahmins who had given him a costly education and a sports car, were scandalised; and the more so when, in 1946, he married a Brahmin girl, Sadhna, who thought nothing of leaving her own sister's wedding to help a servant-woman do the washing.

It was the encounter with the dying leper, however, that shaped Mr Amte's life. He was outraged at the fear he felt: fear of touching, as if he shared the common belief that lepers were paying for their sins and would infect anybody who came close. Where there was fear, he told himself, there was no love; and when an action was not done in love, it had no value. Deliberately, he went back to the gutter to feed the leper and to learn his name, Tulshiram. He then carried him home to care for him until he died, and began—once he had had training in Calcutta—to work in leper clinics all around the town.

His own ashram, founded in 1951 on barren, rocky land full of snakes, was specifically for the handicapped and for lepers, who built and tilled it from scratch with half a dozen tools and their stumps of hands. It was called Anandwan, "grove of joy"; its philosophy was that lepers could be rehabilitated not by charity, nor by the begging life in railway stations and on streets, but by hard work and creativity, which would bring self-respect. Not by tears, but by sweat, Mr Amte wrote once, and noted how similar those were.

By his death around 3,000 people lived at Anandwan. The farm grew millet, grains and fruit; in the schools, lepers taught the blind, deaf and dumb; there were colleges, two hospitals, workshops and an orchestra, where popular songs were conducted by a polio victim. Warora townsfolk, who had shunned the ashram in its early years, had learnt to buy its vegetables and drink its milk without fear of contagion. And at its centre, himself crippled from his 50s by degeneration of the spine, lay Mr Amte on his cot in his white home-woven vest and shorts, smilingly encouraging human beings to see the divine spark in each other.

On the river bank

The Indian government liked what he did and gave him prizes for it. But Mr Amte was a difficult character politically: a non-believer who rejected idol-worship, an excoriator of politicians, rich landlords, agri-business and big corporations, and above all a Gandhian of the pure, old style, who believed that economic development had to be person by person and village by village, by means as small as handwoven threads and fingerfuls of salt. On the outlying fields of his ashrams he held camps where the young were inspired to be social activists; he led them, lying in a van, on rallies for peace and social unity throughout India; and he never ceased to beat the drum of self-sufficiency, for he had proved that even lepers could achieve it.

In his last three decades, however, his focus shifted to the preservation of rivers and the well-being of the tribes who lived in the unexploited forest. These people too, like lepers, had to be taught to eat properly, to bathe and to use toilets, and their habitat had to be saved from the building of huge dams. To the fury of both state and federal governments, Mr Amte campaigned against these projects, rubbishing the official cost-benefit analyses and blocking main roads with his supporters.

From 1990 he went to live by the Narmada, the most threatened river, building another ashram from scratch on stony, empty ground. Each day, until he grew too frail and the slippery banks too hazardous, he would walk to the river to watch it flow. Atheist though he was, he saw the Narmada as a goddess whose beauty should be decorated only with micro-dams on a human scale. And certainly he did not want his ashes to float there after his death. He insisted on burial, where his body—becoming what he had once been most disgusted and afraid of—might go on being useful and productive, inside the earth.

Overview

Feb 28th 2008
From The Economist print edition

America's battered **housing market** took some fresh blows. New-home sales fell by 2.8% in January, reaching levels last seen in 1995. Sales of existing homes edged down by 0.4%. The S&P/Case-Shiller house-price index, which covers ten large cities, fell by 9.8% in the year to December, the largest decline since the series began in 1987.

In a further sign of mounting inflation, **America's** wholesale prices rose by 7.4% in the year to January—the largest increase since 1981. The jump owed much to large rises in food and energy costs. Meanwhile, the Conference Board's index of consumer confidence plunged by 12.3 points, to 75.0, its lowest level in five years.

Business confidence in **Germany** improved during February, according to Ifo, a Munich-based research institute. Its business-climate index recorded a second successive increase, rising from 103.4 to 104.1. French and Italian firms were less cheery. **Italy's** ISAE gauge fell to a two-year low, while the INSEE index of business confidence in **France** edged down to its lowest level for a year.

South Korea's seasonally adjusted current-account deficit widened to $2.6 billion in January, its highest since the Asian crisis.

Israel's central banked lowered its benchmark interest rate from 4.25% to 3.75%, because of concerns that slower global growth and a rapidly rising exchange rate would hurt the economy. The move was a surprise; the bank had raised its key rate by 0.25 percentage points as recently as December.

Output, prices and jobs

Feb 28th 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	+2.5 Q4	+0.6	+1.6	+2.5	+2.3 Jan	+4.3 Jan	+2.1	+2.9	4.9 Jan
Japan	+2.0 Q4	+3.7	+1.3	+1.8	+2.5 Jan	+0.7 Dec	+0.3	+0.6	3.8 Dec
China	+11.2 Q4	na	+9.9	+9.5	+17.4 Dec	+7.1 Jan	+2.2	+4.0	9.5 2007
Britain	+2.9 Q4	+2.3	+1.7	+2.1	+0.7 Dec	+2.2 Jan§	+2.7	+2.3	5.2 Dec††
Canada	+2.9 Q3	+2.9	+1.7	+2.4	+0.7 Nov	+2.2 Jan	+1.1	+1.8	5.8 Jan
Euro area	+2.3 Q4	+1.6	+1.8	+1.9	+1.3 Dec	+3.2 Jan	+1.8	+2.4	7.2 Dec
Austria	+3.3 Q4	+2.9	+2.5	+2.5	+3.4 Dec	+3.6 Dec	+1.5	+2.3	4.3 Dec
Belgium	+2.4 Q4	+2.0	+1.9	+2.0	−1.9 Dec	+3.5 Jan	+1.7	+2.3	10.8 Dec‡‡
France	+2.0 Q4	+1.2	+1.7	+1.9	+1.4 Dec	+2.8 Jan	+1.2	+2.2	7.9 Q3§§
Germany	+1.8 Q4	+1.1	+1.8	+2.0	+4.4 Dec	+2.7 Jan	+1.6	+2.1	8.1 Jan
Greece	+3.6 Q4	+2.9	+2.4	+2.5	+0.8 Dec	+3.9 Jan	+2.7	+3.3	7.6 Nov
Italy	+1.9 Q3	+1.7	+1.2	+1.5	−6.4 Dec	+2.9 Jan	+1.7	+2.4	5.9 Q3
Netherlands	+4.4 Q4	+4.7	+2.0	+2.1	+10.2 Dec	+2.0 Jan	+1.4	+2.1	4.1 Jan††
Spain	+3.5 Q4	+3.2	+2.4	+2.4	−0.3 Dec	+4.3 Jan	+2.4	+3.2	8.6 Dec
Czech Republic	+6.9 Q4	na	+4.7	+5.4	+2.9 Dec	+7.5 Jan	+1.3	+5.7	6.1 Jan
Denmark	+1.7 Q3	+6.7	+1.6	+1.8	−2.6 Dec	+2.9 Jan	+1.8	+2.2	2.7 Dec
Hungary	+0.7 Q4	+0.8	+2.8	+3.6	+5.3 Dec	+7.1 Jan	+7.8	+4.7	7.7 Dec††
Norway	+5.2 Q4	+5.2	+2.9	+2.6	−1.9 Dec	+3.7 Jan	+1.2	+3.1	2.4 Dec††
Poland	+6.4 Q3	na	+6.3	+3.7	+10.8 Jan	+4.3 Jan	+1.6	+0.3	11.7 Jan‡‡
Russia	+7.7 Q3	na	+6.7	+5.7	+4.8 Jan	+12.6 Jan	+8.2	+11.5	6.1 Dec‡‡
Sweden	+2.5 Q3	+2.4	+2.6	+2.6	+1.2 Dec	+3.2 Jan	+1.9	+2.8	6.4 Jan††
Switzerland	+2.9 Q3	+1.3	+2.0	+2.0	+10.7 Q3	+2.4 Jan	+0.1	+1.6	2.6 Jan
Turkey	+1.5 Q3	na	+3.7	+5.4	−1.4 Dec	+8.2 Jan	+9.9	+8.2	10.1 Q4‡‡
Australia	+4.3 Q3	+4.1	+3.5	+3.3	+1.6 Q3	+3.0 Q4	+3.3	+3.1	4.1 Jan
Hong Kong	+6.7 Q4	+6.6	+4.0	+4.6	−2.1 Q3	+3.3 Jan	+2.0	+3.7	3.4 Jan††
India	+8.9 Q3	na	+7.5	+7.2	+7.6 Dec	+5.5 Dec	+6.9	+5.8	7.2 2007
Indonesia	+6.3 Q4	na	+6.1	+5.7	+1.6 Dec	+7.4 Jan	+6.3	+6.4	9.8 Feb
Malaysia	+7.3 Q4	na	+5.5	+5.7	+5.9 Dec	+2.3 Jan	+3.2	+2.8	3.1 Q3
Pakistan	+7.0 2007**	na	+5.4	+5.4	+4.7 Nov	+11.9 Jan	+6.6	+7.9	6.2 2006
Singapore	+5.4 Q4	−4.8	+4.9	+4.7	+6.9 Jan	+6.6 Jan	+0.2	+3.0	1.6 Q4
South Korea	+5.5 Q4	+6.3	+4.6	+4.6	+12.4 Dec	+3.9 Jan	+1.7	+2.9	3.0 Jan
Taiwan	+6.4 Q4	na	+4.5	+4.0	+12.3 Jan	−1.1 Jan	+0.4	+2.3	4.0 Jan
Thailand	+5.7 Q4	+7.3	+4.7	+4.0	+11.6 Dec	+4.3 Jan	+3.0	+3.2	1.1 Nov
Argentina	+8.7 Q3	+11.7	+5.5	+4.5	+12.9 Jan	+8.2 Jan	+9.7	+11.4	7.5 Q4‡‡
Brazil	+5.7 Q3	+6.9	+4.5	+4.1	+6.4 Dec	+4.6 Jan	+3.0	+4.5	7.4 Dec‡‡
Chile	+4.1 Q3	−2.5	+4.0	+4.3	+3.4 Dec	+7.5 Jan	+2.8	+6.2	7.2 Dec††‡‡
Colombia	+6.6 Q3	+6.9	+5.5	+4.5	+8.7 Dec	+6.0 Jan	+4.7	+5.0	9.9 Dec‡‡
Mexico	+3.8 Q4	+3.0	+1.9	+3.0	+1.3 Dec	+3.7 Jan	+4.0	+4.1	4.1 Jan‡‡
Venezuela	+8.5 Q4	na	+5.0	+3.7	+7.2 Oct	+24.1 Jan	+18.4	+24.0	6.7 Q4‡‡
Egypt	+8.1 Q4	na	+7.3	+6.7	+7.5 2007**	+10.5 Jan	+12.4	+6.6	8.8 Q3‡‡
Israel	+6.8 Q4	+6.4	+3.7	+4.2	+4.0 Dec	+3.5 Jan	+0.1	+2.8	7.3 Q3
Saudi Arabia	+4.3 2006	na	+6.0	+5.6	na	+7.0 Jan	+3.6	+5.0	na
South Africa	+4.6 Q4	+5.3	+4.7	+5.4	+0.3 Dec	+9.3 Jan	+6.0	+6.6	25.5 Mar‡‡
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*									
Estonia	+4.5 Q4	na	+4.3	+4.7	−2.1 Dec	+11.0 Jan	+5.1	+8.2	5.2 Nov
Finland	+4.1 Q3	+3.0	+3.1	+2.8	+2.6 Dec	+3.8 Jan	+2.3	+2.2	6.4 Jan
Iceland	+4.3 Q3	+4.0	+2.3	+2.8	+7.6 2006	+6.8 Feb	+7.4	+4.6	1.0 Jan‡‡
Ireland	+4.1 Q3	+5.6	+2.8	+2.9	+0.8 Dec	+4.3 Jan	+5.2	+3.0	4.9 Jan
Latvia	+9.6 Q4	na	+6.6	+6.5	−5.4 Dec	+15.8 Jan	+7.1	+10.5	5.4 Dec
Lithuania	+7.9 Q4	−4.3	+7.2	+6.4	na	+9.9 Jan	+4.0	+7.0	4.6 Jan‡‡
Luxembourg	+5.6 Q3	+2.8	+4.4	+4.8	−1.4 Nov	+3.3 Jan	+2.3	+2.3	4.4 Dec‡‡
New Zealand	+3.4 Q3	+1.1	+2.0	+2.7	+1.3 Q3	+3.2 Q4	+2.6	+2.8	3.4 Q4
Peru	+9.9 Dec	na	+6.1	+6.7	+6.5 Dec	+4.2 Jan	+0.6	+2.7	7.0 Dec‡‡
Philippines	+7.3 Q4	+7.4	+5.3	+5.3	−1.8 Dec	+4.9 Jan	+3.9	+3.7	6.3 Q4‡‡
Portugal	+2.0 Q4	+2.4	+2.0	+2.2	−0.9 Dec	+2.9 Jan	+2.6	+2.3	7.8 Q4‡‡
Slovakia	+14.1 Q4	na	+7.0	+5.7	+14.2 Dec	+3.8 Jan	+3.0	+3.0	8.0 Dec‡‡
Slovenia	+6.3 Q3	na	+4.8	+4.0	nil Dec	+6.4 Jan	+2.7	+3.6	7.3 Dec‡‡

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

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

The Economist commodity-price index

Feb 28th 2008
From The Economist print edition

The Economist commodity-price index

2000=100

	Feb 19th	Feb 26th*	% change on one month	% change on one year
Dollar index				
All items	252.2	258.3	+11.2	+34.1
Food	251.6	257.2	+11.2	+61.1
Industrials				
All	253.0	259.7	+11.1	+10.4
Nfa†	190.5	197.5	+7.8	+25.7
Metals	287.2	293.7	+12.4	+5.7
Sterling index				
All items	196.0	198.6	+12.0	+33.6
Euro index				
All items	158.2	160.5	+10.3	+19.3
Gold				
$ per oz	927.95	942.95	+1.7	+38.8
West Texas Intermediate				
$ per barrel	99.53	101.03	+10.2	+67.0

*Provisional †Non-food agriculturals.

The brain drain

Feb 28th 2008
From The Economist print edition

Migrants to rich countries are often better-educated than natives, according to the OECD. Less than a fifth of locals in OECD countries are university-educated compared with almost a quarter of foreign-born workers. However, immigrants find it harder to match their skills to a job than locals do. The more educated migrants are, the more likely they are to be over-qualified for their work. In Greece, for example, migrants are three times as likely to be too qualified for their jobs as native-born workers are. Immigrants to Spain, Sweden, Italy and Denmark are twice as likely as locals to be over-qualified. New Zealand's immigrants tend to be better-matched to their jobs than natives are.

Trade, exchange rates, budget balances and interest rates

Feb 28th 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 $ Feb 27th	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	−815.6 Dec	−752.4 Q3	−4.8	–	–	−2.5	2.73	3.85
Japan	+105.6 Dec	+212.8 Dec	+4.8	107	118	−2.4	0.74	1.47
China	+265.2 Jan	+249.9 2006	+10.7	7.14	7.74	0.2	4.50	4.32
Britain	−175.1 Dec	−129.4 Q3	−3.7	0.50	0.51	−3.2	5.68	4.69
Canada	+45.9 Dec	+16.3 Q3	+0.3	0.98	1.17	0.6	3.22	3.89
Euro area	+39.0 Dec	+18.9 Dec	nil	0.66	0.76	−1.0	4.39	4.09
Austria	+1.2 Nov	+11.3 Q3	+3.1	0.66	0.76	−0.7	4.39	4.18
Belgium	+16.2 Dec	+13.3 Sep	+2.5	0.66	0.76	−0.6	4.45	4.38
France	−53.8 Dec	−33.8 Dec	−1.4	0.66	0.76	−2.8	4.39	4.20
Germany	+257.8 Dec	+223.2 Dec	+5.7	0.66	0.76	0.6	4.39	4.09
Greece	−55.2 Nov	−48.3 Dec	−12.9	0.66	0.76	−2.7	4.39	4.52
Italy	−12.8 Dec	−45.2 Dec	−2.4	0.66	0.76	−2.6	4.39	4.50
Netherlands	+57.0 Dec	+50.1 Q3	+7.3	0.66	0.76	0.3	4.39	4.17
Spain	−136.0 Dec	−136.9 Nov	−9.0	0.66	0.76	nil	4.39	4.27
Czech Republic	+4.2 Dec	−5.4 Dec	−3.8	16.6	21.4	−2.6	3.97	4.52
Denmark	+3.8 Dec	+3.2 Dec	+1.3	4.94	5.64	2.8	4.80	4.19
Hungary	−0.6 Dec	−6.8 Q3	−6.0	171	193	−4.1	7.76	7.70
Norway	+60.8 Jan	+59.9 Q3	+15.8	5.20	6.14	17.9	6.01	4.44
Poland	−12.1 Dec	−15.5 Dec	−5.1	2.34	2.96	−1.3	5.85	4.40
Russia	+132.1 Dec	+76.6 Q4	+4.3	24.1	26.1	1.2	10.25	6.59
Sweden	+17.7 Jan	+29.4 Q3	+6.0	6.18	7.02	2.2	4.21	4.13
Switzerland	+11.6 Jan	+69.6 Q3	+14.7	1.07	1.22	0.6	2.79	3.01
Turkey	−62.8 Dec	−38.0 Dec	−7.4	1.18	1.41	−2.9	16.47	6.35‡
Australia	−18.0 Dec	−49.9 Q3	−5.4	1.07	1.27	1.5	7.83	6.41
Hong Kong	−23.5 Dec	+27.0 Q3	+7.0	7.79	7.81	3.8	2.36	2.99
India	−68.9 Dec	−10.9 Q3	−2.3	39.8	44.3	−3.2	7.37	7.96
Indonesia	+39.7 Dec	+10.3 Q3	+2.5	9,053	9,132	−1.8	8.09	6.73‡
Malaysia	+29.3 Dec	+28.7 Q3	+13.9	3.20	3.50	−3.1	3.62	3.38‡
Pakistan	−16.1 Jan	−8.4 Q4	−6.9	62.5	60.7	−5.1	10.13	9.04‡
Singapore	+34.5 Jan	+39.1 Q4	+22.4	1.40	1.53	0.1	1.56	2.43
South Korea	+10.4 Jan	+3.8 Jan	+0.8	941	942	0.2	5.20	5.23
Taiwan	+16.3 Jan	+31.7 Q4	+5.9	30.9	33.0	−2.1	2.60	2.40
Thailand	+10.9 Jan	+14.9 Dec	+2.2	32.1	34.0	−2.1	3.28	4.07
Argentina	+11.9 Jan	+6.8 Q3	+2.0	3.16	3.10	1.2	10.19	na
Brazil	+38.5 Jan	−1.2 Jan	−0.1	1.67	2.11	−2.5	11.18	6.16‡
Chile	+23.7 Jan	+6.7 Q3	+4.0	462	539	5.3	6.24	3.91‡
Colombia	−1.4 Nov	−5.2 Q3	−3.8	1,854	2,231	−1.3	9.32	5.86‡
Mexico	−11.6 Jan	−7.4 Q4	−1.5	10.7	11.2	nil	7.42	7.59
Venezuela	+23.4 Q3	+20.0 Q4	+7.3	4.68	4.23§	−2.6	13.38	6.55‡
Egypt	−20.5 Q4	+0.5 Q1	+0.9	5.50	5.70	−7.0	5.26	5.15‡
Israel	−10.7 Jan	+5.9 Q3	+1.3	3.61	4.22	−1.4	3.88	4.92
Saudi Arabia	+146.6 2006	+98.9 2006	+21.8	3.75	3.75	12.0	2.99	na
South Africa	−9.8 Dec	−19.9 Q3	−7.8	7.43	7.27	0.6	11.35	8.84
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*								
Estonia	−4.5 Dec	−3.4 Dec	−14.1	10.4	11.8	1.3	6.60	na
Finland	+12.2 Dec	+11.3 Dec	+4.2	0.66	0.76	3.7	4.29	4.18
Iceland	−1.2 Jan	−3.0 Q3	−10.3	65.3	66.3	2.3	13.52	na
Ireland	+36.5 Dec	−11.1 Q3	−3.2	0.66	0.76	−1.1	4.39	4.34
Latvia	−7.2 Dec	−6.4 Dec	−21.5	0.46	0.54	1.0	6.56	na
Lithuania	−7.1 Dec	−5.3 Dec	−13.5	2.29	2.61	−0.6	4.83	na
Luxembourg	−6.0 Nov	+4.7 Q3	na	0.66	0.76	0.9	4.39	na
New Zealand	−3.9 Dec	−10.2 Q3	−7.4	1.22	1.43	3.8	7.30	6.48
Peru	+8.3 Nov	+2.2 Q3	+1.3	2.89	3.19	1.4	5.25	na
Philippines	−5.0 Dec	+5.8 Sep	+4.6	40.3	48.5	−0.3	6.56	na
Portugal	−26.4 Dec	−19.8 Nov	−8.1	0.66	0.76	−2.6	4.39	5.94
Slovakia	−0.9 Dec	−0.8 Oct	−2.4	21.7	26.1	−2.3	4.20	4.32
Slovenia	−2.9 Dec	−1.9 Nov	−2.5	0.66	0.76	−0.7	na	na

*Merchandise trade only. †*The Economist* poll or Economist Intelligence Unit forecast. ‡Dollar-denominated bonds. §Unofficial exchange rate.
Sources: National statistics offices and central banks; Thomson Datastream; Reuters; JPMorgan; Bank Leumi le-Israel; Centre for Monitoring Indian Economy; Danske Bank; Hong Kong Monetary Authority; Standard Bank Group; UBS; Westpac.

Markets

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From The Economist print edition

Markets

	Index	% change on	Dec 29th 2006	
	Feb 27th	one week	in local currency	in $ terms
United States (DJIA)	12,694.3	+2.1	−4.3	−4.3
United States (S&P 500)	1,380.0	+1.5	−6.0	−6.0
United States (NAScomp)	2,353.8	+1.1	−11.3	−11.3
Japan (Nikkei 225)	14,031.3	+5.4	−8.3	−3.9
Japan (Topix)	1,364.5	+4.7	−7.5	−3.0
China (SSEA)	4,547.5	−5.1	−17.6	−15.8
China (SSEB, $ terms)	310.1	−3.5	−17.1	−15.3
Britain (FTSE 100)	6,076.5	+3.1	−5.9	−6.0
Canada (S&P TSX)	13,778.4	+1.7	−0.4	+0.3
Euro area (FTSE Euro 100)	1,216.7	+2.5	−11.5	−8.6
Euro area (DJ STOXX 50)	3,856.7	+2.6	−12.3	−9.5
Austria (ATX)	3,957.3	+0.3	−12.3	−9.4
Belgium (Bel 20)	3,787.5	+1.4	−8.2	−5.2
France (CAC 40)	4,968.8	+3.2	−11.5	−8.6
Germany (DAX)*	6,997.9	+1.4	−13.3	−10.4
Greece (Athex Comp)	4,316.6	+0.7	−16.6	−13.9
Italy (S&P/MIB)	34,532.0	+2.1	−10.4	−7.5
Netherlands (AEX)	462.6	+3.6	−10.3	−7.4
Spain (Madrid SE)	1,457.0	+2.7	−11.3	−8.4
Czech Republic (PX)	1,567.6	−0.1	−13.6	−5.2
Denmark (OMXCB)	419.7	+2.5	−6.5	−3.4
Hungary (BUX)	23,834.3	−0.2	−9.2	−8.0
Norway (OSEAX)	501.4	+2.2	−12.0	−8.1
Poland (WIG)	48,910.1	−1.9	−12.1	−7.5
Russia (RTS, $ terms)	2,096.4	+3.7	−10.1	−8.5
Sweden (Aff.Gen)	315.2	+4.0	−7.4	−3.2
Switzerland (SMI)	7,782.6	+5.4	−8.3	−2.6
Turkey (ISE)	46,260.3	+0.8	−16.7	−17.2
Australia (All Ord.)	5,842.5	+4.8	−9.0	−2.2
Hong Kong (Hang Seng)	24,483.8	+3.8	−12.0	−11.9
India (BSE)	17,826.0	+1.2	−12.1	−12.9
Indonesia (JSX)	2,740.1	+1.9	−0.2	+3.5
Malaysia (KLSE)	1,376.6	−2.7	−4.7	−1.6
Pakistan (KSE)	15,019.7	+1.3	+6.7	+5.2
Singapore (STI)	3,094.5	+2.2	−10.7	−8.0
South Korea (KOSPI)	1,720.9	+2.0	−9.3	−9.8
Taiwan (TWI)	8,462.1	+7.2	−0.5	+4.6
Thailand (SET)	832.0	+0.6	−3.0	+1.7
Argentina (MERV)	2,166.2	+4.4	+0.7	+0.4
Brazil (BVSP)	65,494.0	+2.7	+2.5	+9.2
Chile (IGPA)	13,544.6	+0.8	−3.8	+3.7
Colombia (IGBC)	9,400.9	−0.5	−12.1	−4.3
Mexico (IPC)	30,424.8	+4.1	+3.0	+4.8
Venezuela (IBC)	34,788.3	−1.1	−8.2	−57.9
Egypt (Case 30)‡	11,240.0	+5.6	+7.4	+7.7
Israel (TA-100)	1,042.7	+2.7	−9.7	−3.6
Saudi Arabia (Tadawul)	10,291.5	+1.6	+29.7	+29.8
South Africa (JSE AS)	30,058.1	+1.9	+3.8	−4.5
Europe (FTSEurofirst 300)	1,358.2	+2.8	−9.8	−6.9
World, dev'd (MSCI)	1,498.2	+3.8	−5.7	−5.7
Emerging markets (MSCI)	1,190.9	+4.5	−4.4	−4.4
World, all (MSCI)	380.9	+3.9	−5.6	−5.6
World bonds (Citigroup)	760.5	+1.8	+4.1	+4.1
EMBI+ (JPMorgan)	434.2	+0.7	+0.1	+0.1
Hedge funds (HFRX)	1,329.0	+0.7	−0.1	−0.1
Volatility, US (VIX)	22.7	24.4	22.5	(levels)
CDSs, Eur (iTRAXX)†	110.9	nil	+213.5	+223.7
CDSs, N Am (CDX)†	145.7	−8.5	+83.7	+83.7
Carbon trading (EU ETS) €	21.3	−0.8	−4.2	−1.0

*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. ‡New index.

Patent filings

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The World Intellectual Property Organisation estimates that 156,100 patent applications were filed under the Patent Co-operation Treaty in 2007. Israel, Switzerland, Finland and Sweden all generated a good many patent applications given their size, whereas China, a much larger economy, makes up a small—albeit rapidly increasing—share of total submissions. America accounted for over a third of total patent filings in 2007. Although its contribution appears modest compared with its share of global income, the number of patent filings adjusted for national income is only a crude indicator of a country's ability to generate ideas. That is because the usefulness of each patent can vary widely.