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The Economist

APRIL 5TH–11TH 2008 www.economist.com

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Politics this week

Apr 3rd 2008
From The Economist print edition

Though **Zimbabwe's** official electoral commission delayed the publication of results of a presidential election for five days after the poll on March 29th, it looked likely that Robert Mugabe had lost. A run-off within three weeks between Mr Mugabe and Morgan Tsvangirai, who would be the strong favourite, remained a possibility. An independent challenger, Simba Makoni, was predicted to have won less than 8% of votes cast. The commission announced that Mr Mugabe's ruling ZANU-PF party had been defeated in the parliamentary election. See article

Ian Khama, son of **Botswana's** first president, Sir Seretse Khama, was inaugurated as the country's new president. Festus Mogae voluntarily stepped down after ten years in office.

Reuters

Côte d'Ivoire faced violent protests against the high cost of food, leaving one person dead. Similar demonstrations have erupted in other parts of west Africa.

Syria hosted the 22-country **Arab League's** annual summit, but only half of the leaders turned up. Saudi Arabia, Jordan and Egypt sent insultingly low-ranking delegations in protest against alleged Syrian meddling in crisis-ridden Lebanon, which boycotted the meeting outright.

The authority of **Iraq's** prime minister, Nuri al-Maliki, was badly undermined by the failure of the Iraqi army to defeat the militias loyal to a radical cleric, Muqtada al-Sadr, in Basra. Hundreds of people were reported to have been killed in fighting there, in other southern towns and in Baghdad. See article

The dirt sticks

AFP

Bertie Ahern, **Ireland's** "Teflon *taoiseach*", announced his resignation. Mr Ahern has been fighting to clear his name of bribery allegations before a special tribunal. His successor as prime minister is likely to be Brian Cowen. See article

The **Polish parliament** approved the European Union's Lisbon treaty. Some observers had suggested that it might resort to a referendum. Ireland will now be the only one of the EU's 27 members to put the treaty to a popular vote.

As expected, Nicolas Sarkozy, the French president, announced at the NATO summit in Bucharest that **France** would send an extra 800 troops to Afghanistan. However, the summit was divided over the question of offering a membership action plan to Ukraine and Georgia, a split that pleased the Russians. See article

Turkey's constitutional court said it would take up a case to ban the ruling Justice and Development Party, and to bar both the prime minister, Recep Tayyip Erdogan, and the president, Abdullah Gul, from politics for five years. See article

In it to win it

Supporters of **Barack Obama** stepped up the pressure on **Hillary Clinton** to withdraw from the Democratic presidential race (though Mr Obama himself backed away from saying she should end her campaign). Howard Dean, the chairman of the national party, said he hoped the nomination would be resolved by July 1st. Bill Clinton said everyone should just "chill out", his fury at Bill Richardson's endorsement of Mr Obama notwithstanding.

John McCain began a "service to America tour", visiting the town where he attended high school and the military bases where he trained as a navy pilot. See article

Meanwhile, **Al Gore** launched a campaign. The former vice-president is heading a three-year, $300m advertising blitz to increase the American public's awareness about climate change. Mr Gore wants America to reduce its greenhouse-gas emissions by 90% by the middle of the century.

Republican senators agreed to work with their Democratic colleagues on crafting a bill to alleviate the pain in the **housing market**. The Republicans had resisted further measures to those proposed by the White House.

Uncertain harvest

Argentine farmers suspended their roadblocks and protest “strike” in the hope of talks with the government. The farmers want a recent increase in export taxes reversed. Cristina Fernández de Kirchner, Argentina's president, offered subsidies to small-scale farmers.

In **Colombia** there were rumours that Ingrid Betancourt, a Franco-Colombian politician held hostage by the FARC guerrillas since 2002, might soon be freed. France sent doctors to the Colombian jungle to try to treat Ms Betancourt, who is feared to be in very poor health. See article

Cuba's government lifted a rule that barred Cubans from staying at tourist hotels or hiring cars on the island. But they will have to pay in hard currency, and monthly wages average just $17. In recent weeks bans on owning mobile phones and other consumer-electronics have also been removed.

The North-South divide

Relations between **North** and **South Korea** worsened as the North expelled South Korean officials from their joint industrial park at Kaesong. It also gave warning that the policies of South Korea's president, Lee Myung-bak, whom it called a “traitor”, would lead to catastrophe. America expressed concern that North Korea has still not kept its promise to declare all its nuclear programmes, which it was supposed to divulge last year. See article

American officials expressed scepticism about plans by the new government in **Pakistan** to open talks with pro-Taliban militants in the tribal areas on its border with Afghanistan.

Getty Images

China's president, Hu Jintao, hosted a tightly guarded ceremony for the **Olympic torch** in Tiananmen Square. The torch is to be carried around the world and through Tibet before the Beijing Olympics in August. It is expected to draw protests in many countries after the quelling of the recent anti-Chinese riots in Lhasa.

Hu Jia, a well-known **Chinese human-rights campaigner**, was given a three-and-a-half-year prison sentence for subversion. Last month another activist, Yang Chunlin, was jailed on similar charges.

Petrol prices fell in **Japan**, as the government failed to prevent the lifting of a levy for road-building. The government is likely to reimpose the petrol tax after forcing legislation through parliament at the end of April. But Yasuo Fukuda, the prime minister, has said he will try to ensure that from next year the revenues are directed into the general budget, not road-building. See article

Business this week

Apr 3rd 2008
From The Economist print edition

Hank Paulson, America's treasury secretary, unveiled a blueprint for the biggest overhaul to the **financial regulatory system** since the Depression. It included new powers for the Federal Reserve that formalise its attempt at policies to stabilise the markets. Work began on the plan last spring, before the trouble in subprime-mortgage markets emerged, but Mr Paulson acknowledged that it probably would not be implemented until after the credit crisis had passed. With congressmen, small banks and state officials lining up in opposition, observers wondered if Mr Paulson's proposals would ever be passed at all. See article

Meanwhile, **Ben Bernanke** admitted for the first time that America could slip into recession in the first half of the year. But the Fed's chairman remained optimistic that the government's recent emergency measures would spur growth in the second half.

UBS said it would write down an additional $19 billion because of losses in America's housing market and related credit structures. Marcel Ospel's departure from the job of chairman was also announced. However, the Swiss bank's share price soared after it confirmed it had secured underwriting for a SFr15 billion ($15 billion) rights issue.

Lehman Brothers raised $4 billion in a share offering, which bolstered its cash position and dampened market rumours that it was running out of money. Its share price also soared, as it increased the size of the offering, which had been oversubscribed. See article

Bamboozled

Separately, Lehman sued **Marubeni**, one of Japan's biggest trading houses, for money the Wall Street bank claims it lost through what is thought to be the most elaborate case of corporate fraud in recent years. Lehman alleges it was swindled out of $350m in a deal involving a hospital- investment partnership by two former Marubeni employees. The two forged documents and used an impostor to act as the partnership's manager. Marubeni said this constituted “personal acts” by its former employees, and it was under no obligation to recompense Lehman.

Just the tonic

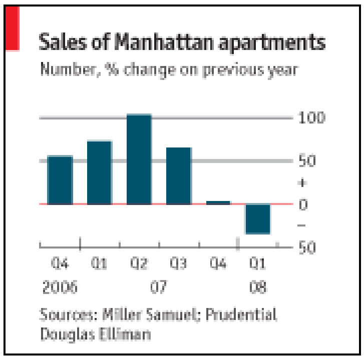
Pernod Ricard won the auction to buy Sweden's Vin & Sprit, which makes **Absolut** vodka, with a bid of *euro*5.6 billion ($8.9 billion). The deal propels the French drinks company almost to the front of the bar in terms of global sales; it is just behind Diageo. See article

France's stockmarket regulator recommended that prosecutors investigate its evidence of insider trading and an attempt to mislead investors at **EADS.** The allegations stretch back to 2005 and centre on executives' knowledge of delays to Airbus's A380 super-jumbo.

A court ruled that a plan to split **IAC/InterActiveCorp** could proceed. IAC's boss, Barry Diller, wants to restructure the conglomerate, which includes Ticketmaster and Ask.com among its assets, but he is opposed by **Liberty Media**, IAC's majority-voting shareholder, which is led by John Malone. Analysts predicted that the legal fight between the two media moguls was far from over.

Western Union unveiled a service that enables **remittances** to be sent home by mobile phone. The money-transfer business is evolving with the rise of “m-banking”, which is very popular in some Asian and African countries. Western Union is marketing its new service to Latino immigrants in the United States.

Trouble in the sky-rise?



The number of **apartment sales in Manhattan** fell by 34.3% in the first quarter compared with a year earlier, according to a report from Miller Samuel and Prudential Douglas Elliman, both in the property business. The survey said sales may have recorded so steep a decline because demand was "elevated" last year by record Wall Street bonuses and a falling dollar. Buyers waiting for Manhattan's red-hot property market to cool down were disappointed to learn that the average price for an apartment rose to more than $1.7m (the median price is a more affordable $945,276).

Alitalia was in full crisis mode after **Air France-KLM** failed to reach an agreement with the Italian carrier's unions about a takeover. Its chairman resigned. Italy's government has tried several times to offload Alitalia, which loses around *euro*1m ($1.6m) a day. The Air France deal was seen as its best hope.

British Airways apologised to passengers for the chaos that marked the start of operations at **Heathrow's Terminal 5**. The airline had to cancel hundreds of flights when problems in the baggage-handling system resulted in a backlog of at least 20,000 bags. In a sign of how bad the situation had become, BA had to send thousands of suitcases to a sorting facility in Italy. See article

KAL's cartoon

Apr 3rd 2008
From The Economist print edition

Illustration by Kevin Kallaugher

Credit crisis

Fixing finance

Apr 3rd 2008
From The Economist print edition

Crises are endemic to financial systems. Attempts to regulate them may do more harm than good

AS IF collapsing prices were not enough, American mortgage firms now have to cope with home rage. Borrowers vent their fury on the system that is repossessing their properties by smashing holes in walls and tipping paint over living-room carpets. Something similar is going on in the house finance built. Faith in open markets has been poisoned by a crisis that has spread from one asset to the next. First there was disbelief and denial. Then fear. Now comes anger.

For three decades, public policy has been dominated by the power of markets—flexible and resilient, harnessing self-interest for the public good, and better than any planner-in-chief. Nowhere are markets deeper and more liquid than in modern finance. But finance has stumbled and there are growing calls from all sides for bold re-regulation.

New rules became inevitable the moment the Federal Reserve rescued Bear Stearns and pledged to lend to other Wall Street banks. If taxpayers are required to bail out investment banks, the governments need to impose tighter limits on the risks those banks can take. This week Hank Paulson, America's treasury secretary, unveiled a longer-term plan to deal with this and other weaknesses in America's regulatory system (see article); and next week the G7 finance ministers will meet in Washington, DC, where they will discuss a report on the crisis by the Financial Stability Forum.

It is natural and right that regulators should seek to learn lessons. The credit crisis will damage not just the reputation of the financial system but also the lives of those who lose their houses, businesses and jobs as a result of it. But before governments set about reforming financial regulation, they need both to be clear about the causes of the crisis and to understand just how little regulators can achieve.

Arm's-length finance

The history of financial markets is not a stable one. They have imploded every decade or so, whether because French and Spanish kings reneged on their debt in the 16th century or because speculators inflated railway stock in the 19th century. But this crisis is unusually shocking, if only because the mild business cycle and the fast pace of world economic growth in recent years had lulled people into a false sense of security.

The view that the only sensible response to the 21st century's first serious financial crisis is a wholesale reform of the system is now gaining ground. Josef Ackermann, über-capitalist and chief executive of Deutsche Bank, summed it up in a call for governments to step in: “I no longer believe in the market's self-healing power.” The implication is that, if the market cannot heal the wounds it sustains as a result of its own risky behaviour, then it must be discouraged from taking such risks in the first place.

But there are two reasons to hesitate before plunging headlong into a purge of the system. First, finance was not solely to blame for the crisis. Lax monetary policy also played a starring role. Low interest rates boosted the prices of assets, especially of housing, which in turn fed into complex debt securities. This created a spiral of debt that is only now being unwound. True, monetary policy is too blunt a tool to manage asset prices with, but, as the IMF now says, central banks in economies with deep mortgage markets should in future lean against the wind when house prices are rising fast.

The second reason to hesitate is that bold re-regulation could damage the very economies it is designed to protect. At times like this, the temptation is for tighter controls to rein in risk-takers, so that those regular, painful crashes could be avoided. It is an honourable aim, but a mistaken one.

The inevitable crash

Finance is a brain for matching labour to capital, for allowing savers and borrowers to defer consumption or bring it forward, for enabling people to share, and trade, risks. The smarter the system is, the better it will do that. A poorly functioning system will back wasteful schemes and shun worthy ones, trap people in the present, heap risk on them and slow economic growth. This puts finance in a dilemma. A sophisticated and innovative financial system is susceptible to destructive booms; but a simple, tightly regulated one will condemn an economy to grow slowly.

The tempting answer is to try to wriggle free from the dilemma with a compromise that would permit innovation but exert just enough control to squeeze out financial failure. It is a nice idea; but it is a fantasy. The experience of the past year is an object lesson in the limited power of regulators.

Just look at their mistakes. Before the crisis, hedge funds were regarded with suspicion as vulnerable and irresponsible. But, with a few notable exceptions, they have weathered the storm less as culprits than as victims. Instead, the system's own safety features turned out to be its weakest points. The copper bottom fell out of AAA bonds when housing markets failed to do what the rating agencies had expected. Banks avoided rules requiring them to put aside capital, by warehousing vast sums off-balance sheet with disastrous results.

It would be convenient to blame the regulators for all that, but the system is stacked against them. They are paid less than those they oversee. They know less, they may be less able, they think like the financial herd, and they are shackled by politics. In an open economy, business can escape a regulatory squeeze in one country by skipping offshore. Once a bubble is inflating many factors conspire to discourage a regulator from pricking it.

And even if you could put all that right, regulators would still fail, because of the nature of finance itself. Financial progress is about learning to deal with strangers in more complex ways. The village moneylender, limited by his need to know those he did business with, was gradually superseded by ever-broader impersonal markets that can cheaply mobilise colossal sums and sell more complex products. The remarkable thing is not that finance suffers from booms and busts, but that it works at all. People who would not dream of lending £1,000 to that nice family three doors down routinely hand over their life savings to strangers in a South Korean *chaebol* or an Atlantan start-up. It all depends on trust.

Regulators cannot know how trust will ebb and flow as new markets develop the experience and practice they need to work better. They therefore cannot predict the peril of new ideas. They have to let new markets develop, or stifle them. The system learns—dangerous junk bonds are reborn as respectable high-yield debt; bankers will now be scared of extreme leverage—but it is delicate, as the world learned last summer. The regulator is condemned to muddle through.

The notion that the world can just regulate its way out of crises is thus an illusion. Rather, crisis is the price of innovation, so governments face a choice. They can embrace new financial ideas by keeping markets open. Regulation will be light, but there will be busts. The state will sometimes have to clear up and regulation must be about cure as well as prevention. Or governments can aim for safety and opt for dumbed-down financial systems that hobble their economies and deprive their people of the benefits of faster growth. And even then a crisis may strike.

Zimbabwe

The end of another African tragedy beckons

Apr 3rd 2008
From The Economist print edition

As power slips away from Robert Mugabe, the world faces the huge task of saving a country

AFP

AT LAST, one of the world's worst rulers may be on his way out. As *The Economist* went to press, Robert Mugabe was hanging on by his fingertips. His people had conceded defeat in the parliamentary election (see article). His press mouthpiece had admitted he may have to face an unprecedented second round in the presidential one. His electoral commission, which tallied the count, was refusing to declare Morgan Tsvangirai, the challenger, an outright winner in the first round of the presidential race, which requires the victor to get more than 50% of votes cast. But unless Mr Mugabe used violence and ballot-rigging on a massive scale, he seemed bound to lose to Mr Tsvangirai in a second round.

So Zimbabwe's long misery may be near its end. Joy is mingled with trepidation. The rich world will rightly pile in with help. The country is on its knees but it has brains and resources. What was once a beacon of African hope can one day shine again. But it has been a tragedy in every way.

It did not have to be like this. After he came to power in 1980 on the back of huge popular support, Mr Mugabe started off well. The economy was one of Africa's perkiest, and he abandoned his former Marxist beliefs. In the aftermath of a bitter war for independence, he seemed genuine in urging reconciliation. He behaved well to the white farmers, on whom much of his economy depended and whose farms were to be gradually and voluntarily redistributed under a constitutional accord. He had fair elections, a decent judiciary, a free press.

Yet a vicious authoritarian streak was always there—too readily ignored by friends and former foes wanting to give him a fair wind. Two years into office, he suppressed dissent in Matabeleland, where many thousands of civilians belonging to a disgruntled minority were massacred. Opposition became harder, and by the end of the decade had been emasculated though not outlawed. He began to tamper with the courts. Corruption began to take hold. Most tellingly, he made too little effort to redistribute the land. The cash provided by Britain and others for the purpose was not even fully spent; and when he did start dishing out land, he gave it to party cronies and top soldiers rather than the landless poor.

But it was his shock defeat in 2000 in a referendum on a new constitution to boost his powers that maddened him—and induced him, belatedly, to play the land card, and with it the race card, eventually confiscating 90% of white-owned farms, most of which had actually been bought in an open market since independence. Mr Tsvangirai, a trade unionist who led the main opposition, was treated as a traitor. The biggest independent newspaper had its printing press blown up. Fair-minded judges were squeezed out. Opposition campaigners and journalists were tortured; thousands were beaten up, hundreds were killed. As the economy imploded, corruption and venality at the top got vastly worse. Yet the landless benefited hardly at all.

A particularly tragic—indeed, disgusting—aspect was the failure of other African leaders to take Mr Mugabe to task. A clever manipulator, he persuaded many of them—and, for a while, a lot of his compatriots—that he was fighting a conspiracy of white farmers and British colonialists. South Africa's President Thabo Mbeki, Africa's most powerful leader, hid behind a policy of “quiet diplomacy”, when one of vigorous condemnation backed by economic arm-twisting could have brought Mr Mugabe rapidly to his senses. For Africa's leaders, it has been a shameful failure of morality and diplomacy, harming the region in every way.

Out of Africa something hopeful?

Are African governments fated always to make a hash of things, ensuring that their continent deserves its description—once harshly made by this newspaper (see article)—as “hopeless”? No; but events give the optimists little reason for cheer. Compared with former colonies in Asia, Africa is still a dismal failure. For sure, many African countries have relied on commodities whose prices go up and down, and face unfairness in trade and tariffs. Africa's climate is wayward. Its ethnic kaleidoscope makes it hard to create political consensus. But bad government is the primary reason for its failure.

In the past decade or so, hope had slowly risen again. The rich world seemed keen to help Africa out of its pit. The sub-Saharan economy, buoyed by high commodity prices, has been growing annually at 6% or so for the past few years. Yet democracy still lags. Africa's most populous country, Nigeria, had a rotten election last year. Kenya, east Africa's engine, had a rigged one more recently. The ruling party in South Africa, the continent's leading country, sounds increasingly authoritarian. Restoring true democracy to Zimbabwe will be a mammoth task. Yet hope for Africa lives eternal.

Economist.com OPINION LEADERS

Italy's election

A Leopard, spots unchanged

Apr 3rd 2008
From The Economist print edition

Silvio Berlusconi has failed to show that he is any more worthy of leading Italy today than he was in the past

AFP

UNLESS a technical hitch causes a postponement, Italy will go to the polls on April 13th and 14th to elect its 62nd post-war government—and the signs are that it will be led by Silvio Berlusconi, just like the 53rd, the 59th and the 60th. By clinging to the familiar, are the Italians paradoxically hoping for change? Theirs, after all, is a country in which "everything must change so that everything can stay the same," according to Giuseppe di Lampedusa, author of "The Leopard", the great Sicilian novel. Perhaps they believe that by bringing Mr Berlusconi back to power they can invert this maxim and keep everything the same in order to promote reform. If so, they are likely to be disappointed.

During his most recent spell in office, between 2001 and 2006, Mr Berlusconi did achieve modest improvements to Italy's unsustainable pension system and to its inflexible labour market. Much of his energy, though, was devoted to furthering his own, or his friends', interests. Some of his efforts took the form of laws (like the country's statute of limitations) that helped him to avoid conviction, some to attacks on the judiciary, some to the introduction of a voting system partly designed to keep him in power. In this he was disappointed, but the new system did lead—as intended—to a parliament in which a plethora of parties was represented, nine of the 39 in a centre-left government with a carpaccio-thin majority. Predictably, it carried out few reforms. Predictably, too, it came to a premature end. Hence the election.

Perhaps, now that he is rid of most of his legal troubles, he can start to think more about a place in history as a great reformer and less about staying out of jail. It's possible. He is 71, and could take the view that he has nothing to lose by attacking the *immobilismo* of politics that lies behind the relative decline of the Italian economy (see article). But that is unlikely. He has never shown much interest in reform. He is more likely to have his eyes on a populist route to the presidency.

Besides, more is at stake in this election than the possibility of real change. For this year, as in every year in which Mr Berlusconi has been a candidate, Italians are being asked to vote for someone who is simply unfit to lead a modern democracy. That seemed likely from the very first, in 1994, when he came to office presiding over a huge business empire that included a virtual monopoly of Italy's commercial television. He merely shrugged at this, just as he shrugged when corruption came to light at his main company and his brother Paolo, to whom he had entrusted some of his affairs, was charged. The magistrates were politically motivated, he averred.

His government fell, for unrelated reasons, but just over six years later he was back. The judicial investigations into his affairs had multiplied and the conflicts of interest were still unresolved. *The*

Economist, which had called on him to resign in 1994, declared him unfit to run Italy (see article). His response was a libel suit, which remains open. Our judgment, however, has been amply vindicated. Not only did the charges and conflicts of interest persist but so did the attacks on the judiciary. They were accompanied by changes in the law designed to ensure that no conviction would ever sully his name. In January this year, for instance, he was acquitted of false accounting in the 1980s because a law passed by his government in 2002 had decriminalised the activities he was accused of.

Two months ago the European Court of Justice ruled that Italy smothered competition in broadcasting. Private television is still dominated by Mr Berlusconi. He is still Italy's richest man, still beset by conflicts of interest, still unfit, even if he were a great reformer, to rule Italy. Italians should vote for Walter Veltroni, his opponent from the centre-left, instead.

Economist.com OPINION LEADERS

Turkey's government

Courtroom drama

Apr 3rd 2008
From The Economist print edition

The constitutional court's case against Turkey's ruling political party is a dangerous mistake

Reuters

IN A modern democracy, the notion that a court might ban a political party that has been in government for over five years and was re-elected only nine months ago seems bizarre. Yet it may happen in Turkey. On March 31st the constitutional court decided unanimously to take up a case brought by the chief prosecutor to ban the Justice and Development (AK) Party and to bar 70 party officials, including the prime minister, Recep Tayyip Erdogan, from politics for five years. By a majority, it decided to pursue a similar case against Turkey's president, Abdullah Gul.

Outlandish as this case appears, there are plenty of precedents in the strictly secular Turkish republic created in the 1920s by Kemal Ataturk (see article). Indeed, a forerunner of today's AK, the Welfare Party, was banned only ten years ago, shortly after the army had forced out its leader (and prime minister at the time), Necmettin Erbakan. Then, as now, the prosecutor's case asserted that the avowedly Islamist governing party was guilty of “anti-secular activities”. Mr Erdogan himself, at the time the Welfare mayor of Istanbul, was caught in the judicial net when he was briefly jailed for reading an Islamist poem in public.

Yet the circumstances today are very different from 1997-98. The AK, though mildly Islamist, is more moderate than Welfare. It has a big parliamentary majority, where Welfare was in a shaky coalition. Moreover, it has given Turkey its best government since the war. It has modernised the penal code, given new rights to Kurds, other minorities and women, brought the army under civilian control and presided over a stable, fast-growing economy—a record unmatched by any of its secular predecessors. And it has capped this by securing in 2005 a prize sought by Turkish governments for over 40 years: the opening of membership talks with the European Union.

It is no wonder that Turkish voters re-elected Mr Erdogan and the AK by a landslide last July. Yet the party has incurred the wrath of the army and of staunch secularists. The army fears that it may lose its privileged status if the government goes ahead with plans to produce a new constitution. The secularists fret that the AK leadership has a hidden agenda to turn the country into an Islamic republic, complete with *sharia* law. They cite various statements made by Mr Erdogan and Mr Gul (for instance, Mr Erdogan's claim that democracy was a train from which one should disembark on reaching one's destination). Most recently, they have objected vociferously to the government's plan to lift the ban on women wearing the Islamic headscarf at public universities.

Ataturk's secular tradition has proved the best way to preserve liberal democracy in a mainly Muslim country. It is a tradition worth preserving. But Mr Erdogan and Mr Gul have explicitly undertaken to stick to it. And it is absurd to assert that the lifting of a headscarf ban that was strictly enforced only a decade ago will lead to *sharia* law. Moreover, the reforms that the AK promises in order to prepare Turkey for possible EU membership, including the new constitution, would make the establishment of an Islamic republic impossible.

None of this has appeased the army and the secularists, whose own belief in democracy looks feebler. The generals openly threatened a coup last April in a bid to stop the AK installing Mr Gul as president. When the party then won re-election in July, the army backed down, allowing him to become president after all. The prosecutor's case against the AK in the constitutional court is just the next stage in this cynical game.

Bring forth a new constitution

Will it succeed? Since the case so plainly lacks merit a wise court would simply throw it out. The fact that the party enjoys strong electoral support makes proceeding even more perilous, and the financial markets have already taken fright. Unfortunately, however, the court is itself part of the fiercely secular establishment, as it showed by its strange decision to overturn Mr Gul's election by parliament last May. There is every chance that, after months of argument and political paralysis, it will rule against the AK.

To avert a prolonged crisis, Mr Erdogan should bring forward his plans to replace the constitution the army wrote after a coup in 1980 with one that makes it harder to close down peaceful political parties. The AK has a three-fifths majority in parliament, so it can propose changes for approval in a referendum. Only by showing once and for all that democracy matters more than secularism will Turkey become a truly modern European country.

North Korea

Kim Jong Il's ashes

Apr 3rd 2008
From The Economist print edition

Time for North Korea to come clean about its nuclear past

AFP

POLITICAL theatre in North Korea has long tended to the absurd. What else to expect from a country that has Kim Il Sung, its current leader's long-dead dad, as president for eternity? Little more than a month ago in Pyongyang, a concert hall of mere party mortals stood respectfully for the “Star-Spangled Banner”, as the New York Philharmonic tried through orchestral diplomacy to take America and North Korea beyond habitual frustrations of trying to hold Kim Jong Il to his disarmament promises. But the illusion didn't last. North Korea now threatens not just to turn the neighbourhood into a “sea of fire”, but to reduce South Korea, America's ally, to “ashes”. That is Mr Kim's reminder to a wider audience that he has tested one nuclear bomb, in 2006, and could let off another.

And the reason for the theatrics? South Korea's new president, Lee Myung-bak, has had the effrontery to suggest that big new investments in North Korea be put on hold until Mr Kim fulfils pledges made in 2005 and 2007, at six-party talks that also include America, Japan, China and Russia, to take steps to abandon his bombs and account for other nefarious nuclear activities (see article). In return for the dollops of food aid and fertiliser South Korea regularly sends north, Mr Lee thinks it high time Mr Kim started letting go the many South Korean prisoners of war and others held captive for years.

For raising such issues, and for his concerns about human rights in North Korea too, Mr Lee is to be applauded; his predecessors had mostly kept shamefully silent. North Korea growls that Mr Lee risks damaging prospects for disarmament. But that is another theatrical ploy. Mr Kim is rehearsing his annoyance at Mr Lee publicly so that he can use it as an excuse, if he decides he needs one, for not doing what he may never have intended to do in the first place: give up his nuclear arms.

Failure to fess up

The six-party talks have got further than previous efforts to lever North Korea out of the bomb-making business. Especially since Mr Kim's provocative bomb test, this time all the neighbours have done their bit, leaving the recalcitrant Mr Kim little wiggle room. If he wants promised six-party benefits, with North Korea taken off America's list of state sponsors of terrorism, wider sanctions lifted, diplomatic relations restored and investments on the scale promised by South Korea and others starting to flow, he first has to come up with a credible account of all his past nuclear activities. That includes not only plutonium making (he has owned up to a modest 30 kilograms, enough for three to five bombs), but also suspected uranium dabbling and any nuclear help given to others.

Mr Kim says there is nothing to tell. No one believes that. The final list was due in December but North Korea and America have spun out talks. North Korea was no doubt keen to keep promised oil flowing over the winter, but work to disable its plutonium-producing reactor at Yongbyon—another of Mr Kim's six-party obligations—has now slowed too. America, keen for diplomatic success to burnish George Bush's legacy, has negotiated on doggedly, lately and most convolutedly on the form a separate declaration might take, should Mr Kim decide to disclose the activities he claims not to have been up to.

Now things are stuck. Getting an accurate list of past nuclear work is essential if the six-party deal—verifiable nuclear dismantlement and disarmament in return for massive energy and other assistance—is not to be abused and discredited. But Mr Kim may have other ideas: waiting out Mr Bush to drive a less onerous bargain with his successor, perhaps; or simply hanging on to weapons he has spent 30 years building.

Persuading him differently will be tough. The other five, but especially China, his semi-friend, need to deliver the same message: the deal is not for renegotiation; oil will flow only as fast as Mr Kim meets his obligations; and until then sanctions too, including those imposed by the UN Security Council after the 2006 bomb test, will be properly enforced by all. The theatrics should end. It is Mr Kim's curtain call.

Economist.com OPINION LEADERS

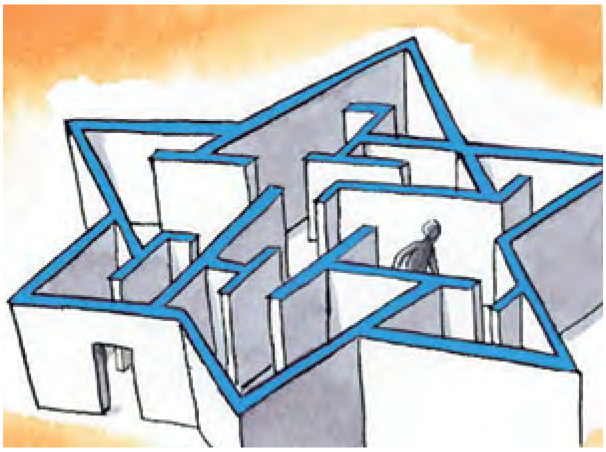
Israel at 60

The dysfunctional Jewish state

Apr 3rd 2008
From The Economist print edition

The best 60th birthday present Israel could give itself is a new political system

Illustration by David Simonds



THERE are many reasons why the Israeli-Palestinian conflict has remained so intractable: land, religion, national identity, history, the scars of violence, the meddling of outside powers and global ideological strife. But one factor that gets less attention than it should is quite mundane, and yet extremely influential: the Israeli electoral system.

Israel, which turns 60 this May, is a pure representative democracy. Virtually every social group has its own political party, if not several. This means that none of the country's many ethnic and religious subsets is disenfranchised. But as a result all governments are unstable multi-party coalitions subject to perverse incentives that have more to do with politicians' careers than with the wishes of the electorate at large.

The peace process Israel launched last autumn with the Palestinian president, Mahmoud Abbas, exemplifies this. Its goal is to make the moderate Mr Abbas more attractive to Palestinians than the Hamas party, which rejects full peace with Israel and which took control of the Gaza Strip last summer. The method is for Israel to negotiate a deal for a future Palestinian state with Mr Abbas, while improving life for Palestinians in the West Bank, where he remains in charge. But the plan is failing because Israel cannot make concessions that would give Mr Abbas the necessary boost. This is not just because Israelis distrust the Palestinians in general and Mr Abbas's capabilities in particular. For all their distrust, most Israelis still think a Palestinian state is their own best chance for a peaceful life.

No, the main obstacles are political. One party in Ehud Olmert's coalition, Shas, has sworn to scupper the peace talks as soon as they get anywhere meaningful. Another, Labour, is led by Ehud Barak, who as the defence minister oversees many aspects of Palestinian life in the West Bank. It falls to him to do things that might make Mr Abbas more popular, such as reducing the number of checkpoints that throttle the West Bank. But he has prime ministerial ambitions and is trying to brand himself as more hawkish than Mr Olmert in anticipation of an election that could happen at any time. This week he seemed to soften a little, but only under American pressure.

Meanwhile, Israel's settlers in the West Bank have woven such tight alliances with various parties that they have made themselves effectively untouchable, even though they are only a tiny proportion of Israeli society. As a result, the government is incapable even of enforcing Israel's own laws in the West Bank. It has not made good on a promise to remove even a few of the hundred-odd settlement “outposts” built without permission. Nor has it done anything about revelations that much of the building in even the officially approved settlements has been on illegally expropriated private Palestinian land, not state land as originally claimed.

Let the voters decide for a change

As our special report this week explains, political deadlock or the capture of the political system by special-interest groups add to many of Israel's other woes, such as the botching of the war against Hizbullah in Lebanon in 2006, the decline of the education system and the dwindling pool of army conscripts due to religious exemptions. In other democracies a rebellion by members of the government is rare and extreme. In Israel it is the norm. This makes it hard to take bold decisions and almost entirely banishes considerations of the greater good and the longer term—all things that making peace requires.

Not that the Palestinians themselves are ready and waiting for Israel to sign a treaty. Thanks to the Hamas-Fatah schism (for which Israel and its allies are partly responsible), there is nobody with full authority for Israel to negotiate with. Even when there was, that leader—Mr Abbas, and before him Yasser Arafat—did too little for peace, in part because Palestinian politics is just as dysfunctional as Israel's, though in a different way. Nonetheless, there have often been times when Israel could have done more than it did without taking undue risks. Petty calculations of coalition politics stopped it.

Israel has achieved some remarkable things during its 60 years. But for the sake of its security and domestic well-being, it now needs a system that makes politicians answerable to voters, not to other politicians. What shape it should take—whether a mixture of proportional representation with electoral districts, higher thresholds to keep small parties out of the parliament, or just rules to make it harder to topple governments—is up to Israelis. Unfortunately, since their politicians will design and vote on it, it is unlikely to be optimal; but almost anything would be better than what there is now.

Economist.com OPINION LETTERS

On Argentina's monetary policy, screaming children, the rule of law, language, Bear Stearns

Apr 3rd 2008
From The Economist print edition

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Argentina's monetary policy

SIR – Your article on the economies of Brazil and Argentina did not consider all the facts behind Argentina's monetary policy ("The tortoise and the hare", March 22nd). Doing so would have better informed your analysis, notably your statement that Argentina's Central Bank "could hardly print more money than it does already".

We do not have an inflation-targeting regime. This would not work at this point in time in Argentina because the power of monetary instruments (the use of interest rates in particular) is limited as the credit channel is still very shallow.

It is also important to acknowledge the transition phase the economy is going through after a painful crisis before making simplistic comparisons with other countries. The 2001-02 financial crisis remains a world precedent. We witnessed an institutional breakdown, a huge devaluation, the destruction of the financial system and a default on the public debt, all at the same time. Not all countries are in the same stage of recovery following the crises in emerging markets over the past decades. Our economy is still in a transition towards a long-term equilibrium of macroeconomic variables.

The Central Bank sees its main policy goal as targeting the growth of monetary aggregates. We have consistently met quarterly targets to keep money growth under strict control. Monetary aggregates have now stabilised at rates that are below the growth of nominal GDP. The control of the growth in M2 is based upon a deep sterilisation policy, the key element of which is the issuance of bills and notes of the Central Bank. These securities do not translate into straight public debt. They reflect postponed liquidity and will be monetised when circumstances require, as happened in the second half of 2007. So every peso issued that exceeds money demand is absorbed by the Central Bank. There is no money overhang whatsoever.

Even though we value exchange-rate stability, and given the history of macroeconomic instability in Argentina, we do not have a commitment to any particular exchange-rate level. Our commitment is to control the growth of the quantity of money.

Martin Redrado
Governor
Central Bank of Argentina
Buenos Aires

Why kids scream

SIR – You reported that mongoose infants modulate the noise of their begging according to the levels with which adult mongooses are able to supply them with adequate food ("Sob story", March 15th). You compared this to children who also adapt to circumstances sensing just how and when to make demands, as parents often find when they are queuing at a supermarket.

Unfortunately you drew the wrong implication when you concluded that parents' attentiveness to fussy children makes matters worse. Many fussy infants find it difficult to detect responsiveness in their parents' care. Psychological research indicates that sensitive parenting cultivates secure attachments and helps children learn how to defuse anger, fear, and frustration. Expressing sensitivity and spoiling are two different things, at least when it comes to children.

Teresa McDevitt
Professor of psychological sciences
University of Northern Colorado
Greeley, Colorado

Requirements for growth

SIR – The debate about the relationship between the "rule of law" and economic growth could benefit by looking at the parallel role of investment in human capital ("Order in the jungle", March 15th). Factors such as health and education are probably just as important as institutional stability in explaining growth. Healthy, educated people are more able to leverage the new economic opportunities presented by legal reforms and may be less likely to resort to illegal shortcuts to make ends meet.

Moreover, successful policy interventions on issues like health and education offer a country's citizens the most immediate and palpable evidence of effective government. Such interventions also help a government prove that it can indeed deliver on its promise of grandiose institutional reform (as in Taiwan). In countries that lack formal assurances about institutional reform (such as China), commitments on health and education act as signals that the government will do whatever it takes to promote economic development.

Randall Kuhn
Director, Global Health Affairs Programme
University of Denver
Denver, Colorado

SIR – You say there is nothing in China that most Westerners would recognise as a rule-of-law tradition. As one Westerner who has practised maritime and commercial law in Shanghai for the past 15 years, I disagree.

China has developed a modern body of maritime law, expanded a dedicated maritime-court infrastructure and encouraged a specialist bar of maritime lawyers. In the truly international business of shipping, China has emerged from being a jurisdiction of last resort to a jurisdiction of choice in many cases.

There is every indication that over the next 15 years China will produce a body of maritime jurisprudence that will be of persuasive authority in other jurisdictions. There is also every indication that the powers in Beijing recognise the importance of the rule of law and that its proper observance in the commercial arena is good for business and at the core of China's prosperity and stability.

Peter Murray
Ince & Co
Shanghai

Speaking in tongues

SIR – Your article on the science of religion suggested that language is not "the subject of violent disagreements" ("Where angels no longer fear to tread", March 22nd). History provides lots of examples of people bickering over language, from Juvenal decrying his Hellephonic Rome, through Dante and Luther fighting for the vernacular, to more recent contention over the identity of Croat and Serbian. That such disagreement may lead to violence is known to all those who have been prevented from using their native language, including generations of Native Americans. There is also the more abstract violence of "language death", about which you have written eloquently in the past.

Benjamin Stevens
Assistant professor of classics
Bard College
Annandale-on-Hudson, New York

SIR – I liked your comment that "groups whose members fail to collaborate in an individually self-sacrificial way may be wiped out entirely". It should be required reading for the two remaining Democratic presidential hopefuls.

David Bowman

Fullerton, California

A new economic dictionary

SIR – The present economic situation requires a new terminology, borrowed from physical science ("Sore heads", March 22nd). For example, sublimation: the process by which assets considered solid evaporate without first passing through a liquid phase, as in, "Oh, no. My stock in Bear Stearns just sublimated."

John Baumeister
Edmonds, Washington

Germany's Turkish minority

Two unamalgamated worlds

Apr 3rd 2008 | BERLIN
From The Economist print edition

Germany's Turks do not properly belong. But what is it that they should belong to?

AP

HE DID not plan it that way. But when Recep Tayyip Erdogan, Turkey's prime minister, arrived in Germany for an official visit in February he found the Turkish community in turmoil. A few days before his arrival nine Turks, five of them children, had died in a fire in the south-western city of Ludwigshafen. A hate crime, many Turks suspected. The month before, Roland Koch, the conservative premier of the state of Hesse, had tried to win re-election by promising to deport foreign criminals (two-thirds of Turks do not have German citizenship). The transparent appeal to xenophobia backfired, costing Mr Koch his majority and perhaps his job.

Mr Erdogan both calmed tempers and inflamed them. In Ludwigshafen he reassured sceptical Turks that German police and firemen could be trusted. But then he seemed to urge them to hold themselves aloof from German society. Assimilation was a “crime against humanity”, he told a crowd of 16,000 in Cologne. Turkish children should be able to study in Turkish-language schools and at a Turkish university. With that, he largely wore out his welcome. Politicians across the spectrum accused him of fomenting Turkish nationalism on German soil. Perhaps, some mused, the European Union should suspend membership talks with Turkey.

These are awkward times in the fraught 47-year history of Germany's 2.6m Turks, the country's largest ethnic minority. They have powered Germany's industry, populated its cities and produced more than a handful of millionaires, artists and politicians. Doner kebabs, invented by Turks in Berlin, are edging aside currywurst as Germany's favourite fast food. Yet on average these Turks are poorer, less well educated and more violent than ordinary Germans. Even those who speak Germany's language, carry its passport and thrive in its economy are not sure they belong. “We're in, but not in all the way,” says Yasemin Kural, who works in public relations.

How Germany deals with its minorities is a mounting preoccupation for its leaders. In cities with more than 200,000 inhabitants 45% of children under 15 have a “migration background”, meaning either that they immigrated themselves or have parents or grandparents who did. Across Germany, the proportion is nearly a third (including children born to ethnic-German immigrants). Migrants have starring roles in crime, poverty and now terrorism, both as perpetrators and as victims. They and their children account for 36% of the population at or near the poverty line and for 29% of the unemployed.

They are also an asset. Migrants can relieve the shortage of expert labour that now plagues industry and the dearth of children that threatens Germany's future. The chancellor, Angela Merkel, rightly insists that their integration into Germany's society and economy is “decisive” for its well-being. Much of what must be done, such as upgrading education, is colour-blind. But to convert foreigners into fully fledged Germans, Germany is having to redefine itself.

Opening the door, and closing it

The story of Turks in Germany can be told as a tale of two shocks. In 2001 Germans were stunned by mediocre results in the first international PISA test of reading and maths, which was largely due to the poor performance of its “migration-background” students. The second shock was September 11th 2001, when Turks became Muslims in the eyes of many Germans and thus a threat to peace. The PISA shock matters more.

The school authorities in Neukölln, a multi-ethnic part of Berlin, deployed guards to 13 schools in December 2007, not so much to enforce good behaviour as to ward off outside gangs. That modest deterrent barely begins to address their problems. In one such school, Thomas Morus, only two or three of the 50 or so pupils who graduate each year find apprenticeships, the stepping-stone to employment for most young Germans. Four-fifths of the students, with Turks the biggest group, come from homes where German is not the first language. Most speak neither German nor their mother tongue well, says Volker Steffens, the school's principal. Thomas Morus entered the news briefly in 2005, when a student defended the “honour killing” of a Kurdish girl because “the whore lived like a German”, prompting Mr Steffens to send a written rebuke to pupils and parents.

As a *Hauptschule*, Thomas Morus is in the lowest of the three orders of high school into which most German children are streamed, usually at ten but, in Berlin, at 12. Just 14.8% of German children but 45.4% of Turks end up in *Hauptschulen*, which ought to prepare them for simple trades but often fail to do even that. In Neukölln they are a dumping ground. Graduates cannot work out how many square metres of carpet would cover a floor, says the district's education chief, Wolfgang Schimmang. The “negative selection” of Thomas Morus's student intake, says Mr Steffens, is “downright extreme”.

The plight of Turkish students has many causes, but they begin with an earlier act of negative selection, the “guest-worker” programme launched in the 1950s. From 1961 onwards, Turkish workers streamed out of the Anatolian countryside to take up West Germany's offer to join its “economic miracle”, which needed unskilled labour to keep it going. Alongside lesser numbers of Italians, Yugoslavs and others, the Turks mined coal, forged steel and manned factories, transferring their earnings back to the home country they assumed they would return to.

When the miracle ended, Germany tried to get rid of them. It shut the door to new guest-workers in 1973, which had the unintended effect of encouraging migrants to import their families. By the early 1980s the government was offering Turks cash to return; it was accepted only by the few who were planning to go back anyway.

As the migrants dug in to Germany, they lost their footing in its economy. The steel and coal industries of the Ruhr slumped in the face of foreign competition. After the Berlin Wall fell in 1989 the government withdrew subsidies to industry in West Berlin; more than 200,000, many of them Turks, were fired, says Nihat Sorgec of BildungsWerk in Kreuzberg, which trains young Turks for work. Many eluded unemployment—and some entered the middle class—by starting their own businesses; Turks own more than 70,000 across the country, often doner-kebab joints. But many drifted. The unemployment rate among foreigners is more than double the overall German rate of 7.8%. In Neukölln, says Mr Schimmang, 40% of the workforce is jobless and half the families live off government handouts.

Guest-workers are bequeathing some of their handicaps to later generations. Having grown up in Germany, the young are better educated than their parents and would be strangers in Turkey if they returned. Yet many Turks remain misfits at home. In the 2003 PISA test the maths scores of second-generation Turks placed them more than two years behind their German contemporaries. A sixth of migration-background pupils drop out of school, compared with less than a tenth of Germans. And Turks are three times as likely as non-migrants to have committed multiple acts of violence.

Schools are supposed to even out the odds among children of different backgrounds, but by the time migrant children arrive at Thomas Morus, its director thinks, it is almost too late. Their parents are “education-shy” and boycott the get-togethers over coffee that the school offers. At home, satellite television beams foreign-language programming at children whose German is already imperfect.

Germany has few ethnic ghettos. Heavily Turkish Kreuzberg, once on the periphery of West Berlin and now at the centre of the united city, feels more like Greenwich Village than the South Bronx, and even Neukölln "rocks", according to the cover of a Berlin entertainment magazine. But migrants and Germans lead largely separate lives: when German children reach school age their parents flee (along with middle-class Turks), leaving poorer migrants alone together. "The education system transmits inequality among parents extremely strongly to the successor generation," says Frank Kalter, a sociologist at the University of Leipzig.

Not by design. *Hauptschulen* spend more per student than loftier tiers of high school, and in Berlin there is a supplement when the proportion of foreigners passes 40%. But the effort falls short. The city's teachers have been demoralised by pay cuts and a heavier teaching load. Many were transferred unwillingly to Neukölln from East Berlin's shrinking schools; less than 1% of the district's 2,500 teachers share their students' migrant backgrounds. That may be why the concern Thomas Morus's staff feels for its students seems tinged with a sense of estrangement. More than two-thirds of Turks see themselves as victims of discrimination, says Faruk Yen of the Centre for Studies on Turkey in Essen. And alienation can be dangerous.

The radical fringe

When police rounded up the plotters of what would have been Germany's worst terrorist attack last autumn, Germans were shocked to learn that two of the four young conspirators were Turks. Turks account for the bulk of Germany's 3.2m-3.4m Muslims. But the border between religion and politics, policed until very recently by the Turkish state, has been largely respected in Germany, too. "Islamic activism appears to be confined to the non-Turkish element" of Germany's Muslim population, said a study published last year by the International Crisis Group. Now that assumption looks shaky. In the past year the amount of Turkish-language material preaching *jihad* over the internet has exploded, intelligence officials say.

Even more than most Europeans, Germans are wary of Muslims. According to a 2006 survey by the Pew Research Centre, 82% of Germans were "very" or "somewhat" concerned by the rise of Islamic extremism, compared with 77% in Britain and 76% in France. In Germany 51% of Muslims thought "many" or "most" Europeans were hostile to them; in France 39% of Muslims had that feeling and in Britain 42%. Disputes over headscarves and mosques bruise Muslim feelings as often in Germany as elsewhere in Europe (minarets should not "ostentatiously" overshadow church spires, Ms Merkel has said). After September 11th 2001, "Suddenly we were all suspect," says Ahmet Iyidirli, a politician from Kreuzberg.

Partly in defiance, says Werner Schiffauer of the Europa Universität Viadrina, "the Turkish community is becoming more Muslim," reinforced by a global quickening of Islamic feeling. Profound faith is probably less widespread than its symbols: drug-dealers in Frankfurt flaunt Islam as rappers do bling. But 29% of adult Muslims attend mosque regularly and 87% call themselves believers, according to a recent study by Germany's interior ministry.

Religiosity arouses two fears: that the devout will create "parallel societies" incompatible with German culture and democracy and that a few of their number will become recruits to extremism and violence. The interior-ministry survey found that nearly half of Muslims consider their religion to be more important than democracy; more alarming are the 9% who do not condemn suicide attacks and the 15% of school children who are anti-Semitic or anti-Christian. Islamists who advocate violence account for about 1% of adult Muslims, and just a handful will act on their beliefs. The domestic intelligence agency monitors 28 Islamist groups with 32,000 members, most of them adherents of IGMG, the European arm of Turkey's Islamist Milli Gorus movement. "Germans seem to perceive a visible Islamic way of life as an entryway to terrorism," says Oguz Ucuncu, IGMG's general secretary.

Good Germans?

So integration must now proceed along two tracks: guiding Turks into the social and economic mainstream and Muslims toward allegiance to the *Rechtsstaat*, the state conditioned by the rule of law. There is a risk of collision.

Turkish Muslims are a diverse group. They include some 600,000 Alevis, who practise an easy-going form of Islam, and the same number of Kurds, whose occasional confrontations with Turks in Germany mirror strife between the two peoples in Turkey. DITIB, the largest grouping of Turkish Muslims, is a creature of

Turkey's traditionally secular state, which pays the salaries of imams in Germany and until recently wrote their sermons.

Since 2006 representatives of these and other brands of Islam have been part of the German Islam Conference established by the interior minister, Wolfgang Schäuble, which seeks to make religion a bulwark against extremism rather than a conduit to it. In March it backed German-language teaching of Islam in public schools and agreed that religious freedom must be bounded by the “basic democratic order”. The test may be whether IGMG, an informal participant despite the spies' suspicions, can get along better with the German state than it has with the Turkish one. Milli Gorus rejects Turkish secularism and can sound anti-Semitic when berating Israel. IGMG's adherents want to be good German citizens, Mr Ucuncu insists. The group defends religious scruples that look to Germans like a rejection of their norms—keeping schoolgirls out of mixed-sex swimming classes, for example—as exceptions to a general willingness to integrate. “We want to immunise against extremism and terrorism,” says Mr Ucuncu.

The state's deference to religion alarms secular Turkish groups, one of which is setting up a council of liberal theologians to contest orthodox rulings on issues such as headscarves. Rather than catering to the zealotry of a minority, they insist, the state should ensure that all Turks gain full access to Germany's bounty. Achieving that requires a two-front approach, says Lale Akgun, a Social Democratic member of the Bundestag from Cologne: an “education offensive” as bold as the one that vaulted workers' children into universities in the 1970s, and an “openness offensive” to instil a sense of fellowship between migrants and native Germans.

On both sides there is resistance. Even six decades after Hitler, Germany has not sloughed off the idea that Germanness is a matter of blood rather than of culture or allegiance. However high they rise, however good their German, Turks are not allowed to forget that they are foreigners. “I employ 100 people and still I'm not seen as German,” says Mr Sorgec.


In Gelsenkirchen

Mr Erdogan's sortie against assimilation plays to Turkish inhibitions, like the sort expressed by Mrs Aydin, a *hijab*-wearing housewife from Neukölln. She sees “no future” in Germany for her three children because there are “no jobs”. Her 17-year-old son has no intention of returning to Turkey, yet is not a German citizen. “He is a Turk and remains a Turk,” says Mrs Aydin. Even winners are readier to call themselves Berliners or Europeans than Germans. Andreas Cem Vogt, head of marketing at a call-centre company, opted for civilian rather than army service, a common decision, on the uncommon grounds that he did not feel “100% German”. With a German father and a Turkish mother, “I grew up in two worlds.”

The middle ground between assimilation and aloofness is just being marked out. The 2000 citizenship law allows non-ethnic Germans to obtain citizenship. The 2005 immigration law marked the start of an integration push that now enlists all levels of government and the private sector. Some 250,000 migrants have taken federally financed language and civics classes. States are rushing to upgrade children's German before they enter primary school. Under Berlin's Deutsch Plus programme, pre-schoolers who fail a test get six months of tutoring. Attitudes are changing, too. Surveys show that young Turks cling less tightly to Turkish culture than older ones, and that the share of Germans who think too many foreigners live among them has shrunk from a large majority 25 years ago to a narrow one now.

Turks still bristle at what seem to be anti-Turkish obstacles, such as requiring spouses from poor countries to learn a bit of German before arrival. They resent having to choose between German and Turkish citizenship. Germans are unsure what it is foreigners should embrace in order to belong. They want them to absorb their *Leitkultur*, but the pre-war charisma that made Jews passionate Germans has gone.

That may not matter so much in a Europeanising Germany whose sense of itself is based largely on the rule of law. Refashioning identity is likely to be a collaborative process, enlisting people like Aylin Selcuk, a dental student from Berlin who grew weary of being asked where she came from and whether she spoke German. She started DeuKische Generation to persuade Germans that Turks could be as German as anyone, and to push Turks to embrace the language and norms of their adoptive country. “Germans think we'll leave, but I'm mainly German,” she insists in *Hochdeutsch* as mellifluous as anyone's. Astonishingly poised for a 19-year-old, she might just become the first German chancellor to boast a Turkish name.

The states' budgets

Time to turn out the lights

Apr 3rd 2008 | LOS ANGELES AND WASHINGTON, DC
From The Economist print edition

State fiscal crises may deepen America's downturn

APRIL is always a tense month in America. Their tax forms due in, Americans scramble to organise a year's worth of assorted paperwork. Post offices stay open long past their usual closing times on the 15th, as last-minute filers dash to send off their returns and beat the deadline.

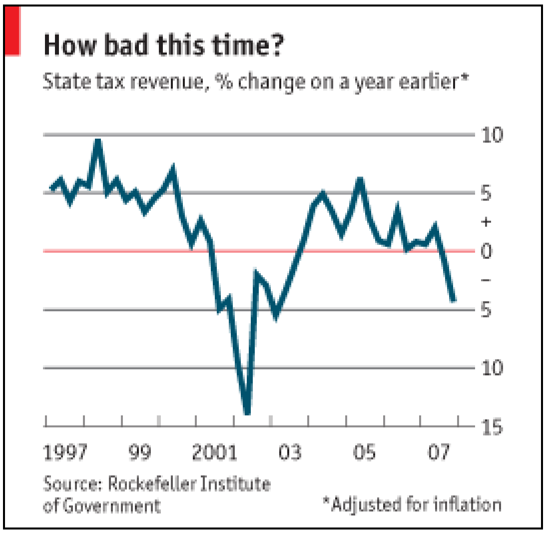
This spring promises to be even more nerve-racking than usual for treasurers in the 50 states who wonder how much, or how little, the tax filers will send them. As America's economic doldrums persist, some states' budgets are feeling the pinch. California has told 20,000 teachers and support staff that they may be sacked. People whose health insurance is subsidised by their state may face higher fees in Vermont or be cut out entirely in Maine. Massachusetts's governor wants to legalise gambling in order to raise revenue.

Economic downturns depress tax receipts and boost demand for state-provided social services. And while the federal government can weather a slide in revenue by borrowing, most states are required by law to balance their operating budgets every year, leaving the cash-strapped with two unattractive options: raise taxes or cut spending. State legislatures usually take the second course, scaling back public services or freezing hiring.

The consequences, though, can be nasty. State and local government spending accounted for 13% of GDP in the last quarter of 2007, so spending cuts put further pressure on demand and employment. That, at least, is what happened the last time America slipped into recession, back in 2001. During the worst quarter of that episode, real state revenue plummeted 14% (see chart), and did not begin to grow again until the end of 2003. The Centre on Budget and Policy Priorities, a think-tank, calculates that 1m people were thrown out of public health-care programmes during the slump. Another 1.5m, says the centre's Iris Lav, would have followed if the federal government had not stepped in to help in 2003. Now her outfit is calling for a similar federal relief package, sooner than last time.

The last recession was unusually bad for states' budgets. Donald Boyd of the Rockefeller Institute of Government, the public-policy research arm of the State University of New York, found that in the recessions of the early 1980s and 1990s state tax revenues declined at about the same rate as the national economy. In the last recession, however, the decline in real state revenue was vastly disproportionate to that of the economy as a whole, mainly due to a big drop in capital-gains-tax receipts. The question for the states is which downturn the current one will look like.

Ms Lav frets that, in terms of the number of states facing problems and the scale of their difficulties, the picture looks much as it did heading into the last state-level budget crisis. Seventeen states are now considering cuts in everything from public-health services to higher-education funding in the next fiscal year, which for most states begins on July 1st. Over half of all Americans now live in a state facing fiscal problems.



The worst off are those at the centre of the housing crisis: Arizona, California and Florida. Although states get little revenue from property taxes, the subprime bust has hit sales-tax revenue as fewer people buy durables for new homes, and unemployment in construction cuts into income-tax receipts. Sinking home prices also sap consumer confidence.

California now faces a $16 billion budget shortfall. The obvious remedy is out: crisis or no, raising taxes in California remains extremely unpopular. The state's otherwise puny Republicans have the power to block tax increases, which require a two-thirds majority vote. Arnold Schwarzenegger, the governor, proposed very few tax hikes in his budget (and naturally did not call them that). One would have closed a loophole on yachts and aeroplanes, bringing in perhaps $21m to the state. Republicans reacted as though he had proposed a levy on first-born sons.

They are no keener on a plan to reduce the state prison population by 20,000 and the number of parolees by a similar number. Cutting spending on prisons and rehabilitation, which accounts for an eye-opening 10% of California's budget, is in any case virtually impossible because of the enormous power of the prison guards' union. Cuts to primary and secondary education will be opposed by the even mightier teachers' unions. The budget will probably be balanced by cutting spending on universities and health-care programmes, by a few “fees” (not taxes, you understand) and by a dollop of accounting wizardry. Possible victims include AIDS services and the Medi-Cal programme, which serves children and the elderly.

The aggregate national outlook is better than California's, but hardly encouraging. Real state revenue fell in the last two quarters for the first time since 2003, despite a sharp increase in tax receipts from export industries booming on the back of the weak dollar. Some of the pain has been self-inflicted. Heading into the current downturn, almost half of states faced structural deficits as non-discretionary spending outpaced revenue growth. And some states' income forecasts were too optimistic. For now, states can close the resulting budget gaps by raiding rainy-day funds. But if their revenue continues to decline, many more will resemble California.

The National Governors Association estimates that budget problems could afflict 35-40 states in fiscal 2009. Growth in sales-tax revenue, a critical source of state income, has tumbled and will struggle as long as consumer spending does. The other big revenue source for most states is their income tax. The returns Americans are rushing to finish now will be coloured by economic weakness at the end of 2007. Next year's receipts may be far worse.

A distinctive feature of the current downturn, moreover, is that it began in the housing market. Property taxes are usually relatively buoyant during downturns. But plummeting home prices affect property-tax revenue as values are reassessed, which will pinch local governments that rely on them. Fewer home sales also mean less money for cities from property transfer taxes. The hangover from America's latest slump could be painful indeed.

On the campaign trail

Primary colour

Apr 3rd 2008
From The Economist print edition

Show me the money

"It was only $607, but I'm a small guy; I could use that."
Jim Philips, an Ohio event organiser, is one of several businessmen complaining about bills left unpaid by the Clinton campaign. Politico.com, March 30th

Striking out

"My economic plan is better than my bowling."
Barack Obama went bowling in Pennsylvania, but proved that it is not one of his skills. Hillary Clinton later challenged Mr Obama to a game in order to settle the primary. CNN.com, March 30th

Do not touch

"I'm trying to stay out of it."
Al Gore wants to avoid the current Democratic campaign. CBS, March 30th

Speaking for the nation

"To be honest, I haven't been following [the Democratic campaign] any more. I lost my interest."
50 Cent, a leading rapper, originally supported Hillary Clinton, then switched to Mr Obama. Now he's not sure. MTV.com, March 28th

Women's suffrage

"You are very sexy."
Barbara Walters interviews Mr Obama. ABC, March 28th

With friends like these

"If I had to make a prediction right now, I'd say Barack Obama is going to be the next president. I will be stunned if he's not the next president of the United States."
Emmanuel Cleaver, a congressman from Kansas City and Hillary Clinton supporter. Canadian Broadcasting Corporation, March 30th

False imprisonment

"I hope that attendance here was not compulsory...I apologise if you were unwillingly in attendance here."
John McCain spoke to pupils of his former high school in Virginia. Attendance was required. The Hotline, April 1st

Planning for the future

"How do you get to be, how do you run for president?"
Michael LaCoste had a question for Mr Obama. The eight year old previously wanted to be a gangster. AP, April 1st

John McCain

Warrior or warmonger?

Apr 3rd 2008 | ANNAPOLIS, MARYLAND
From The Economist print edition

Do voters want a war hero as commander-in-chief?

NINE years ago, when John McCain was about to begin his first presidential run, he donned a chestful of huge fake medals and gave a humorous speech at a Washington dinner where such things are expected. Each day while shaving, he said, he asked himself: “Okay John, you're an incredible war hero, an inspiration to all Americans. But what qualifies you to be president?”

His answer was that five-and-a-half years in a North Vietnamese prison cell was good training for the Oval Office. “In both cases you know that every time someone walks in the door, it's gonna be bad news.” The joke went down well because it was true. Senator McCain suffered fire, shrapnel, three broken limbs and prolonged torture for his country. Many voters figure that makes him tough enough to be commander-in-chief.

Attitudes towards soldiers have warmed immensely since the Vietnam era, when anti-war types tarred veterans as baby-killers. Today, the armed forces are widely admired. In one poll last year, Americans rated military experience the most desirable attribute in a president. Some 48% said they would be more likely to vote for a candidate who had served, while only 3% said they would be less likely to do so. Strikingly, more voters want their president to be a veteran than want him or her to be Christian. Which is why Mr McCain spent this week promoting his life story.

On Monday, the presumed Republican nominee made a speech in Meridian, Mississippi, where he once trained naval fighter pilots. On Tuesday, he addressed students at the boarding school he attended while his father, later an admiral, worked at the Pentagon. On Wednesday, he spoke at the Naval Academy in Annapolis, where he graduated sixth from the bottom of his class.

Mr McCain's aim was to spark news stories about his martial exploits. He succeeded. It is now widely known that he flew 23 bombing missions over Hanoi, was nearly killed several times and went on to command the largest squadron in the navy.

All this will surely help him in November. But will it make up for his numerous handicaps, such as his age, his temper, his likely opponent's eloquence, the ailing economy and the national tilt towards the Democrats? Not necessarily. The last three war heroes to run for president all lost: John Kerry, Bob Dole and George Bush senior when he ran for re-election.

Most Americans admire soldiers, but relatively few understand them, reckons Robert Timberg, a military historian and McCain biographer. The greatest generation is mostly dead. The boomers mostly avoided service in Vietnam. Today's wars are fought by a small corps of volunteers. After September 11th 2001, President George Bush urged everyone else to go shopping.

The military is a culture apart, and Mr McCain's background is extreme even by military standards. His grandfather, another admiral, fought the Japanese across the Pacific and then dropped dead as soon as the war was over. His father worked 365 days a year, including Christmas Day, and spent much of Mr McCain's boyhood thousands of miles away in a submarine. One of Mr McCain's greatest fears, as he was being tortured in Vietnam, was that he might disappoint his family.

In all his speeches, Mr McCain urges Americans to make sacrifices for a country that is both “an idea and a cause”. He is not asking them to suffer anything he would not suffer himself. But many voters would rather not suffer at all. Some find his talk of self-sacrifice alarming. Democrats gleefully fan such alarm. He'll attack Iran, they say. Plucking a line out of context, they pretend that he wants to keep fighting in Iraq for 100 years. One might argue that a man who knows first-hand the horrors of war, and who as a congressman opposed deployments in Beirut and Somalia, is likely to be cautious about future entanglements. That will not stop his foes from branding the warrior a warmonger.

Policing in New York

NYPD blues

Apr 3rd 2008 | NEW YORK
From The Economist print edition

The thin blue line is getting thinner

“BEING a cop was a great job in the late '80s. It paid well. Now, I would never encourage people to do it,” confides a veteran New York police officer. For the past couple of years the New York Police Department (NYPD) has been having trouble attracting recruits, largely because of the paltry $25,100 starting salary decreed by a state arbitrator in 2005. Previously, annual pay had started at $40,000. It took a little while for NYPD to feel the impact as it had a big pool to draw from, but now recruitment is drying up.

The department cannot even hold on to the recruits it does manage to find. Since the salary cut, the numbers graduating from its police academy have steadily fallen. Of the 1,968 hired in July 2005, 1,736 graduated, but only 914 graduated out of the 1,142 hired last summer. The NYPD blames a combination of tougher academic standards and reduced pay.

The NYPD has shrunk by 5,000 from a high of 41,000 in 2001. The good news is that crime continues to fall; the bad news is that this may not be sustainable. Crime is down 25% since 2001 and 75% since 1993. Operation Impact, which floods troubled areas with police, has been credited with the continuing improvement. When two-thirds of recent police academy graduates were sent out to a dozen or so notorious zones, crime went down by about 30% there. But without a steady supply of new recruits, Operation Impact could be in serious danger. Ray Kelly, the police commissioner, has assigned all rookies to the operation to ensure that the flooding strategy continues.

The most experienced officers, too, are leaving the force. Huge numbers were hired in the late 1980s. They can retire after 20 years on half-pay, and most do; about 3,000 leave each year. Around 40% of today's force has been hired since Michael Bloomberg became mayor in 2002. Eugene O'Donnell, a former cop and a professor at John Jay College of Criminal Justice, says the NYPD is demoralised and is on the verge of terminal decline.

Mr Bloomberg's recent calls to cut a further 1,000 officers could result in the smallest police force for 16 years. The NYPD points out that it would have been unable to fill those jobs anyway. But the police union fears that cuts may strain the force to breaking point. Paul Browne, the deputy police commissioner, says the NYPD “is keeping all the balls in the air”, but conceded it cannot continue indefinitely. An arbitrator is expected to come up with a new salary limit later this month.

But it's not just about the money. Greg Ridgeway of RAND, a think-tank, points out that Los Angeles, San Diego and Pittsburgh pay their cops double the New York rate but are also having recruiting problems; the value of the NYPD brand, he adds, should not be underestimated. Using it, the force is recruiting at military bases and college campuses all over the country. But a bit more cash would help.

Smoking and drinking

Unlucky strikes

Apr 3rd 2008
From The Economist print edition

America's smoking bans are causing fatal accidents

BANNING smoking in public places is supposed to save lives. It encourages people to smoke less, so they do themselves and those around them less harm. That, at least, is the theory. Whether it works may depend on how uniform anti-smoking legislation is.

Although many countries have introduced national bans, America has taken a piecemeal approach. A number of states, counties and municipalities have introduced various types of bans, and have enforced them with varying degrees of rigour.

The problem with this, say Scott Adams and Chad Cotti, economists at the University of Wisconsin-Milwaukee, is that smoking bans seem to have been followed by an increase in drunk-driving and in fatal accidents involving alcohol. In research published in the *Journal of Public Economics*, the authors find evidence that smokers are driving farther to places where smoking in bars is allowed.

The researchers analysed data from 120 American counties, 20 of which had banned smoking. They found a smoking ban increased fatal alcohol-related car accidents by 13% in a typical county containing 680,000 people. This is the equivalent of 2.5 fatal accidents (equivalent to approximately six deaths). Furthermore, drunk-driving smokers have not changed their ways over time. In areas where the ban has been in place for longer than 18 months, the increased accident rate is 19%.

The findings, say the pair, are consistent with the suggestion that smokers are driving farther to alternative places to drink. This may be because they are driving to bars with outdoor seating, or to bars which are not enforcing the smoking ban.

Another explanation is that some smokers are “jurisdiction shopping” to places where they may puff. Accident rates can be especially high where border-hopping to still-smoky bars is possible. Accidents in Delaware county in Pennsylvania increased by 26% after the next-door state of Delaware introduced a smoking ban in 2002. Similarly, when Boulder county banned smoking, fatal accidents in Jefferson county, between Boulder county and Denver, went up by 40%. How this weighs up against the long-term health effects of smoking bans is unclear. But it serves as a warning to well-meaning legislators.

Public housing

For richer, for poorer

Apr 3rd 2008 | CHICAGO AND ST LOUIS
From The Economist print edition

America's mixed-income experiment

Community Builders

The new paradigm

ABOUT a year ago Sandra Young moved into Oakwood Shores. The mixed-income development, south of downtown Chicago, is neat and new. But head west along 38th Street and the tidy scene gives way to an expanse of dirt, rubble and what remains of the Ida B. Wells Homes, where Ms Young lived from 1978. Wells was where she brought up her children, where she attended picnics and dances, where she dealt with rats and gangs, and where she, as a tenant leader, helped plan for the demolition of her own housing estate and two nearby, so that Oakwood Shores could rise in their place.

Ten sites in Chicago are being reborn as mixed-income communities, part of the city's big plan to transform its public housing. Cities across America have seen similar developments, driven largely by HOPE VI, a controversial federal law passed in 1992 to target the worst housing estates (the acronym stands for Housing Opportunities for People Everywhere). Now, with HOPE VI up for reauthorisation, cities are seeing some results of the mixed-income experiment.

A few favourite success stories have come from Richard Baron, a developer based in St Louis. With Murphy Park in St Louis and Centennial Place in Atlanta, Mr Baron helped create models for other estates: a developer uses public money to leverage private investment, builds public housing within mixed-income developments and owns the estate. (Previously, only the government owned public housing.) Centennial Place, which Mr Baron built with a local developer, has been a particular source of pride. It has one of the best schools in Atlanta. A good school, Mr Baron explains, not only serves local children, but unites families of all incomes. A further selling point for Centennial Place is that its crime rate dropped 93% between 1993 and 2004, according to a report for the Brookings Institution, a Washington, DC think-tank.

Such statistics suggest that mixed-income estates help to revive neighbourhoods and attract further investment. Others have produced less encouraging numbers. In a survey of five public-housing developments, the Urban Institute, another Washington think-tank, found that in 2005 only 5% of original residents had moved back to the revitalised sites.

No city is debating the displacement of residents more heatedly than Chicago. When the city's “Plan for Transformation” was announced in 1999, the Chicago Housing Authority (CHA) had a whopping 25,450 leaseholders, many in some of the most dangerous housing estates in America. When the plan is completed, supposedly by 2015, the city will have redeveloped 25,000 public-housing units, with 7,697 built in mixed-income developments. It is an epic task.

At Oakwood Shores, with only the first phase built, about 150 original residents have moved back. The development will eventually offer 3,000 homes: 1,320 market-rate units, 680 “affordable” ones (for those earning below 60% of the area's median income) and 1,000 units to replace the 1,426 public-housing flats that were occupied at the time when the redevelopment was announced.

The challenge, as building continues, is to help more residents return. Under a contract with the CHA, displaced tenants have the right to move into the new developments. But many have trouble meeting screening criteria. At Oakwood Shores the developer, the Community Builders, worked with residents and their advocates to draw up leasing requirements. These now include working 30 hours a week, passing a criminal background check and being tested for drugs each year.

The work requirement, according to the developer, has been the biggest hurdle. More than a year before new buildings are scheduled to be finished, caseworkers call residents who might want to move back. If a resident does not have a job, a caseworker tries to help him get one. Spruiell White of the MacArthur Foundation, which supports such efforts, describes an array of barriers, from poor literacy to poor health. The CHA is launching a programme this month that it hopes will smooth the path to work.

The share of residents moving back to the mixed-income developments will probably increase as more projects are completed. But many will stay away, either because they do not meet a site's criteria or because they are settled elsewhere, many using vouchers. “I think we can solve one problem,” Mr White says of tearing down the old estates, “and create an entirely new set of issues...But that's the nature of evolution.”

Lexington

Demolition derby

Apr 3rd 2008
From The Economist print edition

Illustration by Kevin Kallaugher

The Democrats may be throwing away their chances of retaking the White House

IT LOOKS as if Pat Robertson and his cohorts were right all along: God really is a Republican. The Democrats ought to have little problem retaking the White House this November, given the unpopular war, the weakening economy and the anti-Republican backlash. But instead of measuring the White House drapes they are engaged in what Bill Kristol, a Republican commentator, has gleefully dubbed a “rollicking demolition derby”.

The past month has seen the Democratic candidates hit by a couple of monster trucks in the form of Barack Obama's former pastor and Hillary Clinton's repeated fantasies about Bosnia. It is true that these would surely both have come to light during the general election campaign. You cannot associate with an America-bashing preacher or invent a story about braving sniper fire while landing in a quiet airport in Tuzla without paying a price. But the stories are much more damaging because fellow Democrats have been fanning the flames for months. The Clintons have been determined to define Mr Obama as just another “black candidate”. And the Obamaites have been whispering that Mrs Clinton is as untruthful as Slick Willie himself.

The Democratic candidates have also gone on record making explosive charges that they cannot now defuse. Mrs Clinton has argued that there are only two candidates in the race capable of being commander-in-chief—herself and John McCain. Mr Obama has argued that his “baggage” could be stored in an overhead locker whereas Mrs Clinton's would fill an entire plane.

In other words, the Democrats are cheerfully doing the Republicans' dirty work for them. The Republicans had hitherto been nervous about raising “the black issue” for fear of being branded “racist”, or the “Hillary is a liar issue” for fear of being tarred with Ken Starr's brush. But now the Democrats have written the Republican attack ads for them, and starred in them too. It is worth remembering that the first person to raise the spectre of Willie Horton, a black murderer who committed a rape while on furlough, to demolish Michael Dukakis was a fellow Democrat, Al Gore. Come the general election, Mr McCain will not have to do much more than repeat the winning strategy of George Bush senior—use the Democrats' own poison against them.

The Democrats are also wasting precious time. It is an iron rule of American politics that the best way to win is to define your opponent before he gets a chance to define him or herself. The Republicans released their killer ad, which showed John Kerry saying that he had voted for funding the Iraq war before he voted against it, on March 18th, 2004. But rather than defining Mr McCain the Democrats are letting Mr McCain define himself.

This might not matter so much if the senator from Arizona were a mere Bush clone. But he is more than that—a spunky maverick who has frequently broken with the Republican machine and earned admiration from moderates and independents. He is also using his time wisely. He has tried to look presidential by touring the Middle East and Europe (not without mishap, as when he managed to confuse Sunni and Shia extremists in Iraq). And he has tried to distance himself from George Bush's foreign policy by stressing the importance of global co-operation, calling for a reduction in stockpiles of nuclear weapons and pledging that he will do more to deal with global warming and malaria. He is also turning his ragtag primary operation into a presidential campaign machine.

The Democrats are all too aware that their civil war could spell disaster. A cavalcade of senior Democrats, including senators Patrick Leahy and Chris Dodd, have advised Mrs Clinton to retire to her room with a glass of whisky and a loaded revolver. Howard Dean, the head of the Democratic National Committee, and Harry Reid, the majority leader of the Senate, have both urged the superdelegates to make their votes public on July 1st, effectively ending the nomination race at that point. Some Democrats have suggested that an Obama-Clinton ticket would turn a fight into a triumph; others, perhaps after a few too many drinks, have suggested that the party should end the deadlock by drafting Mr Gore.

She's no lamb

But the chances of a peaceful solution look vanishingly small. Why should Mrs Clinton turn herself into a sacrificial lamb? If anybody is defined by what Thomas Hobbes called “a perpetual and restless desire of power after power that ceaseth only in death” then it is the junior senator from New York. But it is not just that self-sacrifice would be against her nature. She can also make a plausible case that she is the stronger candidate. She has so far won 14 states with 44% of the country's population (16 states with 53% of the population if you include Florida and Michigan) compared with his 27 states with 34% of the population. She has won Florida and Ohio, two vital battleground states, and will almost certainly win Pennsylvania, a third. The polls show her beating Mr McCain in the last two of these, while Mr McCain beats Mr Obama in all three.

Besides, why should either side bury the hatchet? The Obamaites regard the Clintons as narcissists who were responsible for losing the House in 1994 and wrecking Mr Gore's chances of winning the presidency in 2000. The Clintonites regard the Obamaites as neophytes who will snatch defeat from the jaws of victory, as the Democrats have so often contrived to do.

The battle is also fuelled by grievances of race, sex and class. Blacks vote overwhelmingly for Mr Obama. Older white women vote overwhelmingly for Mrs Clinton. Professionals vote for Mr Obama, blue-collar workers for Mrs Clinton. Mr McCain the warrior is well-positioned to pick up votes from white working-class Democrats, and Mr McCain the reformer can pick up votes from independents and moderates. One party's demolition derby is another party's gift from God.

Foreign investment in Canada

Lie back and forget the maple leaf

Apr 3rd 2008 | OTTAWA
From The Economist print edition

NASA

Contrary to the fears of many Canadians, foreign takeovers are a sign of economic success, not failure

THE timing was embarrassing. On March 11th Jim Prentice, Canada's industry minister, went to Cape Canaveral to boast of his country's prowess in the space industry. He watched the launch of a space shuttle carrying robotic fingers for the retractable arm attached to the International Space Station, just as the shareholders of MacDonald, Dettwiler and Associates (MDA), the Canadian firm which designs and builds the fingers, the arm and some highly sophisticated satellites, voted to sell these businesses to Alliant Techsystems, an American defence company.

The news has prompted much handwringing. That is partly because of the nature of the firm's business: its iconic Canadarm has been used by the shuttle since 1981, and some Canadians worry that foreign ownership of its satellites, which keep an eye on the Arctic and the coasts and were developed partly with public subsidy, would threaten national security.

More broadly, the sale plays on a growing fear that Canadian industry is being hollowed out and that many emblematic firms are being sold to foreigners. Such fears are hardly unique to Canada. But Canadians perennially fear becoming a branch office for their mighty neighbour to the south. In fact, a string of recent takeovers has mainly featured investors from further afield. Two mining giants, Falconbridge and Inco, were bought respectively by Xstrata, a Swiss firm, and Brazil's Vale, each for close to C$20 billion ($20 billion). Rio Tinto, an Anglo-Australian firm, took over Alcan, an aluminium producer, for twice that figure. Saudi investors joined with Americans to snap up Four Seasons and Fairmont, two posh hotel chains.

Less noticed was that Canadian firms gave almost as good as they got. Thomson, a media group, bought Reuters (for C$19 billion) while TD Bank bought Commerce Bancorp, an American bank, for C$8.5 billion. Canadian investors purchased 508 foreign firms last year, compared with 192 acquisitions made by foreigners in Canada, according to Crosbie & Company, which tracks mergers and acquisitions. Still, for the first time in 13 years, the number of deals worth more than C$1 billion that involved foreign takeovers of Canadian companies was greater than those in which Canadians bought firms abroad. Similarly, the total value of foreign takeovers of Canadian firms was around twice that of foreign purchases by Canadians.

The boom in foreign acquisitions seems to be waning, thanks to the credit crunch and the strength of the Canadian dollar. But not before it has percolated into the collective consciousness. A poll last year by The Strategic Counsel, a market-research firm, found that almost 70% of those surveyed were concerned about foreign ownership of Canadian companies and more than half wanted limits imposed. “There's a sense of malaise that these icons are leaving and they won't come back," says Peter Donolo of The Strategic Counsel.

This is particularly acute in the case of MDA. Alliant has promised to continue the company's operations in Canada and to leave the maple-leaf flag on the Canadarm. But unlike a mine or a hotel, technology and engineers can be moved.

Hugh Thompson, a spacecraft engineer at MDA, told a parliamentary committee last month that he believed that Alliant wanted his firm's satellite technology in order to win classified defence work in the United States on which only Americans can work. Speaking to the same committee, Steven Staples of the Rideau Institute, a left-wing think-tank in Ottawa, argued that "the loss of technology and scientists, if we sell off this system, will be felt for generations." Not so, says Daniel Friedmann, the boss of MDA. He insists that concerns over job losses and sovereignty are groundless.

The Conservative government has ignored calls for curbs on foreign investment. Stephen Harper, the prime minister, says that he does not want to "micromanage" international investment flows and pick which transactions to allow. However, he has appointed a committee, which is due to report in June, to look at competition and investment laws and to consider whether to insert a new national-security test, as in the United States.

Many business groups support Mr Harper's stance. Report after report has found no evidence that corporate Canada is being hollowed out. Openness to foreign investment has brought many benefits. Far from losing head-office jobs, always the fear in foreign takeovers, Canada has steadily gained them. More than three times as many Canadian companies rank in the world top five in their industry as did 20 years ago. Foreign investors spend more on research and development in Canada than do local firms.

The Conference Board of Canada, a business group, recently noted a stark contrast between most economists, who think Canada needs even more foreign investment, and most voters, who want less. It is this divide that Mr Prentice, the industry minister, must cope with as he muses on the MDA sale. As with any foreign takeover worth more than C$295m, he has to rule whether it is of "net benefit" to Canada. Awkwardly, he must decide before the committee reports. It will be a test of whether the government puts political reflexes ahead of economic principles.

Colombia

Death or freedom

Apr 3rd 2008 | LA LIBERTAD, GUAVIARE
From The Economist print edition

Rumours of Ingrid Betancourt's release

Reuters

From asset to liability for the FARC

FOR more than six years Ingrid Betancourt, a Colombian politician who also has French nationality, has been held hostage by the FARC guerrillas. According to accounts by other hostages who have been freed, for much of that time she has been held in chains or tied to a tree, and is now in very poor health. Might her calvary be about to end?

So go the rumours in the south-eastern department of Guaviare, an area of cattle ranches, coca plantations and jungle where all but the largest towns have been under FARC control for decades. If the rumours are true, Ms Betancourt is being held near places whose names must seem like a cruel taunt. She was sighted in late March near El Retorno (“The Return”) by a local resident who gave this information to Manuel Mancera, the parish priest of nearby La Libertad (“Freedom”). She is said to have been treated at a rudimentary health centre in El Capricho (“The Caprice”). Mr Mancera says that she was reportedly “very weak and in the last stage of depression”, weeping when trying to talk. Some local officials suggested that she might be on hunger strike.

Ms Betancourt is just one of several hundred hostages held by the FARC. But she is by far the most prominent one: a former senator and anti-corruption campaigner, she was running for president when she was seized by the FARC. She was a marginal candidate, but her captivity has made her a heroine and a *cause célèbre* in France. Oddly, many French people seemed to blame Colombia's government for her plight, pressing President Álvaro Uribe to agree to a prisoner swap on the FARC's unreasonable terms.

Last year 11 other politician-hostages were killed by the FARC in confused circumstances. At the instigation of Hugo Chávez, Venezuela's leftist president, this year six others were freed. Their harrowing accounts seem to have made the FARC's leaders realise that Ms Betancourt has become a political liability for them—especially were she to die in their hands. Hundreds of thousands of Colombians demonstrated against the FARC in February; they were likely to turn out in similar numbers on April 4th for a march demanding the release of all its hostages.

The rumours are being taken seriously by the governments of both Colombia and France. Mr Uribe promised that all the FARC's people held in government prisons would be released as soon as Ms Betancourt was freed (many promptly said they did not want to return to the jungle). Previous proposed prisoner releases included only those not convicted of murder, which in effect excluded mid-level cadres. Mr Uribe also offered a reward to any guerrillas who hand over hostages.

This week France's government sent a team of doctors to Guaviare to try to provide Ms Betancourt with medical treatment. Mr Uribe agreed to facilitate this by suspending military operations in the relevant area. In Paris, her son said his mother needed an urgent blood transfusion.

Last month the Colombian army killed Raúl Reyes, who had been the FARC's hostage negotiator. It was not clear whether the guerrillas will let the doctors see their most famous prisoner. Even if they do release her, they will still have in their clutches other trophy hostages—three more politicians, three American defence contractors and some 30 police and army officers—as well as hundreds of others kidnapped for ransom. Unfortunately for them and their families, they lack the international connections of Ms Betancourt.

The Caribbean

A storm brews

Apr 3rd 2008 | CAP-HAÏTIEN AND SANTO DOMINGO
From The Economist print edition

Worrying about an American recession, inflation and Venezuelan aid

THE market bustles. Foul-smelling puddles lap at the feet of women selling rice and men selling charcoal. Cap-Haïtien, Haiti's second city, on its north coast, is a place struggling to escape its present. On the edge of town, by the ocean, the poorer residents of this poor city in a poor country build houses on a rubbish dump, their floors a thin layer of dirt. Outside are glimpses of a better future. Chilean soldiers from a United Nations peacekeeping force play football with the locals. The road to the border with the Dominican Republic is being paved, and plans are afoot to pave the highway to Port-au-Prince, the capital, as well.

But this air of possibility amidst penury is in peril. Though Haiti is far worse off than the other larger countries in the Caribbean, it shares two vulnerabilities with them. First, its economy depends greatly on the United States: for remittances (which account for 21% of GDP); as its main export market; and (potentially in Haiti's case) for tourists. So the economic slowdown in America is a problem, and a slump would be a disaster. Second, Haiti imports much of its food and all its oil. With world commodity prices at record levels, that threatens recent progress in controlling inflation, one of several successes since the UN began to try to rebuild Haiti in 2004. Market traders in Cap-Haïtien say that cooking oil and rice have doubled in price in the past few months.

The only shelter from this brewing storm is a rickety one: a scheme known as Petrocaribe under which Venezuela's president, Hugo Chávez, provides oil to 15 Caribbean and Central American countries on easy terms. But Mr Chávez is increasingly unpopular back home in Venezuela. That is a potential problem for Cuba in particular, which gets subsidies of around $2 billion a year from him. America's trade embargo has ensured that Cuba is not dependent on the United States. But Cuba, like Haiti, imports much of its food.

Adjacent to Haiti on the island of Hispaniola there is a similar story in the Dominican Republic. Leonel Fernández, the president (who is seeking a new term in an election in May), has restored the country after a financial collapse. The economy has grown at almost 10% a year for the past three years, and inflation had fallen to single digits from over 50% in 2004. Now this progress is threatened. Exports from the country's assembly plants, which ship most of their output to the United States, are already falling. Hopes for growth in holiday homes have vanished with the housing crash on the mainland. Tourism revenue was flat last year. Tourism is a mainstay in many other Caribbean states. More than 80% of visitors to the Bahamas come from the United States; in Jamaica the figure is around two-thirds.

For some countries the commodity boom has been a blessing. The Dominican Republic and Cuba export nickel and Jamaica alumina. But prices for both have dipped sharply in recent weeks. Only gas-rich Trinidad seems secure. Along with prosperous Barbados, it has been able to snub Mr Chávez.

Under Petrocaribe, Venezuela supplies 25-year loans at 1% interest, with which the beneficiary countries buy some 185,000 barrels per day (b/d) of Venezuelan oil (of which more than half goes to Cuba). This scheme has brought Mr Chávez political dividends. No visible strings are attached. But Petrocaribe may explain why the small island state of Dominica has joined the Bolivarian Alternative, Mr Chávez's anti-American block based on Venezuela and Cuba. Haiti's president, René Préval, attended one of its meetings in January. George Bush is said to have told Mr Préval last year that he understood why Haiti was friendly with Venezuela. Georgemain Prophete, a local official, says the turbines for a power station going up just outside Cap-Haïtien are paid for by Venezuela. The Dominican Republic's Mr Fernández is on good terms with the United States. But even his government has discussed joining the Bolivarian Alternative, according to Miguel Mejía, a minister.

The worry for the countries lining up for Venezuelan help is that Petróleos de Venezuela (PDVSA), the state oil company, may be unable to maintain the oil shipments indefinitely. That is because its production is declining, whereas oil consumption at home is rising. PDVSA exports around 1m b/d to the United States, full-price sales it needs to pay for the imports it is sucking in. Unless this economic storm dissipates, the IMF, which helps Haiti but has recently had little work elsewhere and is so hated by Mr Chávez, may find itself called upon to launch some financial lifeboats.

Brazil

Dilma and the goat

Apr 3rd 2008 | SÃO PAULO
From The Economist print edition

The pros and cons of Lula's top aide

AP

The mother of growth acceleration

AS POLITICAL branding goes, “Mother of the PAC” (Programme for Accelerated Growth) is not the snappiest. For Dilma Rousseff, though, this title just might provide a route to Brazil's highest office in 2010. She is “head of the civil household”, or chief of staff for President Luiz Inácio Lula da Silva. In recent weeks she has been touring the country with Lula, standing next to building projects and looking bountiful. But now she is taking cover from a convoluted political affair involving ministers' use of their corporate credit cards.

When introduced by the previous government, ministerial credit cards were designed to cut down on paperwork for spending on small items and to increase openness. In February it became clear that some current ministers had been having too much fun with them. The champion spender, the minister for racial equality, Matilde Ribeiro, lost her job and Congress set up an inquiry into their abuse.

The government decided that attack was the best form of defence. It said that spending by ministers in the previous government would be examined too, to show that they had been just as bad. Somehow the bills for the credit card in the name of Fernando Henrique Cardoso, Lula's predecessor, found their way into the press. They did not reveal anything spectacular, but there were some groceries and other small personal items that should not have been there. The information probably came from Ms Rousseff's office. She denies leaking it, and has phoned Mr Cardoso's wife to apologise for the mishap.

Mrs Cardoso was apparently very nice about it, but her husband's party will not be so forgiving. Ms Rousseff's predecessor, José Dirceu, was forced out, accused of orchestrating bribes to members of Congress to keep Lula's legislative coalition together. Though the charges against Ms Rousseff are far less serious, the opposition will try to exploit them. Attacking Lula, who gets more popular every time pollsters ask about him, has not worked well. Attacking his most powerful minister, and the nearest thing he has to an anointed successor, is much easier.

Since the accusation against her is indirect, Ms Rousseff is likely to survive. She has an interesting past (she was once a Trotskyist, holds a doctorate and, like many of Brazil's senior politicians, was blacklisted by the military government of 1964-85). She is impressive up close, mixing personal charm with firmness and an evident grasp of technical detail. But she is not yet a viable candidate for the 2010 presidential election. She is little known outside politically attentive circles.

Indeed, some think that Lula is pushing Ms Rousseff now only to switch his affections later. “You know the story about the man who puts a goat in your living room and then offers to negotiate with you to remove it?” asks Bolívar Lamounier, a political consultant, somewhat ungallantly. Ms Rousseff will need to become mother to a lot more of the government's spending if she is to become the negotiator.

North and South Korea

Rocket man v Bulldozer

Apr 3rd 2008 | SEOUL
From The Economist print edition

A rapid return to the bad old days of lurid insults and apocalyptic threats

Illustration by Claudio Munoz

JUST a few weeks ago, when the New York Philharmonic performed in Pyongyang, Kim Jong Il's North Korea seemed to want to present a friendly face to the world. Its scowl is back, with a vengeance. On March 27th it expelled all South Korean officials from an inter-Korean industrial complex just north of the shared border. The next day its navy fired elderly ship-based missiles into the sea. This week the government said it needs its “nuclear deterrent” to ensure its survival, and labelled South Korea's president, Lee Myung-bak, a “traitor”, not to mention an “anti-North confrontation advocator”. North-South relations seem in a tailspin.

North Korea has been working itself up to this hissy fit since the inauguration of the conservative Mr Lee, nicknamed “the Bulldozer”, in February. Mr Lee has linked further economic co-operation with North Korea to its keeping its promise to declare all its nuclear programmes to America's satisfaction. North Korea bristles at this.

South Korea's *Chosun* newspaper has reported that North Korea's MiG fighters have on at least ten occasions since February crossed South Korea's “tactical action line”, some 20km (12 miles) north of the border, after which they can be over Seoul in minutes. *Chosun* also reported that mechanised North Korean army units have been moving towards the border.

South Korea's response to the military provocations has been muted. The foreign ministry described the missile tests as “routine military exercises”. Some in Seoul link North Korea's belligerence to parliamentary elections in the South on April 9th. The North may hope voters will reject Mr Lee's Grand National Party (GNP). It also hopes that by stoking security fears in South Korea it can drive a wedge between it and its American ally. Those fears might encourage Mr Lee to soften his stance in order to avoid worsening tension and risk damaging South Korea's investment climate. Mr Lee was elected on the promise of revitalising the economy.

Mr Lee's critics believe a South Korean government has no option but to co-operate with the North, especially on humanitarian matters such as family reunions or food supplies for malnourished North Koreans. They say Mr Lee is in thrall to GNP hardliners. These are mostly older politicians who scorn the “sunshine policy” towards the North of former presidents Kim Dae-jung and Roh Moo-hyun. A decade of sunshine, they grumble, has cost a fortune in economic assistance to an evil neighbour, without enhancing national security: witness North Korea's successful nuclear test in October 2006.

Still, every South Korean president has to profess support for closer integration and eventual reunification with North Korea. Mr Lee has promised massive economic assistance and investment if the North gives up its nuclear programme.

That does not seem very likely in the near term. Progress on the six-party deal supposed to lead to the North's denuclearisation has stalled. Few in Seoul hold out hope that North Korea will make a proper declaration of its nuclear programmes, including its secret uranium-enrichment activities. It was supposed to deliver this by the end of 2007. On April 2nd Christopher Hill, the American negotiator on the issue, said in Seoul that he was “very concerned” by the lack of progress.

The opening of diplomatic relations between America and the North looks increasingly unlikely. Nor does the Bush administration seem willing to remove the North from the list of nations that sponsor terrorism. For its part, Kim Jong Il's regime seems to be biding its time until it can deal with a new American president.

As inter-Korean relations deteriorate, so do prospects for investment by South Korean firms in the North. Optimists had hoped that this might help open the country and hasten political change. But South Korean shipbuilders, for example, who had been exploring setting up shipyards in the North, have shelved such plans.

In the meantime many in South Korea expect mounting tension on the border. North Korea is expected to conduct further provocative military exercises near the demilitarised zone and the maritime “northern limit line”, which it wants moved further south. Some in Seoul predict naval clashes. One gloomy North Korea expert who has Mr Lee's ear expects North Korea to restart its nuclear-weapons programme and perhaps conduct another test this year. Even if he is wrong about that, few dispute his view that “a very tough time” looms on the peninsula.

Chinese nationalism

Land of the Yellow Emperor

Apr 3rd 2008 | BEIJING
From The Economist print edition

The dangers of confusing patriotism with ethnic pride

EyePress

The ultimate in ancestor-worship

MAO ZEDONG sent troops to “liberate” unenthusiastic Tibetans, but he also admitted that his country had a problem with “chauvinism” in its handling of ethnic minorities. As China tries yet again to quell an unruly Tibet, it still does.

More than two weeks after an eruption of rioting directed at ethnic Chinese in the Tibetan capital, Lhasa, China has yet to show much interest in what made Tibetans so angry. In an effort to display a little openness, it has allowed a small group of foreign journalists and an even smaller one of diplomats to pay brief visits to the city. To the alarm of officials, some Tibetan monks complained to the journalists about their lack of religious freedom. When the diplomats were later taken to the same temple the authorities made sure that only a tame monk was on hand to talk.

The state media's focus on the alleged pro-Tibetan bias of the Western press in covering the violence in Lhasa has triggered an outpouring of anti-Western sentiment on the internet. Jane Macartney, the China correspondent of the *Times* of London, has received death threats from callers to her Beijing office because of a commentary in her newspaper comparing the Beijing Olympics in August to the Nazi-organised Olympics in Berlin in 1936.

Fearing protests by Tibetans and others, officials imposed tight security on March 31st around an Olympic torch-lighting ceremony in Tiananmen Square. At the event President Hu Jintao lit a cauldron on which were carved 56 “lucky clouds”. The official news agency, *Xinhua*, said these symbolised good wishes from China's 56 officially recognised ethnic groups.

But the next day a police spokesman, Wu Heping, said that Tibetan separatists were preparing to send out “dare-to-die” squads to stage violent attacks (he offered no details). Mr Wu said police had recently seized 178 guns, some 13,000 bullets, more than 3.5 tonnes of explosives, more than 19,000 detonators and two hand-grenades from Tibetan monasteries. He also said they had arrested a man suspected of acting as an agent for the “Dalai Lama clique” to incite the Lhasa unrest. The Dalai Lama denies any involvement.

China has produced little convincing evidence of any terrorist campaign within its borders. Diplomats say China tends to exaggerate such threats as an excuse to crack down on separatist movements. Its crude methods of doing so often heighten ethnic tensions. After the rioting an armoured personnel carrier with helmeted troops on top cruised through Lhasa, displaying a red banner that read “religious activities must keep to the law”.

Official insensitivity to ethnic minorities is evident in attempts in recent years to foster a cult of the Yellow Emperor, a mythical ancestor of the Han race, who supposedly lived 5,000 years ago. Senior leaders have taken part in ceremonies paying homage to him. Last October officials arranged for groups of ethnic minorities, including Tibetans, to join one such rite at a shrine in Shaanxi province where the Yellow Emperor is said to be buried. After passing through Tibet, where officials fear it could spark more protests, the Olympic torch will be carried to the shrine in July.

Yellow Emperor-worship will enjoy a boost from the introduction this week of a new public holiday known as *Qingming*, Tomb Sweeping Day. This is a festival at which Chinese traditionally pay their respects to ancestors. Governments in Shaanxi and in Henan province, which claims to be the emperor's birthplace, are competing (and reportedly spending millions of dollars) to make their respective Yellow Emperor shrines pre-eminent. Officials in Henan say they are expecting 20,000 emperor-worshippers this month.

That ethnic minorities have no interest in the Yellow Emperor is occasionally noted by Chinese commentators. But many Chinese officials see the cult as a useful way of promoting patriotism. Just before the Lhasa riots four advisers to China's parliament proposed that presiding over Yellow Emperor ceremonies should become an annual duty for state leaders. This, they said, would help “unite and consolidate forces from all sides”. Tibetans would differ.

Japan

Road warriors

Apr 3rd 2008 | TOKYO
From The Economist print edition

An end to the construction state, or to Mr Fukuda?

WITH a slowing economy and rising energy costs, a fall in petrol taxes on April 1st of up to ¥24 (24 cents) is something to celebrate. Not, however, if it causes a political smash-up. That is why Yasuo Fukuda, the prime minister, apologised to Japan for “the failure in politics” that had led to the cut. He had proposed ways to extend a “temporary” petrol levy that had been in place for over 30 years. But the opposition Democratic Party of Japan (DPJ), which controls the upper house of parliament, rejected them. So a showdown looms at the end of April, when Mr Fukuda can use his coalition's two-thirds “supermajority” in the lower house to override the upper. If he does, then the upper house may pass a rare motion of censure.

The crisis has prompted the boldest move Mr Fukuda has made in a career drenched in caution. Japanese governments have long used the petrol levy and other tax revenues to splash out on road-building, in a form of patronage politics that has helped the ruling Liberal Democratic Party (LDP) to hold on to power while smothering a once gorgeous country in concrete. Instead of scrapping the levy, Mr Fukuda proposed that from next year its proceeds would be applied to the general budget. This has shocked his own party's pro-construction “road tribe”, with which he may now face as fierce a battle as he does with the opposition.

It is far from certain that the opposition will profit from the chaos. The DPJ's leader, Ichiro Ozawa, is praised for having highlighted the scandal of taxes earmarked for road-building, which symbolise everything that is wrong with Japan's “construction state”. Not even Junichiro Koizumi, the reformist LDP prime minister of 2001-06, managed that. But the DPJ's refusal to consider Mr Fukuda's proposals smacks of opportunism. So does Mr Ozawa's recent insistence that the main reason for scrapping the petrol levy was to boost the economy. If Mr Fukuda judges the public readier to punish the opposition rather than him for the “failure in politics”, he may choose to ignore any censure.

Mr Fukuda's bigger challenge may be the one from his own party. For the moment, even the road tribe has fallen sullenly into line. The prime minister holds a powerful if unspoken sanction over its members: the ability to call a snap general election in which many would lose their seats. But the tribe will not give up without a fight. Meanwhile, the restless modernisers who convinced Mr Fukuda to be bold will want to keep him to his promises. Their unspoken sanction is to vote against his government at the end of April, or leave the ruling party altogether, either way threatening the supermajority on which he depends.

Tibetans in Nepal

Good neighbours

Apr 3rd 2008 | KATHMANDU
From The Economist print edition

Tibet's troubles spill over the border

KELSANG PHUNTSOK, a 25-year-old Tibetan, lies with his legs stretched out. Both feet are in thick plaster. They were fractured by the police during a protest in Kathmandu. He was hit on the head, fell, and was then beaten on the ground with bamboo sticks for five minutes by three policemen.

Scores more of Nepal's 20,000-strong Tibetans have suffered similar treatment during peaceful demonstrations since March 10th. They have been beaten, tear-gassed, kicked and, they say, threatened with deportation. Every day dozens are arrested and later released. The United Nations' human-rights office says some people are now being arrested purely “on the basis of their appearance”, without even demonstrating.

The suppression of Tibetan protests by a government that emerged from a people-power movement two years ago seems shocking. Nepal has been destination or transit route for tens of thousands of Tibetans fleeing into exile. But the government bans Tibetan protests because of its “one-China” policy. It values its alliance with China as a balance to its close but prickly relationship with its other neighbour, India.

China enjoys some ideological support, too. Nepal's second-biggest mainstream party is nominally Marxist-Leninist. Some see the Dalai Lama and Tibet's old rulers as a feudal oppressive class and perceive Tibet as a backward region being developed by the Chinese.

China gives Nepal aid and has built a road from Kathmandu to the Tibetan border. It supports whatever government is in power. The Nepali police admit that Chinese diplomats nag them to stop Tibetan protests. At the main border crossing, Chinese officials have been entering Nepal, apparently to reconnoitre.

Tibetans do share cultural, linguistic and Buddhist religious ties with many Nepali ethnic groups. But exiles are resented as well as pitied. Some self-styled “local Nepalis” have clashed angrily with Tibetans, shouting at them not to demonstrate at a Buddhist shrine.

Nepal's Tibetan headache is not over. The government is pondering how much to restrict access to Mount Everest in early May, when the Olympic torch is due on the Tibetan side of the summit. China would like Nepal's side closed. But that might anger mountaineers, who may have more clout than Tibetans.

Afghanistan

Putting the Hell in Helmand

Apr 3rd 2008 | LASHKARGAR
From The Economist print edition

In the war-torn south, the British and the Taliban are both resented

AKHTAR, a well-to-do cloth merchant in his 50s, recalls the optimism Afghans in his province of Helmand felt when the Taliban were defeated in 2001. It is exhausted. “Now we just say everyone should leave us alone.” And that includes British NATO forces. Mr Akhtar speaks for many. In ten days in Helmand this correspondent found no one who would say that British forces had improved things.

As NATO held a summit in Bucharest this week, Mr Akhtar's anger was a salutary reminder of how much it has to do to salvage a respectable outcome from the war. He is just the sort of Afghan who should welcome NATO's efforts to eliminate the Taliban. Yet, like everyone else, he blames the insecurity in Helmand for making life a misery, and his wealth futile.

NATO wants to demonstrate first of all that no ally is withdrawing; on the contrary, France has confirmed it will send another battalion (at least 800 troops). Hamid Karzai, the Afghan president, says the mission is succeeding, and urges patience. NATO also stresses a “comprehensive approach”, in which military action is backed up by political and economic progress, eventually allowing Afghan forces to be at the forefront of the fight.

But, in truth, all sides in the struggle in Helmand—the Afghan government, the British forces supporting it and the Taliban—are steadily losing popularity. In the bazaar of Lashkargar, the Helmand capital, the mood is “a pox on all their houses”. “The sooner the British leave, the better,” says one man, to growls of agreement.

Helmandis have endured instability for three decades. But the arrival of British forces and a surge in fighting two years ago have made things worse. Locals were used to negotiating a passage from a known commander, whether government or Taliban. Now they face a bewildering array of local bandits, corrupt police, tribal militias, Taliban and NATO forces. All can prove deadly. It is a grinding, bloody stalemate, with inevitable “collateral damage”.

Mr Akhtar says he was robbed and beaten by the police when he last attempted the dangerous journey to Kandahar, on business. The new police chief in Helmand, Mohammad Hussein Andiwal, acknowledges the problems in his force. He has arrested 37 of his own officers.

The British government has sought to win local “hearts and minds” with reconstruction aid for roads, wells and the like. But most Helmandis impugn British motives. Xenophobic at the best of times, they spread their accusations widely: the British are intent on avenging 19th-century defeats in Afghanistan; are scheming with Pakistan; they are planning to steal drug profits. Attempts to co-opt elements of the Taliban, which led the Afghan government to expel two Western diplomats last December, reinforced suspicions.

It is some consolation that the Taliban are also ever more unpopular. And Western intelligence officials claim the militants' co-ordination is breaking down under the relentless killing of Taliban leaders (200 have been killed and 100 arrested in the past year) by Western special forces. Taliban commanders in Helmand bear out this claim. Chains of command have become disjointed, they admit, with larger numbers of junior commanders filling the space left by senior figures such as Mullah Dadullah, their overall commander in Helmand, who was killed by British special forces last May. Internal discipline is harder to enforce. New recruits tend to be younger, more radical and from outside.

Two out of five Taliban fighters in Helmand are now outsiders, according to one Taliban leader. This causes friction with local people. One older Taliban commander admitted that some of his colleagues have been treating people “too harshly”. Local people have become more vocal in demanding that reconstruction be allowed and schools reopened. Militants differ over how to respond.

The Taliban's strongest suit has been law and order, thanks to their brutal readiness to string up criminals or chop off their hands and feet. Local people say Taliban-held areas still have the best security in the province. But the Taliban are losing their incorruptible image. One local Talib grumbles that criminals use the Taliban as cover. Another claims they have been forced to weed out corrupt fighters. Suicide-bombings have also cost local support. Western diplomats claim 90% of attempted bombings are now being foiled, mainly thanks to tip-offs from local people. But they must also worry about how much intelligence flows the other way.

Pakistan's tribal areas

Ruling the tiger park

Apr 3rd 2008 | PESHAWAR
From The Economist print edition

The new government offers the militants talks; America balks

Reuters

Another day, another explosion in the tribal areas

THE battle against al-Qaeda and Taliban fighters on Pakistan's borders, says Asif Zardari, Benazir Bhutto's widower, and leader of her ruling Pakistan People's Party (PPP), “is as much Pakistan's war as anybody else's”. But following his pledge to talk to such groups, America seems to doubt his commitment. Its secretary of state, Condoleezza Rice, recalled that President Pervez Musharraf had also made an ineffective pact with the militants. The head of the CIA, Michael Hayden, was blunter. That “disastrous” deal, he said, had allowed terrorists a “free rein”. He added that America, which has stepped up missile strikes in the tribal areas where both groups have their strongholds, was “interested” in further attacks there.

Since Mr Musharraf's supporters were beaten in February's parliamentary election, the president's influence has been waning. His support for America has been extremely unpopular in Pakistan. But Mr Zardari's shift of the government's stance will have to be subtle, not least because economic troubles loom and America has offered more financial inducements in return for co-operation.

The new coalition government of North-West Frontier Province (NWFP) condemned Mr Hayden's remarks. Asfandyar Wali Khan, who leads the Awami National Party, the Pushtun-nationalist party that heads the coalition, says he is in contact with “some Taliban”. He is confident of winning over local militants, starting in the district of Swat where two pro-government tribal elders were killed this week. Mr Wali Khan has been cheered that Pakistan's army has closed several terrorist training-camps. On a grander scale, he wants to build on a cross-border *jirga*, or council, held last year, by bringing the “conflicting parties”—including America—to the negotiating table. “Let America defend its position in public,” he declares.

Policymakers and spooks are once again grappling with the intractable problems of governing the tribal areas. Pakistan inherited what the British had created as a buffer zone where, in the words of one historian, “tribesmen were like tigers in a national park” and omnipotent political agents acted as gamekeepers.

Pakistan's new prime minister, the PPP's Yousaf Raza Gillani, said he would abolish the Frontier Crimes Regulation (FCR). This is a barbaric colonial-era law, ruling the tribal areas through the threat of collective punishment, on which their autonomy is based. A pro-Taliban cleric, Maulana Fazlur Rehman, whose party has joined Mr Gillani's coalition, threatened a tribal uprising if it was axed. An hour later the proposal was under review.

A poll published this year found that 39% of tribesmen wanted the FCR to be amended and 31% want it abolished. Nobody is clear what should replace it but over half of the tribesmen want Islamic *sharia* law. Karim Mehsud, who is part of a tribal-area lobby group, wants an autonomous council or government.

Weak administrative structures have allowed violent groups to flourish. Waziristan has become home to Afghan warlords, feral Uzbeks and assorted local thugs guilty of atrocities against Pakistani troops and civilians. This week a man and a woman were stoned to death for adultery.

Kamran Khan, the 25-year-old member of parliament for North Waziristan, says there will be fighting as long as American troops remain next door in Afghanistan. His constituents are not averse to America's plans to pump $750m into development in the tribal areas. But they think this is peanuts. “We need billions,” he says.

Correction: India

Apr 3rd 2008
From The Economist print edition

Last week's article on India's civil service confused the Hindi word *sarvottam*, meaning “foremost” or “highest”, and *Sevottam*, which combines the Sanskrit words for “service” and “best”. Apologies.

Economist.com WORLD MIDDLE EAST & AFRICA

Zimbabwe

Morgan Tsvangirai waits for power to slip from the old tyrant

Apr 3rd 2008 | HARARE
From The Economist print edition

The omens for Robert Mugabe are bleak: he is unlikely to last much longer

AFP

FOUR days after the votes were cast in Zimbabwe's elections, the only certainty was that President Robert Mugabe's ruling party, ZANU-PF, had lost its majority in parliament. Of the 210 seats on offer, the two wings of the opposition Movement for Democratic Change (MDC) had won 109 and ZANU-PF 97. But the official electoral commission was still refusing to reveal the results of the presidential race, feeding fears of a massive last-ditch rigging operation. The streets of the capital, Harare, were quieter than usual, with people glued to their television sets or radios. For many, the tension was almost unbearable.

The MDC declared early on that its leader, Morgan Tsvangirai, had won the presidency—and would not allow another election to be stolen. The country's only daily newspaper, the *Herald*, a slavish mouthpiece for Mr Mugabe, conceded that he might face an unprecedented run-off, required within the next three weeks if no candidate won more than 50% of the vote in the first round. In that case, most of those who had voted for the third-placed candidate, Simba Makoni, who had run as an independent after recently breaking away from ZANU-PF, would almost certainly choose Mr Tsvangirai second time round. All independent sources put Mr Tsvangirai well in the lead. Bar massive fraud or wholesale intimidation, Mr Mugabe, it seemed, was on the way out.

The Zimbabwe Election Support Network, a clutch of independent civic-minded groups that deployed 8,000 observers on election day, said that its projections based on a representative sample of polling stations suggested that Mr Tsvangirai had won about 49% of the vote to Mr Mugabe's 42%. Mr Makoni, a former ZANU-PF finance minister, was trailing with around 8%. Other calculations put Mr Tsvangirai just above the 50% threshold. A bunch of postal votes, still uncounted, could give Mr Mugabe a last-gasp bonus.

Still, ZANU-PF people began doggedly talking of a second round. Officials warned the MDC not to jump the gun. The government's main spokesman, George Charamba, compared the opposition's claims of victory to a “coup”. But the MDC toned down its early declarations of victory, urged its followers not to resort to violence, and said it would compete in a second round—albeit “under protest”, in the words of its secretary-general.

But a series of hush-hush meetings and telephone calls, ritually denied by all the reported participants, suggested that an array of regional brokers, along with Zimbabwe's security chiefs and some of Mr Mugabe's closest aides, were trying to persuade the 84-year-old not to prolong his—and the country's—agony.

Reports began to swirl of efforts, especially by South African emissaries sent by President Thabo Mbeki, to convince Mr Tsvangirai to form a government of national unity, as eventually happened after a disputed election in Kenya, where some 1,500 people had been killed in post-election violence. So far, the buoyant MDC has sounded loth to share power, if indeed it is found to have won. But Mr Mugabe's apparent readiness to fight on into a second round may have been a negotiating ploy, to persuade Mr Tsvangirai to offer Mr Mugabe and his closest allies a “soft landing” in return for their conceding defeat.

Voting had been largely peaceful and orderly. Campaigning, though still skewed against the opposition, was more open than in previous polls, partly because Mr Mugabe's weapons of patronage and coercion had weakened as the economy has collapsed and the rank-and-file of his underpaid army and police have lost their zeal. But the opposition was constantly harried by the police, who often found reasons to ban heralded rallies. Television and radio, both government-controlled, were entirely hostile. No opposition daily had managed to survive Mr Mugabe's rule.

Would-be voters complained of being turned away from polling stations at schools, tents and community halls because their names were not on the voters' roll, which was controlled by a Mugabe loyalist. Concern about intimidation had risen because, under a last-minute edict, policemen were deployed inside polling stations. But one fear, that voters in densely-populated opposition strongholds would not have time to cast ballots, was unfounded. In some places voters had started queuing the night before, to be ready to cast ballots from 7am, but long lines that extended outside many voting stations in the morning had largely fizzled by the afternoon.

Another worry, that “ghost” voters would inflate support for Mr Mugabe and his ruling party, seemed more justified. About 5.9m voters were registered in 9,000-plus polling stations, some in remote or sparsely populated areas that were hard for the opposition or monitors to visit. Western journalists and observers were barred from the country, but some African monitors raised concerns over irregularities in the voters' roll: in Harare, for example, about 8,500 voters were registered with addresses that turned out to be empty land. The opposition complained that 3m extra ballot papers had been printed, raising fears that they might be used to stuff ballots at remote polling stations. Winning margins for ZANU-PF in some constituencies seemed oddly high.

But an important improvement on previous elections was the posting of results outside the polling stations. This may even have clinched victory for Mr Tsvangirai. Many MDC supporters feared that rigging would take place mainly in the tallying of votes in the centre, after or during the delivery of boxes from the outlying polling stations. But the public posting of results at polling stations made this a lot harder.

With a few exceptions, the foreign monitors' performance was dismal; all the teams had been invited by Mr Mugabe's government. One from the Pan-African Parliament, a creation of the African Union, made some admirably frank observations. But most lamentable was the group from the Southern African Development Community, an influential club of 14 countries, which, with South Africa to the fore, had led diplomatic efforts to solve the Zimbabwe crisis but which had failed repeatedly over the years to upbraid Mr Mugabe for flouting most of the SADC's own election tenets. In a preliminary report, its leader, an Angolan, declared the poll a credible reflection of the voters' wishes—even before the first results had been declared. It was not his team's job, he explained, to report on what went on before or after the poll. Its main aim was to preserve Zimbabwe's “stability”.

But as Mr Mugabe's officials huddled with the electoral commission planning their next move, the regional leaders may have decided his fate—by concluding that his clinging to office would only worsen a crisis that has harmed the entire region. Botswana's new president, Ian Khama, was said to have been most forthright. It was time, he reckoned, for Mr Mugabe to go. And this time it is quite possible that he will.

Nigeria

Another deadline goes up in flames

Apr 3rd 2008 | AKALU-OLU
From The Economist print edition

Continued gas flaring harms both the environment and the economy

LONG before you reach Akalu-Olu village, in Nigeria's oil-rich Delta region, a metres-high flame of gas gives the place away. Solomon Odum's farm is close by. When he was a child, the land grew more than enough cassavas and yams to feed his family. “Now you could plant from here to the school across town and not have enough,” he says. Half a century after oil exploration began, communities across the Niger Delta region say the environment and the livelihoods that relied upon it are permanently damaged.

Gas flares like the one burning in Akalu-Olu may well contribute more greenhouse gas to the atmosphere than any other source in sub-Saharan Africa. Nigeria flares more than any country after Russia: 20 billion cubic metres a year out of a global total of 150 billion. For years oil companies have flared the gas to separate it from the lucrative crude oil. Lacking facilities to harness the gas or a market to sell it, flaring made good business sense, even if it damaged the atmosphere. But flaring not only continues to pollute horribly, it is also wasteful. The gas that is wasted could earn the country more than $500m a year.

AFP

Just part of the scenery

All this was supposed to have changed by this year to meet a deadline to end flaring agreed on by the government and international oil companies. But no one seems to agree on whether the 2008 deadline was January 1st or December 31st. The petroleum minister says it has passed. Billy Agha, head of gas for the government's internal oil regulator, says the president, Umaru Yar'Adua, thinks it means the year's end. Either way, no one expects operators to stop flaring by the end of this year—or next. Bent Svensson, manager of the World Bank's Global Gas Flaring Reduction Partnership, says the volume of gas flared in Nigeria has been stable for a decade, though oil production has risen.

Nigeria outlawed gas flaring in 1979, to be phased out five years later. But since companies pay a minuscule fee for flaring and are allowed to carry on under government-granted exceptions, there is little incentive to stop. No legislation regulates the gas industry; penalties and procedures are irregularly enforced.

In February the government approved a “gas master plan”. This provides for building new facilities and injecting gas into the domestic supply, so encouraging producers to stop flaring once and for all. But although regulators have threatened heavier penalties for flaring, the fact that oil accounts for about 76% of government revenue and 90% of exports makes the government wary of imposing penalties so tough that they might persuade oil companies to shut down production instead.

Turning off the flares and collecting the gas is expensive. The Shell Petroleum Development Company, Nigeria's largest onshore operator, says it has invested $3 billion in the process so far and guesses that that figure will at least double. At the same time the national oil company has only recently moved towards putting up its share of the money needed to reduce flaring. Allowing for the kidnapping and sabotage that increase the already high cost of doing business, some contractors now demand ten times the average global price of $1m to lay a kilometre of pipeline.

Putting the gas to good use in Nigeria will take time. The country has an enormous appetite for new energy sources because the electricity supply is so erratic. But there is no infrastructure that would let gas fill the void. The 18m tonnes of liquid natural gas produced by Nigeria LNG Ltd every year are all sold abroad.

In the meantime, local campaigners say that the flaring causes acid rain, which rusts local roofing material and pollutes ground water. The World Bank is studying claims, backed by anecdotes of respiratory and skin disease, that flaring harms humans. Life expectancy, once just below 70 years in the Niger Delta, is now around 45. The oldest man in Awalu-Olu is not yet 60.

Such statistics help sustain the region's militancy, which, among other things, is responsible for shutting down about a quarter of Nigeria's oil production. “Our environment is being destroyed,” says an angry local. “So there is an acceptance that if [militants] blow up a pipeline, at least they are taking revenue out of the government's pocket.”

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Ethiopia and the United States

A loveless liaison

Apr 3rd 2008 | ADDIS ABABA
From The Economist print edition

America and Ethiopia need each other, but their needs are not equal

Get article background

THE alliance between the United States and Ethiopia was born of pragmatism. In another time, they might have been enemies. Ethiopians do not like American soldiers tramping on their soil. Americans dislike Ethiopia's bad human-rights record. Local elections due this month are a case in point. Ethiopia's opposition, emasculated by the long imprisonment of its leaders (most of whom were pardoned last year) and weakened by its own divisions, will almost certainly be crushed in an unfair contest. “It's going to be a stitch-up,” says a Western diplomat. “Control is what this government is all about.”

America jealously guards information about its more discreet military activities in Ethiopia, while advertising its soldiers' do-gooding: digging wells, vaccinating animals and so on. Officially, it contributes only a sliver of Ethiopia's $300m defence budget. Unofficially, it may have helped pay for the rising costs of Ethiopia's army, one of Africa's largest. Some say America has a secret base in eastern Ethiopia to move CIA, special forces and “friendlies” into next-door Somalia; America says not.

What is certain is that the closest military ties between the two countries involve Somalia, which America fears may have already become an incubator of Islamist terrorism. That is why America backed Ethiopia's invasion of Somalia at the end of 2006. Its own air raids on supposed terrorist targets in Somalia have relied on Ethiopian intelligence, though nearly all appear to have missed. American officials praise the Ethiopian troops who are still in Mogadishu, Somalia's battered capital, as peacekeepers; most Somalis see them as occupiers.

Leftist hardliners in Ethiopia's government think that its prime minister, Meles Zenawi, is doing the Bush administration's bidding. That is not how the Americans portray it. Regardless of Mr Zenawi, who must answer to his party's central committee and is anyway due to step down in 2010, the Pentagon wants to make Ethiopia a bulwark in a region where Somalia is a dangerously failed state, Sudan and Eritrea are pariahs and Kenya has troubles of its own. Ethiopia has other selling points. The African Union is based there. Its ancient Christian history stirs American evangelicals. Its poverty and population (at 80m, Africa's third-largest) attract development-minded foreigners.

But Ethiopia is too poor to be rated an A-list client state. Even American hawks admit that selling guns to one of the planet's hungriest countries, the “cradle of humanity” to boot, would look bad. America says the little it gives Ethiopia's forces is “non-lethal”: boots, night-vision goggles, medical kits and so forth. It would like to do more to train Ethiopian troops for peacekeeping work. A measure of America's realism is the way it has allowed Ethiopia to buy arms from North Korea.

So differences remain. Many in Ethiopia's 1.2m-strong diaspora in the United States have lobbied their congressional representatives to condemn Mr Zenawi's government as tyrannical. A bill passed by the House of Representatives last year called for curbs on aid to Ethiopia, but is unlikely to be passed by the Senate. Yet it points to a division between those in Washington (mainly Republicans) wanting to reward Ethiopia for fighting terrorism in Somalia and those (mainly Democrats) wishing to punish it for its human-rights abuses at home.

Ethiopia, for its part, had hoped for stronger support from America over its border dispute with Eritrea. It wants the administration to list two Ethiopian separatist groups, the Ogaden National Liberation Front and the Oromo Liberation Front, as terrorists. America is reluctant. The process is complex; it has taken a long time to complete listing the Shabab, a Somali jihadist group. The Ogaden and Oromo fronts will go on fund-raising among their supporters in America, just as the Irish Republican Army once did.

Aid from European Union countries will probably keep flowing, however patent Ethiopia's human-rights violations. China will invest more. But Ethiopia's luck may run out. After several years of good harvests, a famine may set in this year. With 8m of its people likely to depend on food aid, much of it paid for by the Americans, Ethiopia still needs America a lot more than America needs it.

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Iraq

Maliki's knights fail to shine

Apr 3rd 2008
From The Economist print edition

An abortive military offensive leaves a weak prime minister looking weaker

“WE HAVE made up our minds to enter this battle, and we will continue until the end. No retreat. No talks. No negotiations.” So declaimed Nuri al-Maliki on March 28th, two days after unexpectedly ordering Iraq's army into battle against the radical Mahdi Army militia in an operation called Charge of the Knights. Within a few days, however, the charge had faltered and Mr Maliki had to let Muqtada al-Sadr, the militia's leader, orchestrate a negotiated end to the fighting. This outcome has been a humiliating turn of events for a prime minister already accused of weakness. Mr Maliki staked his credibility on the operation and lost. Estimates of the death toll run into the hundreds, including militiamen, Iraqi security forces and civilians.

Initially, Mr Maliki's offensive may have seemed like a clever move. Sadrists and others have suggested that the prime minister ordered the attack in advance of provincial elections scheduled for October, to clear the ground for another Shia party, the Islamic Supreme Council of Iraq, to retain its current dominance of local politics. But a successful operation would also have benefited Mr Maliki himself. The politically weak prime minister has to rule largely by consensus, as his own Dawa party lacks a strong grassroots movement of its own. However, through his office Mr Maliki controls the army, now some 200,000-strong. Taking on the militias may have been a way to show that he could impose his will by force.

Mr Maliki struck primarily in the southern port city of Basra. He must have hoped that its citizens, weary of the feuding militias there, would welcome the attempt to impose order. Moreover, the Americans and the Iraqis have both implied that the operation targeted only the splinter groups and criminals on the fringe of the Mahdi Army, who have been launching attacks on American and Iraqi government targets in defiance of a ceasefire called by Mr Sadr himself last August.

However, instead of imposing order, Mr Maliki's offensive stirred up a hornets' nest. The line between renegades and the ordinary Mahdi Army is blurred and the army may have cast its net too wide. Many mainstream Sadrists appeared to take up arms as government forces encroached on their turf. As fighting raged in Basra, gunmen attempted to seize control of other southern provincial cities such as Nasiriya and Kut, and clashed with government forces near the slum of Sadr City in eastern Baghdad. Others rained mortar shells on Baghdad's fortified Green Zone, disrupting life in the centre of government. At least some of the Iraqi units involved in the operation appear to have performed well below expectations. American forces were dragged into what started as a primarily Iraqi operation, launching air strikes to help out beleaguered government troops. British forces in Basra were drawn in too. Plans for a further reduction of the British garrison there have been postponed.

If anyone has emerged from the affair with his authority enhanced, it may be Mr Sadr. He had been struggling to get his fractious movement to respect a ceasefire and was very likely enraged by an offensive that could have wrecked all his efforts. The young cleric appears to have decided that his movement's future lies not as a loose association of armed gangs but as a disciplined political movement.

The manner in which he successfully ordered his followers to pull back from the streets on March 30th, in exchange for terms including the release of detainees, will only have helped him in that aim. If his authority holds, he could be on his way to metamorphosing from a militant firebrand into a sober statesman capable of bridging Iraq's divisions. He is one of the few prominent Shia politicians to have consistently denounced the American occupation. In a rare interview broadcast on the al-Jazeera television network while the fighting was at its height, but presumably filmed earlier, he said he wanted to take time off to study Islamic jurisprudence. Though “religiously” a Shia, he said, “politically I am closer to the Sunnis.”

And Mr Maliki? He has damaged his standing with his fellow Iraqis, as well as with the Americans, whom he is reported to have informed of the operation only just before it began. He may be abandoned by his

Shia and Kurdish allies, and could be replaced by a less tarnished leader. But previous quests for a new man have foundered on the inability of the factions to agree on an alternative. Given the scale of the fighting, Iraq is lucky not to have been tipped into a prolonged inter-Shia civil war. But the “Charge of the Knights” has served only to expose how far Iraq's government still has to go before it can best the militias and impose order.

Bahrain

Not so sunny for Shias

Apr 3rd 2008 | MANAMA
From The Economist print edition

A put-upon majority feels done down—and is getting angry

THE monarchy of Bahrain regards itself as a beacon of democracy in the Middle East. It was the first in the Gulf to give all its citizens the vote, setting up a partially elected parliament, albeit with limited powers, in 2002. Yet in the past few months its officials concede that in an average week there have been more than two riots and five public protests.

Most of the unrest takes place outside the predominantly Sunni capital, Manama, in poorer, mostly Shia, villages. No official statistics are published but some villagers say that a third or even half of them have no jobs. Bahrainis are readier to work in menial jobs than their wealthier counterparts in Kuwait or the United Arab Emirates but cheap foreign workers depress wages. A typical foreign construction worker is housed in a labour camp, cannot bring his family to Bahrain and earns around $160 a month, which would barely support a Bahraini family with four or five children.

The soaring price of land is another grumbling point. Some Bahrainis have been waiting for state housing since 1992. Mortgages are hard to get. Yet the government has embarked on a grandiose campaign to reclaim land, with banks pouring cash into construction. Many of the new schemes are for fancy flats and artificial islands, like those in Dubai, and are more likely to be sold to rich Saudis or people from the emirates than to Bahrainis.

To make matters worse, these inequalities often have a sectarian tint. Most Bahrainis are Shias but the royal family is Sunni. The Shias are more likely to be jobless; many government employers discriminate in favour of Sunnis. “Recently I went for a public-sector job and they asked me what sect I was,” says a sour Shia mechanic. “But I didn't come to the garage to pray!”

Ebrahim Sharif, a former banker, heads Wa'ad, a liberal Arab-nationalist party. Himself a Sunni, he thinks Sunni and Shia Bahrainis should form a united opposition. “Most of the Shias are worse off than the average Sunni but the only first-class citizens are the royal family,” he says. However his party lost all its seats in the last election, and the parliament is dominated by Islamists of both sects.

These included the country's main Shia opposition group, Wefaq National Islamic Society, which joined parliament in 2006 after boycotting the previous election four years earlier. Its presence raised hopes of change. But voters are growing frustrated with parliament as they realise how few powers its elected members have. The government controls the pace of liberalisation. Local political activists get little support from abroad. America is wary of calling for more democracy. It fears that parliamentarians may turn against America's naval base in Bahrain, its biggest in the Gulf; last year a majority of them declared that it should not be used in any war between America and Iran. More recently the government has signed an agreement with America to help Bahrain develop peaceful nuclear technology.

Wefaq must now deal with one of the trickiest sectarian issues raised by its supporters: a widespread rumour that the government is handing out passports to Sunnis from other countries in an attempt to turn the Shias into a minority. These fears were raised in a report in 2006 by a former government adviser, Salah al-Bandar, who said he had confidential government documents revealing such a plan, The government hotly denies any such thing. The row has flared up again with the publication of government statistics that show the population jumping by 41% last year and the number of citizens growing by 15%, against a previous rate of 2.4%.

Wefaq wants to question a minister named in Mr Bandar's report. The constitution says a minister must submit to questions in parliament if five of the assembly's members so demand; in this case, 18 want the minister questioned, so far in vain. The row has paralysed parliament for the past six weeks as debates have descended into shouting matches; for one week it was suspended. A Sunni Islamist member says it should be dissolved. Wefaq is wondering whether it was sensible to have joined it.

This week, just before its officials were to attend a UN meeting to review Bahrain's human-rights record, the government said it would set up a new human-rights task-force. What a coincidence.

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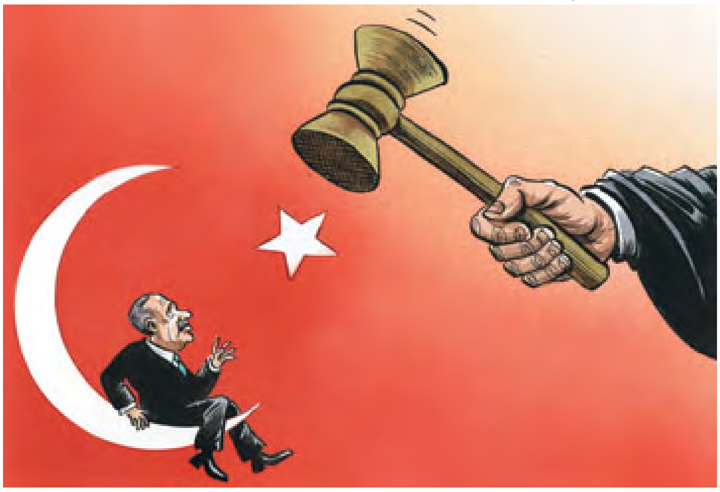
Turkey

The secularists fight back

Apr 3rd 2008 | ISTANBUL
From The Economist print edition

Illustration by Peter Schrank



The constitutional court takes on Turkey's ruling party

THE long battle between Turkey's mildly Islamist ruling party and its fiercely secular establishment is coming to a climax. The outcome could decide the country's future direction, and in particular its hopes of one day joining the European Union. On March 31st the constitutional court decided unanimously to hear a case brought by the chief prosecutor, who is seeking to ban the Justice and Development (AK) Party, and to bar 70 individuals, including the prime minister, Recep Tayyip Erdogan, from politics for at least five years. By a majority vote, the court also decided to hear a similar case against the president, Abdullah Gul.

Turkey is no stranger to bans on political parties. Its court has shut four Islamic ones since 1970, including (in 1998) the Welfare Party, of which Mr Erdogan was a member. The argument is that such parties subvert the strictly secular constitution of Ataturk's republic by promoting anti-secular activities. Yet the prosecutor's case against the AK is overtly political. His 162-page indictment is short on detailed facts, instead making much of lurid comments by local AK officials. It concedes that the party's programme and statutes are constitutional. But it asserts in its introduction that the party “uses democracy to reach its goal, which is installing *sharia* in Turkey.” It goes on to cite statements made some years ago by Mr Erdogan and Mr Gul, even though both men have since insisted that they support the secular republic.

The prosecutor's biggest gripe is the AK proposal to lift the ban on women wearing the Islamic-style headscarf at universities. Indeed, the chief prosecutor explicitly warned the government in January that, if it proceeded with its plan, it might invite “sanctions”. Yet the ban on the headscarf was strictly enforced only after a suggestion by the constitutional court when it banned Welfare in 1998. Its lifting would hardly herald an Islamic revolution.

The truth is that the prosecutor is attempting what might be called a “judicial coup”. This follows the attempted “e-coup” that Turkey's overbearing generals hinted at last April, when they tried to stop the AK government from making Mr Gul (whose wife wears the headscarf) president. During the ensuing row, the constitutional court showed clearly which side it was on by overturning Mr Gul's election by parliament on a thin technicality. Mr Erdogan hit back by calling and winning an early election by a big majority, after which Mr Gul duly became president. The goal of the secular establishment now may simply be to get Mr Erdogan to quit.

That explains the broad condemnation of the court's decision to take up the case. Most media were highly critical. The stockmarket and the currency both tumbled. Turkey's biggest industrial lobby, Tusiad, called the case “unacceptable”. The European Union's enlargement commissioner, Olli Rehn, said it was “difficult to see that this lawsuit respects the democratic principles of a normal European society.”

What will Mr Erdogan do? Mr Gul has promised to “carry on with business as usual”. Mr Erdogan will not back down over the headscarf ban. He has predicted that popular support for the AK Party will rise thanks to the case, as it did after the army's intervention last year. But he knows that a ruling against AK by the court, which is quite likely, would plunge Turkey into a deep political crisis.

His advisers want Mr Erdogan to respond by stepping up the pace of Turkey's EU-inspired reforms. He has been slower about these in his second term than he was in his first. The lack of enthusiasm for Turkish membership in many EU countries has not helped. Nor has his war with the secularists, some of whom want to derail Turkey's EU hopes because, as a report by the European Stability Initiative, a Berlin-based think-tank, puts it, they “prefer international isolation to giving up their traditional power and privileges.”

The most likely course Mr Erdogan will pursue is to accelerate his plans to change the constitution, which was written after a military coup in 1980, to make it harder to ban parties. He needs a two-thirds majority in parliament if he is to do this unilaterally, which would mean getting the backing of either the nationalists or the main pro-Kurdish party. If he cannot secure that, he can use AK's three-fifths majority to propose constitutional changes that must then be ratified in a referendum. The EU wants the constitution to be modernised. But even if he manages it, the court may prove intractable. The next few months are going to be tricky for Turkey.

France and defence

Gaullist no more?

Apr 3rd 2008 | PARIS
From The Economist print edition

Nicolas Sarkozy comes under attack for his new Atlanticism in defence

AFP

Marching to an Atlanticist tune

A NEW Vietnam, a subordination to American policy, an Atlanticist obsession. These were just some objections voiced in France even before President Nicolas Sarkozy announced on April 3rd that he would send a battalion of at least 800 extra troops to join the NATO force in Afghanistan. Denouncing a “global strategic alignment” with America during a parliamentary debate this week, the opposition called for a vote of censure against the government. Mr Sarkozy's decision to lend more help to NATO in Afghanistan, and his wish to return to the alliance's military command, are as politically contested at home as they are symbolically important abroad.

After weeks of speculation, Mr Sarkozy announced his offer of extra troops at the NATO summit in Bucharest (see article). France already has 1,600 soldiers in Afghanistan, mostly around the capital, Kabul. But it was under pressure from America, Britain, Canada and the Netherlands to send more troops, and to more dangerous areas. In Bucharest Mr Sarkozy also confirmed his wish to rejoin NATO's military command—in return for the alliance backing a European Union defence structure.

The backlash was swift. The Socialists were cross that Mr Sarkozy announced France's intention to “reinforce its military presence” in Afghanistan in a speech to Britain's Parliament the previous week, rather than on French soil. “It has little to do with Afghanistan,” declared Jean-Marc Ayrault, leader of the Socialist parliamentary group, “and a lot to do with President Sarkozy's Atlanticist obsession.” Even members of Mr Sarkozy's UMP party were half-hearted, fearing that a reorientation could curb France's ability to pursue an independent foreign policy in the Gaullist tradition. The voters seem hostile: fully 68% are against sending extra troops, says BVA, a pollster, and only 15% are in favour.

Mr Sarkozy's decisions have been brewing for a long time. During his election campaign he made no secret of his admiration for America and his desire to mend Franco-American relations. He called America “the greatest democracy in the world” (this was before he told the British their parliament was the mother of all parliamentary democracies). One left-wing politician called him “an American neo-conservative with a French passport”.

As president, Mr Sarkozy has spelled out his wish to rebuild France's tie to NATO (it is already a big contributor of both troops and money), but only on condition that America drops its objections to a separate European defence project. Although he said during the campaign that he was not committed to keeping French troops in Afghanistan indefinitely, he now recognises the importance of not letting Afghanistan fail, as well as the diplomatic value in NATO's eyes of a bigger French effort. In Washington last November, he promised not to let America down in Afghanistan. And he said other things that pleased the Americans, sounding tough on Iran and sympathetic to Israel.

Yet many observers doubted that all this talk would add up to anything new. Mr Sarkozy may have shared hot dogs with the Bush family while holidaying in New Hampshire, went the line, but his underlying instincts remained Gaullist. Even Jacques Chirac, his predecessor, tried a Franco-American rapprochement in his early years, before the big fall-out over Iraq. “All of the first years of all presidential terms under the Fifth Republic have been characterised by such a tendency,” argues Frédéric Bozo, at the Sorbonne, in a paper for the Foundation for Political Innovation, a centre-right think tank.

The decision to help out in Afghanistan is the clearest sign so far that Mr Sarkozy is prepared to back his Atlanticist words with deeds. It is a reversal of French policy under Mr Chirac. For Mr Sarkozy, it represents a big risk. The decision is unpopular even before any body-bags come home. Defence spending on operations abroad is already running over budget. And even his supporters worry about losing the power to act independently.

Officials retort that Mr Sarkozy has no intention of aligning the country with America. Where his policies coincide, as over Iran, stresses an aide, this results from an independent judgment of French interests, not an automatic siding with the Americans. Mr Sarkozy will speak out when France disagrees, hoping that his voice will carry more weight thanks to gestures such as the one over Afghanistan. The big defence contract just won by EADS, a European aerospace group, along with an American defence firm, to build 179 refuelling aircraft for the American air force is seen in Paris as a sign of a new trust. But it will require deft management by Mr Sarkozy, and perhaps some clearer sign of diplomatic return, to carry public opinion with him all the way.

Ireland's prime minister

So sorry, goodbye

Apr 3rd 2008 | DUBLIN
From The Economist print edition

The Irish taoiseach steps down

BERTIE AHERN announced his resignation as *taoiseach* (prime minister) on April 2nd, so as to go before he was pushed. He was the greatest electoral asset of his party, Fianna Fail, for most of his 11-year tenure in power, securing election three times to lead a string of coalition governments. But Mr Ahern had become an electoral liability. His poll ratings have slumped as the public and his coalition partners lost confidence in his credibility, following his evidence to a tribunal investigating payments to politicians.

The tribunal is examining an allegation that he accepted a bribe when he was finance minister in the early 1990s. That has involved a painstaking trawl through Mr Ahern's bank accounts, which has produced two recent embarrassing revelations that may have accelerated his departure. The first was that party money under his control was given, secretly, as an interest-free loan to his former partner, Celia Larkin, to buy a house. The second came when his former constituency secretary admitted that she had lodged sterling payments in his bank account, something Mr Ahern had previously strongly denied.

In quitting, Mr Ahern acknowledged that his role as a tribunal witness was impeding the government's work. His resignation, he said, was in the national interest. The surprise decision came just before the tenth anniversary of the signing of the Good Friday agreement, which restored devolved government to Northern Ireland, in which he played a big negotiating role with Britain's Tony Blair.

Mr Ahern's damaged reputation has not diminished his achievements in office. He presided over the boom years of the Irish economy, which saw Ireland strongly outperform its European Union rivals, with unemployment all but banished and Ireland's traditional emigration reversed as more people came from abroad to join the workforce than left it.

His resignation should ease the transfer of power. His deputy (and finance minister), Brian Cowen, is likely to take over as Fianna Fail leader and as *taoiseach*. By fixing on May 6th to step down, Mr Ahern has also removed some uncertainties over the Irish referendum on the EU's Lisbon treaty in June. It means that the vote no longer risks turning into a judgment on him. The timing gives Mr Ahern one more last hurrah, when he addresses the two houses of America's Congress in Washington, later this month.

One uncertainty that remains is whether Mr Ahern any longer has a realistic chance of becoming the first permanent president of the European Council when the post is filled later this year. It would be an irony if his troubles at home were to tip the job to his old friend across the water, Mr Blair, instead.

The Italian economy

Rival plans

Apr 3rd 2008 | ROME
From The Economist print edition

Both main parties have similar plans—but neither is bold enough

Alamy

It's hard out there

THE most striking claim in Italy's election comes in the programme of Silvio Berlusconi's centre-right alliance, People of Freedom. “We don't do, or promise, miracles,” it says. Yet Mr Berlusconi has made a fortune (and a political career) from hawking dreams. The threat of world recession, plus Italy's economic fragility, has brought even him down to earth. His centre-left rival, Walter Veltroni, leader of the Democratic Party, is equally downbeat. The scale of Italy's economic problems has encouraged both men to come up with proposals that sound strikingly similar.

Romano Prodi's centre-left government fell in part because it tried to meet the European Commission's demands for smaller budget deficits by raising taxes and cracking down on evasion. His would-be successors appear to accept that they too must attack spending. Mr Veltroni pledges to trim current spending by 0.5% of GDP in the first year and 1% in each of the next two. Mr Berlusconi is less specific, if more convincing on the means: a “digitalisation” of the administration. What neither admits is that serious cuts must lead to job losses that will create a direct conflict with Italy's powerful trade unions.

Both main parties say they want to cut taxes, but both have big new spending plans. The Democrats pledge to pass the benefits of the drive against tax-dodging to employees who are taxed at source. They promise annual cuts in income-tax rates from 2009. Mr Berlusconi plans to scrap a property tax, inheritance tax and gift tax as part of a plan to get the fiscal burden below 40% of GDP. Yet his People of Freedom manifesto offers motorways through the foothills of the Alps and a bridge to link Sicily to the mainland. The Democrats are committed to higher welfare spending.

None of this leaves much scope for reducing Italy's vast debts. Both contenders say that, though the state's debts are huge, its assets are even greater—and lots (the People of Freedom programme estimates €700 billion, or $1 trillion) could be sold. Mr Berlusconi points to disused barracks in city centres as prime examples. If some of the proceeds were used to cut the debt, it would create a virtuous circle, reducing the interest bill and freeing up more cash for tax cuts and increased spending.

It is hard to believe that asset sales can both pay for debt reduction and cover more spending and tax cuts. And there is another problem. Two-thirds of state assets are owned not by the central government but by regional, provincial and local authorities. This, says the People of Freedom, calls for a “grand and free pact” between the various levels of government.

The Democrats' commitment to asset sales underlines another paradox: even as the centre-left has warmed to liberal ideas, the centre-right has deserted them. Mr Berlusconi's likely finance minister, Giulio Tremonti, has talked of lobbying the European Union for tariff barriers on Asian imports. Mr Berlusconi himself has expressed opposition to the sale of Alitalia to Air France, protesting that it is inconceivable for Italy to be without a flag-carrier.

Just as important, both he and Mr Veltroni are vague about plans for deregulation and more competition. Mr Veltroni has promised a liberalisation bill every year, but his programme gives only the sketchiest idea of what these might encompass. Italy needs more clarity in this area if it is to avoid relying on miracles.

Italy's election timing

Putting it off

Apr 3rd 2008 | ROME
From The Economist print edition

Could Italy's election be postponed?

MANY Italians thought it was a *pesce d'aprile* (an April Fool's stunt). On April 1st one of Italy's highest courts gave a ruling that could have meant putting off the election due on April 13th and 14th, at least for some weeks. The court decided that a tiny party, Christian Democracy (DC), had a right to stand. DC, led by one Giuseppe Pizza, claims to be the true successor of the Christian Democrats who dominated Italian politics until the 1990s.

Mr Pizza's group was excluded by a lower tribunal because its symbol is almost indistinguishable from that of another, bigger party, Pier Ferdinando Casini's Union of Christian and Centre Democrats (UDC). As the implications of the appeal-court ruling sank in, the interior minister in the outgoing government, Giuliano Amato, confirmed that he could not rule out a delay.

Mr Pizza insisted that his party had a right to campaign for the 30 days allowed by law. He announced that he would take further legal action to stop the UDC from using the old Christian Democratic symbol of a red cross on a white shield. Most other politicians argued vigorously that the election must go ahead. Among them was Silvio Berlusconi. But several of his opponents accused him of secretly egging on Mr Pizza so as to steal votes from the UDC, which was an ally but has now deserted his coalition. So it wasn't a *pesce*. But it might become one. On April 3rd, Mr Pizza said the poll should go ahead—but that he must be allowed to run.

Nordic labour markets

Where bosses will be your friends

Apr 3rd 2008 | COPENHAGEN
From The Economist print edition

A desperate plea for skilled workers who can bear to stay

IT MIGHT be the endless pine forests, the locals beating themselves with birch twigs in the sauna or the odd notion of golfing in the snow. Whichever it is, the Finnish labour ministry's promotional video to attract skilled foreign workers has a ring of desperation. The video (which is available in English, Polish and Romanian) seeks to brand the country as “the cool attic of Europe” and lists Finland's attractions: high quality of life, clean air, good schools and “managers who treat workers almost like friends”.

The Finns and their Nordic neighbours have reason to worry. Figures from Eurostat show that unemployment in all the Nordic countries is well below the European Union average. In Denmark the seasonally adjusted jobless rate of around 2% is the lowest since the early 1970s. In Norway unemployment is also just over 2% (see chart).

With economies throughout the region expected to slow soon, low unemployment is not necessarily a bad thing. On the other hand, employers across the Nordic region are complaining of labour shortages and fretting about wage inflation and reduced export competitiveness.

The Swedish response has been the most radical: a proposal that will virtually guarantee entry to any non-EU worker with a job offer from a Swedish employer. Residence and employment permits, initially valid for two years, can be extended for an extra two, with the possibility of permanent status afterwards. The labour minister, Tobias Billstrom, says foreign workers are needed to counter a greying population and shrinking labour force. “We've had a one-track immigration policy. The only way to get into Sweden since the 1970s has been as an asylum seeker,” he notes. Norway has also simplified the rules. Previously, foreign workers faced weeks of waiting to have their papers processed. Now they can start work as soon as they have lodged their properly filled out applications.

Yet opening doors and cutting paperwork might not be enough. All Nordic countries have a big problem attracting and retaining the most skilled foreign workers. Some 120,000 foreigners have jobs in Norway, for example, but only a small minority are highly skilled. The directorate of immigration can let in 5,000 highly skilled workers from outside the EU every year, but the annual quota has never been filled. The Danes, too, have difficulties attracting skilled workers. Denmark's new plan to introduce a points-based green-card scheme might woo some engineers and IT wizards, but will it induce them to stay? New figures from the Danish Economic Council, a government-sponsored think-tank, show that 20% of foreign workers leave within a year, and 40% go within two years.

Observers' explanations for this range from the prosaic (dismal weather, difficult languages) to the political (perceptions of hostility to foreigners). But it adds up to the same conclusion: enticing skilled foreigners to the Nordics is a tough job.

Belarus

Dark dance

Apr 3rd 2008
From The Economist print edition

What is going on in Belarus? And in its ruler's head?

AMERICA calls it the “last dictatorship in Europe”. It has political prisoners, police crackdowns, state-run media and a security service called the KGB. So Belarus's image could do with polishing. Its irascible president, Alyaksandr Lukashenka, seems to accept this: Tim Bell, one of Britain's top public-relations men, was recently seen in Minsk, where he was in talks about a consultancy contract. As a Tory spin-doctor, he helped turn Margaret Thatcher into an election-winner. As Lord Bell he represents rich eastern Europeans such as Boris Berezovsky, an émigré Russian oligarch.

Eyevine

Lukashenka: a hard sell

Mr Lukashenka's opponents have highlighted the irony that Lord Bell's visit was followed by a blitz on the opposition. Over 20 journalists from Belarus's independent media (chiefly foreign-based radio stations and small-circulation papers) were detained. The ostensible reason was an investigation into insulting cartoons of Mr Lukashenka on the internet. Defaming the president is a criminal offence.

On March 25th the police violently broke up an opposition rally to commemorate the 90th anniversary of Belarus's short-lived statehood after the first world war. Around 80 people were arrested. Opposition activists were harassed as well: in Vitebsk, Yelena Borshchevskaya, a schoolteacher, was marched from her school by KGB officials and taken home, where they undertook a six-hour search in which they confiscated computer equipment, storage materials and a photocopier, as well as an identity card belonging to Olga Karach, a local politician.

Shortly before the latest crackdown, Mr Lukashenka had ordered the American embassy in Minsk to cut its staff by half. On March 31st Belarus announced that it was reducing the size of its embassy in Washington and would expect America to make further cuts too.

Yet only a few weeks ago Mr Lukashenka had seemed to be going in the opposite direction, putting out feelers to the West, allowing the European Union to open an office in Minsk and releasing all but one of his political prisoners. That reflected official nerves about an economic squeeze by the Russians, who are driving a hard bargain on gas. Russia has little sympathy for Mr Lukashenka's swaggering and bombastic ways.

American sanctions on Belarus's main petrochemical company may have provoked the sharp response against their embassy, but they do not explain the wider crackdown. Some say there is a feud in Mr Lukashenka's circle, between those who want to keep control and those who think their only hope is rapprochement with the West. Or it may reflect the Belarusian leader's capricious thought processes. Lord Bell is used to difficult clients, but Mr Lukashenka may prove a tough challenge even for him.

Charlemagne

The perils of three-legged races

Apr 3rd 2008
From The Economist print edition

Illustration by Peter Schrank

The futile notion that Europe can be run by its top trio

HOW the British press swooned when Carla Bruni came to town on March 26th and 27th. Glamorous in grey, pretty in purple, sleek in her evening gown, the Italian model-cum-singer managed to charm equally the dour politicians and the ageing royals whom she met. It was a remarkable transformation: from rock chick to the new Jackie Kennedy in one elegant step.

Ms Bruni brought her husband to London, too. And though he received less (and less fawning) coverage, the French president, Nicolas Sarkozy, proved to be a bit of a seducer himself. He solemnly informed the British Parliament that “within these walls...modern political life was born.” He asked rhetorically if parliamentary democracy could ever have existed without Britain. He insisted that France would never forget what it owed the British people during two world wars. He praised Britain's economic reforms. And he wound up by calling for a new Franco-British brotherhood.

To celebrate the new spirit of *entente amicale*, Mr Sarkozy went on the next day to kick a football towards an awkward-looking Gordon Brown at Arsenal's Emirates stadium. The two leaders agreed to establish a network of new bilateral contacts, ministerial meetings and official exchanges, consciously modelled on the structure that underpins the Franco-German relationship. Cue some excitable talk in Downing Street of a new Franco-British motor to propel the European agenda—starting under the French presidency of the European Union in the second half of this year.

The Germans were not amused. Mr Sarkozy has learnt nothing from previous botched attempts to construct an alternative to the Franco-German engine in Europe, sniffed the *Süddeutsche Zeitung*. The mood in Berlin is edgy partly because German officials are acutely aware of the bad relations between Mr Sarkozy and Chancellor Angela Merkel. The two leaders have temporarily patched up their spat over Mr Sarkozy's planned Mediterranean Union, a glorified club that he originally wanted to create for all countries on the Mediterranean littoral (ie, not Germany). But there is no longer even a pretence that they will be able to build the sort of close friendship that was eventually formed by such predecessors as Gerhard Schröder and Jacques Chirac, or Helmut Kohl and François Mitterrand.

Hence the glimmering in London of a new role for Britain. In headier versions, there are some who dream of replacing Germany as France's principal partner in the EU. But a more realistic ambition is to establish new trilateral relations. After all, Mr Sarkozy himself repeated in London what he has often said before: that the Franco-German engine, though still essential, is no longer enough to drive Europe forward on its own.

What might replace it? Except for the special case of defence, where Britain and France are the only two

European countries with serious global aspirations, it is hard to imagine anything working without Germany, the biggest EU member, the main paymaster and the hinge between western and eastern Europe. Moreover, Ms Merkel showed during her own EU presidency last year a deftness for compromise that is lacking in either Mr Sarkozy or Mr Brown.

Trilateralism has been tried before. In late 2003 and early 2004 Mr Chirac, Mr Schröder and Tony Blair held two formal summits and even agreed to turn them into regular events. But the process died almost as soon as it began, for two reasons. First, the three leaders fell out: initially over the choice of a new president of the European Commission in mid-2004, and later when Mr Blair upset Mr Chirac by announcing without warning that Britain would hold a referendum on the draft EU constitution. Second, the other EU members, especially Italy, Poland and Spain, began to complain loudly about the dangers of a three-way *directoire* that would sideline normal EU institutions such as the European Council.

Two's company, three's a crowd

The same troubles would surely blight any new attempt at trilateralism. Charles Grant, director of the Centre for European Reform, a London-based think-tank, suggests that it might play a role in foreign policy. The three already steer European policy on Iran, for example. But for internal EU business he sees two big problems, besides the objections of other members to being told what to do. One is the poor relationship between Ms Merkel and Mr Sarkozy. The other, perhaps more intractable, is the disengagement of the British government. Mr Brown himself has made only a couple of brief forays to continental Europe as prime minister. In Berlin officials sometimes call him the “hermit of Downing Street” (if they find Mr Brown tricky, they should just wait for David Cameron to take over).

Disengagement reflects some fundamental differences. In London Mr Sarkozy talked up reform of the common agricultural policy, for example, but when it comes to detailed discussion of EU farm subsidies or Britain's budget rebate, the British and French are likely to be at loggerheads. It is a similar story when it comes to industrial policy, economic nationalism and energy deregulation. For all Mr Sarkozy's praise of the British economic model, neither he nor Ms Merkel is pushing big liberalisation—and, given the gloomy outlook for the British economy, they may feel under less pressure to learn from its success.

The deeper point concerns Britain's semi-detachment from the European project. This is not just a question of non-participation in the euro, the Schengen passport-free zone or EU justice and home-affairs policies. It is also that, whereas the French and German establishments see a need to agree and even to compromise so as to promote a common European agenda, the British do not. On issue after issue, they would be happier if the EU simply went away. It is hard to combine that sort of attitude with a desire to sit in the driving seat.

Electricity

Green and black

Apr 3rd 2008
From The Economist print edition

A looming supply crunch causes problems for a government with green ambitions

Bridgeman Art Library

RHETORIC is a sad fact of political life, and most voters are smart enough to know that grand promises made in the heat of a parliamentary debate or an election battle should be taken with a pinch of salt. But on energy policy the gap between claim and reality is now wide enough to be embarrassing. Grandiose pronouncements about climate change ("our greatest obligation to future generations", according to Alistair Darling, the chancellor of the exchequer) stand incongruously next to Britain's anaemic record on cutting its greenhouse-gas emissions, which have stayed stubbornly unchanged for years.

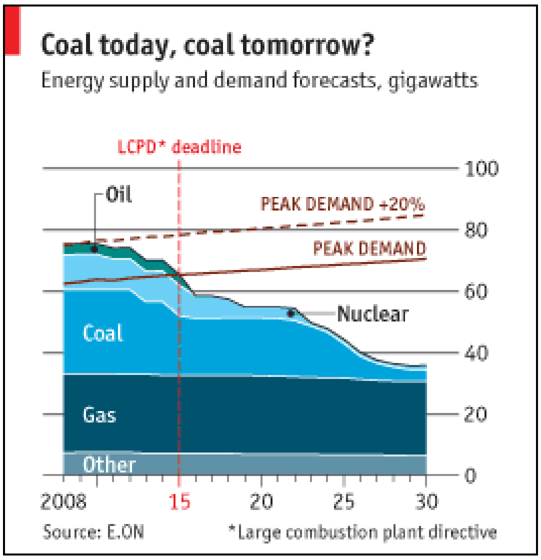
That has led to much rancour, with greens accusing the government of "betrayal". And in the midst of all this acrimony another problem looms: Britain is beginning to run short of electricity. Reversing this trend seems likely to turn up the heat even more.

Two things explain why the situation is growing acute. The first is that Britain's nuclear reactors, which supply just under a fifth of its electricity, are old. Most of the 1950s-vintage Magnox stations are now shut, with the final two due to close over the next two years. Four years later the first of the newer gas-cooled reactors will begin to close. After 2023 only one nuclear plant (at Sizewell in Suffolk) will still be working. And although the government wants a new set of nuclear plants built, even the most ardent atomic optimists reckon that it will be at least ten years before they begin to come online.

Many coal plants will also have to close, thanks to Europe's Large Combustion-Plant Directive, which requires operators to scrub sulphur dioxide and oxides of nitrogen more efficiently from power-station chimneys. But the kit is expensive and some may simply close rather than install it. The rules, which came into force on January 1st, allow non-complying stations to run for 20,000 hours or until 2015, whichever comes first. And those hours are being used up already, as the high price of natural gas makes burning cheaper coal attractive now.

This looming double whammy has led to forecasts of shortages as the amount of spare capacity in the system drops. Engineers reckon 20%, roughly the figure today, is a comfortable margin. E.ON, a German firm that runs power stations in Britain, forecasts that, in the absence of new power stations, the margin will have eroded entirely by around 2015 (see chart). A report prepared for the government estimates, under gloomy assumptions, a 70% chance of at least one blackout in 2012 even with new capacity. Another, from Inenco, an energy-analysis firm, predicts tight supplies from 2015, with capacity falling behind demand in the worst case. Not everyone agrees: Rob Gross, an energy expert at Imperial College, London, thinks blackouts are an unlikely worst-case scenario. But no one disputes that things are getting unpleasantly tight.

There is less agreement about what should be done. The market is beginning to react: several new gas-fired power stations are on the drawing board. Advocates point out that they are cheap, quick to build and relatively clean. But with gas already making up 40% of Britain's electricity generation, putting more eggs into that basket could be unwise, says Paul Ekins, an economist at King's College, London—especially since declining North Sea production means importing gas from abroad. Renewable energy may help, but capacity remains low despite ambitious targets. And it is hard to use intermittent energy sources such as wind to guarantee that the lights will stay on.



Some see a return to coal as the only solution. It is available from stable, friendly countries such as Australia, the technology is well understood and it has political backing: the 2006 energy act promised a future for the black stuff in Britain. E.ON is planning the first new coal station since 1986 on its site at Kingsnorth in Kent. It has won permission from the local council and is waiting for the go-ahead from Whitehall. Should it get the green light, several other plants might well follow.

Coal may be secure, but it is also dirty. Environmentalists, aghast at the idea of a coal revival, are furiously lobbying ministers to sink Kingsnorth. E.ON's offices were blockaded by protesters on April 1st, and the Camp for Climate Action (which set up shop near Heathrow last year) plans to pitch its tents at Kingsnorth this summer.

To ministers' relief, there may be a way to benefit from coal's security without suffering from its dirtiness. Carbon capture and storage (CCS) is a technology that aims to siphon off planet-heating carbon-dioxide and store it safely underground, probably in depleted oil and gas fields. E.ON has tried to mollify environmentalists by entering Kingsnorth in a government-sponsored competition designed to prove that the idea works. Its offering looks impressive, with partners signed up for each stage of the process from capturing the carbon in the first place to piping it out to the North Sea and burying it.

But greens are unmoved. They point out that the competition covers only plants with capacity up to 300MW. Kingsnorth would consist of two units producing 800MW each, meaning in effect that less than half the emissions from half the station would be sequestered. Paul Golby, E.ON UK's chief executive, says the rest of the plant will be “capture-ready” so that CCS equipment can be installed once it is commercially available. But with even optimistic projections suggesting that CCS is years from the market, that pledge does not reassure environmentalists, who worry that vague promises of CCS will be used to buy off objections to other coal plants too. “‘Capture-ready’ is a helpful political concept,” says Martin Brough, an energy-watcher at Oxera, an economics consultancy. “It allows ministers to avoid saying that there is a blunt trade-off between security of supply and greenhouse-gas emissions.”

A few greens admit, privately, that if CCS could be made to work, their objections to coal would disappear. But the government's record inspires little confidence. “It's all just hot air,” says one. “The world has enough of that already.”

Terminal 5

Still a mess

Apr 3rd 2008
From The Economist print edition

Heathrow secures its place as the rich world's least-liked airport

THE horror that is Heathrow continues. The crowded airport's gleaming new Terminal 5 opened on March 27th, and in its first eight days around 430 flights were cancelled and some 20,000 bags separated from their owners.

Reuters

A long way to Tipperary

Blame has fallen on BA's staff, who were unprepared for the big event (and possibly disinclined to go out of their way to make their employer, with which unionised workers have long had a testy relationship, look good). And the terminal's supposedly superfast baggage-handling equipment—for which BAA, the airport's heavily indebted owner, is also responsible—proved anything but efficient. BA had already managed to score worse than any other European airline in 2007 for losing or delaying bags. After a week of misery, it has now decided to outsource the problem of sorting and returning much of the current mountainous pile to centres in Milan, Manchester and Edinburgh.

Most big new airport facilities—not only in Britain—have teething problems, and BA claims to be getting on top of these. It had cut the baggage backlog to 14,000 by April 3rd, for example. But the timing could not have been worse for the airline.

Those arguing for expanding the airport's runway capacity—mainly businesses and BA itself—have been made to look deluded. The government has been pushing for it and a decision is due soon, but meanwhile Ruth Kelly, the transport secretary, has steered clear of Terminal 5. The Conservatives, for their part, seem to have grown a bit more sceptical: on April 2nd their transport spokesman, Theresa Villiers, said that the case for expansion had not yet been made.

BA would do well to take note of another development too. The transatlantic routes from Heathrow are no longer the preserve of a select four airlines. On March 31st Air France-KLM became the first European airline to begin service from Heathrow to America under the new "open skies" agreement—and at a very competitive price. The ancient and clapped-out Terminal 2, from which it flies, has never looked so inviting.

Credit squeeze

Lessons of history

Apr 3rd 2008
From The Economist print edition

The Bank of England needs above all to restore financial confidence

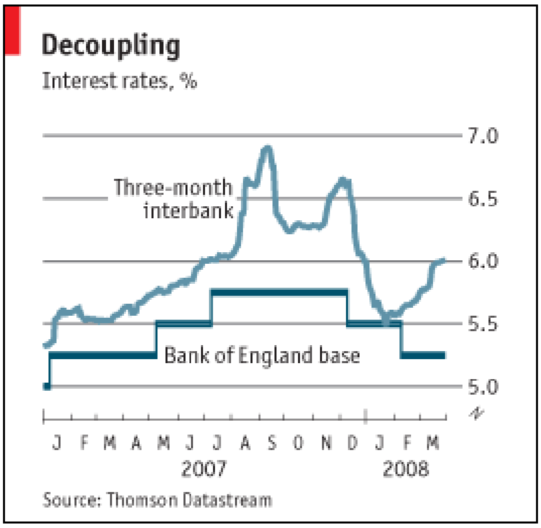
THE banking crisis that started last August has been an unnerving mix of the new and the old. Mystifying financial products have tripped up even their clever inventors. Yet there have also been eerie historical parallels. In Britain, the crisis featured the first bank run since Victorian times. In America, an imperative has been to prevent the banking collapses that caused the Depression of the early 1930s.

Of the three central banks thrust centre-stage in handling the crisis—those in America, Britain and the euro area—the Bank of England might have been expected to rise most to the occasion. Founded in 1694, it has centuries of experience in dealing with financial troubles, not least in acting as a lender of last resort. In the first half of the 19th century, and arguably earlier, the Bank of England made cash available to illiquid but solvent banks. The core central-banking doctrine of lending freely though at a penal rate during a financial panic was set out by Walter Bagehot, an early editor of *The Economist*, in “Lombard Street”.

Yet despite its venerable pedigree it is the Bank of England that has at times seemed the least sure-footed of the three central banks. When the turmoil began in August, it adopted a tough line and made no extra funds available that month to cash-starved banks. Mervyn King, the central bank's governor, seemed to put greater stress on averting future “moral hazard” for banks—taking more risks if they knew the authorities would mop up any mess—than on tackling present dangers.

Tensions between the Bank of England and the banks on its patch had nonetheless eased by the start of this year. This was partly because in December its monetary-policy committee (MPC) cut the base rate, which sets the cost of overnight funds, from 5.75% to 5.5%. More important, the money markets in which banks borrow on longer terms were working better. The gap between the three-month interbank rate, at which banks lend to one another, and the base rate had opened up to an extraordinary extent last year (see chart). By late January it had closed.

Since then the gap has re-opened with a vengeance. The MPC cut the base rate again in February, to 5.25%. But the three-month interbank rate soared, reaching 6% by the end of March, and credit conditions have accordingly tightened despite the lower base rate. The squeeze in the mortgage market has intensified as lenders have raised rates and toughened terms. Figures published this week showed that the number of loan approvals to buy homes was almost 40% lower in February than a year before.



A survey of credit conditions by the Bank of England released on April 3rd suggests that there is more pain to come. Lenders said they were planning to reduce the availability of mortgage loans over the next quarter even more than they did in the three months to mid-March. Companies will also find it harder to borrow.

Britain is not alone in experiencing renewed stresses in the money markets, which have sprung from increased anxiety about banks' creditworthiness. The spreads between three-month interbank rates and expected central-bank policy rates have also risen in America and the euro area. But the gap widened most in Britain between early February and the end of March, points out Laurence Mutkin of Morgan Stanley, an investment bank.

One step the MPC can take is to reduce the base rate when it meets on April 10th. Two of its nine members already voted for a quarter-point cut in March. But the most important thing the central bank can do is to ease tensions in the money markets and reduce the effective cost of money.

The Bank of England has moved a long way from its stony stance last summer, when it argued that there was little it could do to affect three-month interbank rates. In a joint initiative with other central banks in December, it said it would offer funds at this maturity in two monthly auctions, each worth £10 billion ($20 billion). It also widened the category of assets banks could advance as collateral to include top-rated mortgage-backed securities. The medicine helped, if only for a while.

Since then the bank has conducted a third auction in March and confirmed a fourth in April. But when banking chiefs met Mr King on March 20th, they asked him to do more. In a nutshell, they want the central bank to make more money available at longer maturities and against a wider range of collateral. Above all, they want it to take the lead in restoring confidence to the financial system.

The bankers' pleas have not fallen on deaf ears. In a speech on March 31st, Mr King said that banks would in future have to hold more capital and liquid assets. But in the meantime, central banks were “currently at the heart of efforts to restore confidence in the banking system by the provision of liquidity against assets which have proved to be highly illiquid”. That sounds as if more help is on the way. As Charles Kindleberger noted in his history of financial crises, “Today wins over tomorrow.” It is a lesson that the Bank of England seems to have had to learn all over again.

Children's books

Decline of the picture book

Apr 3rd 2008
From The Economist print edition

Why storytime may be ending for British children

THE children's book fair in Bologna this week was full of the bubble and squeak that such events elicit. But a serious sub-theme lurked: how to revive picture books, those lavishly illustrated creations that teach children to love books long before they can read them.

Britons have been market leaders in the field since Kate Greenaway filled books with her delicately garbed girls in the 1880s and Beatrix Potter came up with Peter Rabbit 20 years later. Modern stars include Julia Donaldson, of “The Gruffalo” fame, and Michael Rosen. But a growing number of writers and illustrators warn that British picture books are now in danger.

All publishers find it hard to deal with cut-price internet selling, harder-nosed high-street booksellers and people's increasing reluctance to read. Picture books have a particular problem: they cost a bomb to produce, and unless they are seen and handled, their price can seem prohibitive. Sales in Britain dropped sharply last year, bookstores say, and so has shelf-space for them.

So most picture books cannot be published for British readers alone—but the international market is less welcoming than it was. Americans are favouring home-grown talent, says Wayne Winstone, who sells children's books, and eastern Europeans and Asians are developing their own distinctive styles of illustration. Michael Rosen blames the obsession with synthetic phonics for reducing children's reading horizons to badly drawn leaflets. For Jane Ray, an illustrator, a “culture of safety” among publishers has much to answer for.

Not all are quite so gloomy. The Booktrust, a charity, has launched the Big Picture campaign to raise the profile of picture books. At the Illustration Cupboard, a London gallery, John Huddy reckons the market is correcting itself, rooting out inadequate contenders. Panicky book folk may be talking their business down—but new ways to sell cheaper products across borders must certainly loom.

Northern Rock

What lies beneath

Apr 3rd 2008
From The Economist print edition

The nationalised bank's mortgage book looks less than healthy

ENTOMOLOGISTS often turn over rocks with trepidation, wary of what they may find lurking beneath. It was in a similar spirit that taxpayers took their first proper look this week at the sorry state of Northern Rock, a bank eventually nationalised in February after it ran out of cash last autumn. The delayed annual report did little to inspire confidence that the mortgage lender can be restored to profitability quickly. Taxpayers seem unlikely to get all of the £27 billion ($53.5 billion) that Northern Rock owed them at the end of 2007.

Thousands of shareholders may have lost their investments and many of the bank's employees are likely to lose their jobs, but Northern Rock's boss collected a bonbon. Adam Applegarth, the bank's former chief executive, was given a pay-off of close to £1m after he resigned. It was a pittance, perhaps, by the standards of Wall-Street's ex-bosses, but it provoked anger. Trade unions and shareholders complained, and Vincent Cable, deputy leader of the Liberal Democrats, called the payment an outrageous reward for failure.

The row about Mr Applegarth grabbed the headlines, but the real cause for worry is what the report revealed about the bank's inner workings as it careered towards disaster last year. Whereas many of its rivals were slowing their lending and looking for safer customers, Northern Rock had put the accelerator down and was taking on ever-riskier clients. The value of loans on its books worth 95% or more of the property's value almost doubled; indeed, those worth more than the home quadrupled. By contrast the value of the least risky loans (those worth no more than 70% of the property's value) rose by a relatively sedate 20% from the end of 2006.

Northern Rock's rush to write risky mortgages also embraced the buy-to-let market. In recent years banks have done well out of such loans because landlords have benefited from a rising property market. Few have fallen behind on their repayments because most could sell properties easily if trouble loomed. But the buy-to-let market may be especially vulnerable to a downturn. Estate agents reckon that many landlords are letting out properties at a loss and that the value of newly built flats is plummeting. “In Manchester and Birmingham you've got whole blocks of city-centre flats being filled up with students paying almost nothing because it's that or letting them stand empty,” says one agent.

Northern Rock's lax approach to risk is causing its loan book to sour. The share of mortgages on which customers have missed payments for three months or more rose to 0.57% during the year. This is still lower than the industry average of 1.1%, but it is rising four times as quickly.

More worrying still, Northern Rock's repossession of homes is three times the average, and its losses on loans (as a portion of the total) more than doubled last year to 0.26%. That may seem low but the bank was sailing so close to the wind, making a profit of less than half a penny on every pound it lent, that even small changes in how much it writes off determine whether it makes a profit or a loss.

Things are likely to get worse rather than better. If the nationalisation is to comply with European rules on state aid, designed to prevent unfair competition, the bank must shrink significantly. To do so, Northern Rock is telling customers to go elsewhere and moving them along by offering a poor deal. But with money tight, other banks are being picky about taking on new borrowers. On April 2nd First Direct, part of HSBC Holdings, Britain's biggest bank, closed its doors to new mortgage customers. In time Northern Rock's least risky borrowers should be able to move, but the ones who flunk other banks' credit-scores will stay on its books.

Many had hoped that Northern Rock's nationalisation would draw to a close a sorry chapter in the history of British banking. In fact the bank's tale of woe may only have begun.

Immigration and the economy

Gross domestic problem?

Apr 3rd 2008
From The Economist print edition

The pie has got bigger, but more people are taking a slice

SIX billion pounds is, as Britain's immigration minister Liam Byrne put it, “a big number”. This figure is the amount that the government reckons was added to the economy by immigrants in 2006, and a number that it has repeatedly used to justify the record numbers of migrants that Britain has absorbed in recent years.

But there is another big number: 190,000. That is the amount of net immigration that Britain can expect to receive each year unless the government tightens things up, according to a report published on April 1st by the House of Lords economic-affairs committee. Their lordships put these two big numbers together and calculated that they pretty much cancelled each other out. Gross domestic product (GDP) may have grown handsomely thanks to migrants, they said, but GDP per head—each person's share—has hardly budged. Using bald GDP growth to justify immigration was “preposterous and irrelevant”, the committee's chairman said.

Strong words, and manna for migration sceptics (“Immigration: the great lies”, trumpeted one newspaper, thrilled). The report was actually more balanced than that. It found evidence that immigration had pushed down the wages of the lowest-paid by a fraction but higher-paid people had experienced a small fillip. As far as competition for jobs was concerned, it pointed out that the number of vacancies is about the same now as it was seven years ago, since migrants create jobs as well as taking them. Immigration is pushing up house prices, it observed, which may be good news for some of those who are most vocal about the downside of open borders. And it heard evidence that migrants may push down the “natural” rate of unemployment, since they are more flexible than sluggish Britons about which jobs they take. (“This effect may, however, decrease...as migrants become more like the native population,” noted Stephen Nickell, an economist who gave evidence to the committee.)

This was not, all in all, a bad-news report. But the problem for the government is that it has relentlessly made the case that the economic benefits of migration are vast, in order to buy off those who don't like its social effects. The suggestion that the pay-off is merely neutral is therefore quite a blow. The government's own calculations value the benefits of immigration to Britons at about £30 ($59.4) per person per year. That is not much of a bribe for people who reflexively dislike it—and there may be more of them about. Immigration has raced up voters' worry lists over the past two years and now vies with crime for the top position, according to Ipsos-MORI, a pollster. Some 68% believe that Britain has too many migrants.

But it is hard to cut back. The Lords recommended an annual cap on migrant numbers, a policy that the Conservatives have been plugging as part of a commitment to “substantially lower” immigration. The Liberal Democrats would cut down too but, like the government, they want to tighten the criteria for work permits rather than define a ceiling.

In truth, most immigration to Britain is out of any government's hands. EU citizens, who make up nearly 30% of net immigration, may come and go as they please. (Numbers will increase when Romanians and Bulgarians are given the right to work in Britain, which must be granted before 2014.) Asylum-seekers are entitled by UN conventions to a fair hearing, and the government cannot stop its citizens from marrying foreigners and having children with them.

Such folk account for half of Britain's annual immigration. Of the remainder, the majority are students, prized because they pay hefty tuition fees. The only category left to play with is skilled workers from outside the EU, who make up just one-fifth of all immigrants; and some of them (from American bankers to Brazilian footballers) are among the most useful. Cuts in immigration look on the cards, but it is unlikely they will be substantial.

Economist.com WORLD BRITAIN

Lobbying

Undue influence?

Apr 3rd 2008
From The Economist print edition

Probably not, but questions are being asked

LOBBYING takes its name from the hallways in Parliament, where constituents and campaigners have traditionally made their case to legislators. Yet those who practise it seldom attract the attention in Britain that they do in America. There, presidential candidates earn cheers for lamenting the grip on Washington of political consultants who seek to influence government in favour of their clients. A whole television series was devoted to the theme.

The last time lobbying in Britain received anything like the same coverage was in the 1990s: MPS were found to be taking cash in exchange for asking useful parliamentary questions, and then a former Labour adviser-turned-lobbyist was caught boasting of his access to ministers. Now it is edging back into the news.

On March 31st the House of Lords committee on members' privileges met to discuss whether an inquiry could be launched into the allegation that Lord Hoyle, a former Labour frontbencher, was paid in 2005 to introduce an arms lobbyist to Lord Drayson, then defence-procurement minister. This is not illegal but it is frowned on: Lord Hoyle should have declared to Lord Drayson that he was being paid, something he cannot remember doing. A subcommittee has been charged with investigating complaints about peers since 2002, but its five members, whose average age is 77, have yet to be tested.

In the Commons, meanwhile, the public-administration committee (PAC) has been looking since last June into the impact of lobbying on government decisions. If it decides the line between rightfully conveying constituents' views and unduly influencing those in authority is regularly breached, it may conclude that there is a case for external regulation, as in America.

Britain's lobbyists include big international companies such as Weber Shandwick, Fleishman-Hillard and Hill & Knowlton, smaller specialist firms including Golden Arrow and Munro Forster, and the in-house operations of many companies and charities. There is no way to measure their effectiveness: “even when a policy is changed in the way we wished, it is hard to be sure that it was down to us,” says a partner at one firm. But lobbyists take credit for achievements as varied as favourable pay deals for the police, changing planning law to preserve large shops on greenfield sites and keeping newspapers zero-rated for value-added tax.

Lobbyists insist that theirs is a respectable business. One reason is that the cash-for-questions affair gave rise in 1994 to a self-regulatory body, the Association of Professional Political Consultants (APPC). It forbids practices such as employing serving politicians and requires lobby firms to disclose the names of their clients and consultants. The APPC's 55 members account for four-fifths of industry turnover.

As for non-members, Peter Bingle, chairman of Bell Pottinger Public Affairs (BPPA), a leading firm, told the PAC inquiry that his firm subscribes to every part of the APPC's code except the requirement to name all its clients publicly. Most are disclosed on BPPA's website, and all are revealed to the politicians and civil servants being lobbied. But a few clients ask that their names be kept secret from the public.

Another reason is that personal contacts in government are less important than they were. Lobby firms maintain that ministers will often meet them in their own right if they can provide expertise on a particular subject and mobilise key players. And most of the services that lobbyists provide to clients these days fall under the broad title of “public affairs” or “political communications”—forecasting trends, advising on policy and teaching them to “speak the language of government”.

Nor are profit-seeking businessmen the only folk who lobby. Research by the Hansard Society, a think-tank, found that MPs are more amenable to being nobbled by charities and interest groups than by firms. Public bodies such as quangos and local authorities were second only to businesses in their use of professional lobbyists between 2001 and 2005, according to Karl Milner of the Yorkshire & Humber strategic-health authority—and that excluded the wider “intergovernmental infrastructure” such as hospitals and the BBC. Government lobbying government? Now that would merit a TV drama.

Bagehot

The hand of history, revisited

Apr 3rd 2008
From The Economist print edition

The triumph and disappointments of the Good Friday Agreement ten years on

Illustration by Steve O'Brien

THE first Catholic church to be built in Belfast stands at the bottom of the Falls Road, the main, battle-scarred artery of Catholic west Belfast, an area that Protestants once avoided. Today, almost next door, is a swanky oyster bar, patronised by both Northern Irish tribes as well as the tourists the city has begun to attract since Tony Blair felt “the hand of history” on his shoulder and, on April 10th 1998, the Good Friday Agreement was signed.

Outside Northern Ireland, the agreement is often hailed as an example of how even the most stubborn conflict may be resolved. The results have been astonishing—in the demeanour of downtown Belfast, even more so in the halting political institutions the agreement established. The Rev Ian Paisley, leader of the Democratic Unionist Party, the only mainstream party to oppose the 1998 deal, presides (until his retirement in May) over the devolved executive. His deputy is the former IRA terrorist Martin McGuinness of Sinn Fein, whose Republican ambitions once seemed irreconcilable with peace. Yet inside Northern Ireland the agreement looks like a fine example of another truth: how depressingly thankless politics can be. The intimate sectarian violence is over, but lots of people are unhappy.

They don't call it peace

The most vociferously disgruntled group are the Protestant unionists, for whom the sight of Mr McGuinness in a ministerial chair is morally repugnant. That basic unpalatability wrecked the career of David Trimble, who with the nationalist leader John Hume made the agreement possible; a settlement built by moderates ended up empowering Sinn Fein and the hitherto vituperative, medieval Mr Paisley. But the old unionist pessimism—a sense of being surrounded and imperilled—lives on. So does the atavistic fear of betrayal by the British government: no unionist politician of any stripe seems to have a kind word to say about Mr Blair. “We always knew the British were treacherous,” says one, “and we weren't disappointed.”

Outside the political class, there is a similar feeling of “being on the losing side”, as a community worker from the Shankill Road, an infamous Protestant enclave adorned with garish murals of masked loyalist commandos, puts it. In places they regard as part of their patrimony, ordinary Protestants now encounter Catholics in Gaelic football shirts. Meanwhile the Belfast shipyards, once a staple employer of Protestants, have withered (the city, one local joke runs, should put up a monument to the Unknown British Taxpayer, who continues to provide whopping subsidies to the province, its relative prosperity notwithstanding). The perception is that the Catholics have done better. In a place where old triumphs or injustices, whether inflicted ten years ago or 300, are the stuff of politics and worse, this sense of a Catholic victory is dangerous.

It is not altogether misplaced, however. In economic terms, the buoyant Catholic middle class has been the most obvious beneficiary of the past ten years: freed from discrimination, and aided by the tendency of ambitious young Protestants to leave, Catholics have leapt up the career ladder, colonising the posh villas of south Belfast. In a way, though, that may also be a worry for Sinn Fein. Now that Northern Ireland has become a meritocratic, livable place, unification with Ireland looks less urgent to some. Young middle-class Catholics, says one successful Catholic businessman, are now more likely to demonstrate against American imperialism than the British kind.

Sinn Fein also faces a broader challenge: managing the unfinished transition from terrorism to peacetime politics. In west Belfast there are discontented rumbles about the antics of local yobs—even some calls for the IRA to kneecap miscreants as they used to—and about Gerry Adams, the once-lionised Sinn Fein leader who is the local MP.

Out in the Republican heartland of South Armagh, Sinn Fein faces a different version of the same problem. The country roads are enlivened by shrines to IRA bombers and hunger-strikers, plus mysteriously grand houses reputedly bought with the proceeds of smuggling, long intertwined with paramilitarism. Last October Paul Quinn, a young man from a less-grand house, was lured across the Irish border and horrifically beaten to death—by, his family and others think, local members of the IRA. Quinn, some say, irked the IRA men in pub brawls and otherwise. Though Sinn Fein says the IRA was not involved, the crime may point to the ongoing difficulty of adjusting a movement built for and by conflict to the post-agreement reality.

There is one big and collective reason for disappointment. Belfast now feels like a cosmopolitan city, but it is still a segregated one. Protestants and Catholics may sit next to each other at work, and some of them may rub shoulders in swanky restaurants and shopping centres, but they still overwhelmingly educate their children separately, at least until university, and live in discrete neighbourhoods. The number of Gazan “peace walls”, intended to prevent petrol bombs and the like being lobbed between the communities, has actually risen since 1998.

Still, new housing has been built in the erstwhile badland along the barrier separating the Falls and Shankill roads. (In the main square of Crossmaglen, the nearest town to the Quinn family's home in South Armagh, the hated British watchtower has been dismantled, and an incongruously smart hotel has opened.) The agreement was not the beginning of the peace process; nor was it the end, as was amply demonstrated by the ensuing setbacks and missed deadlines, tantrums and threats, flexibility and dogmatism. But for all the outstanding gripes and confusions—which have consumed some of the deal's architects, and may yet undo their political successors—it did entrench peace. A decade on, it still looks like a triumph, even if not everyone in Northern Ireland sees it that way yet.

Correction: Britain and America

Apr 3rd 2008
From The Economist print edition

In our article on Anglo-Saxon attitudes ("Anglo-Saxon attitudes", March 29th) we said that Americans and Britons felt much the same about the death penalty: they were broadly against it. They do feel strikingly similarly, but not as we said. Between a quarter and a fifth are opposed, the same proportion are in favour, and around half would support the death penalty in some circumstances. Apologies. The online version of the article has been corrected.

The pope and America

Don't all hug him at once

Apr 3rd 2008 | NEW YORK AND ROME
From The Economist print edition

AP

Americans warm to Benedict—but they won't like everything he says

Get article background

SOME serious preparations have been made for this month's papal visit to the United States. For between $10 and $20, Catholic parents can buy their children a “Benny Bear”, on sale at several shops in Washington, DC—where Benedict XVI will arrive on April 15th, and be whisked to the White House by George Bush.

But will Americans find the pope more cuddly than his fellow Europeans do? By some indicators, he certainly ought to be able to count on a better reception in the United States than he gets in his home continent, where his declared aim of shoring up Europe's “Christian heritage” raises hackles in liberal and secularist circles.

Whether or not they have paid close attention to his ideas, many Americans like the pope. A poll for the Knights of Columbus, a Catholic fraternity, showed that 58% of Americans took a favourable or very favourable view of him (though an even bigger share, 65%, admired the Catholic church in general). Since barely a quarter of Americans call themselves Catholics, Benedict must have a large contingent of non-Catholic fans in the United States.

Two related factors seem to be boosting the pope's American ratings. For anyone who takes the conservative side in America's culture wars, the pope's defence both of traditional social values and of old-fashioned intellectual excellence has obvious appeal. And for people who believe that the ideas of “dead white males” of centuries past are still worth studying, he is a natural hero. He may find all that a nice change from his home city, where he recently had to cancel a lecture at a Rome campus because of protesters who called him a science-hating obscurantist.

The second factor at work is the pope's image in the United States as one of those rare Europeans who takes a rigorous view of Islamic fundamentalism. The most quoted part of the pope's Regensburg speech in 2006—in which he implied that Christianity is rational in a way that Islam is not—was a synthesis of several ideas that conservative Americans (by no means all religious) hold dear. In the words of George Weigel, a Catholic thinker on America's ideological right, the pope's “challenge to reconnect faith and reason resonates with everyone...who understands that a disconnect between faith and reason is at the heart of jihadism.”

Then there is the fact that on Easter Saturday, Benedict publicly baptised an Egyptian-born journalist, Magdi Allam, who then unleashed a tirade against Islam. The gesture dismayed many Muslims (including those engaged in a formal dialogue with the Vatican); but it will have done the pope no harm in middle America.

On another touchstone issue for Islamic-Western relations, the Vatican has yet to express a view on a new film by Geert Wilders, a maverick Dutch politician, which excoriates Islam. The movie has been deplored by the (mainly Protestant) World Council of Churches.

But is it the real Benedict conservative Americans are hugging tight, or a caricature of him that they have sewn together? People are arguing already about the meaning of his appearance at the United Nations on April 18th. For liberals, this may be the time when the visitor gives right-wing admirers a cold shower by reminding them of the Vatican's opposition to the Iraq war.

Moreover, they point out, Benedict is a defender of a Catholic social doctrine, and an economic world-view, that in American terms sound quite socialist. And he will surely use his UN address to affirm his support for the world body, and more generally for multilateral diplomacy. “It's a stretch for the neoconservatives to recruit the pope as the leader of the war on terror, and it's also a stretch to associate him with the uncritical acceptance of capitalism,” says Paul Baumann, editor of *Commonweal*, a (liberal) Catholic magazine.

But American conservatives are insisting that the assault on Saddam Hussein, at least, is not going to come between them and their pontiff. As Mr Weigel puts it: “The Vatican and the United States are now on the same page on Iraq—the job is to bring into being an Iraq that is safe for pluralism, including religious freedom.”

Only relative agreement

Look more closely at some of the pope's views, and there are items which conservatives and liberals alike may find uncomfortable. Despite his reputation as a critic of the Muslim faith, he has also made clear that he sees a reformed Islam as a potential ally in challenging the “dictatorship of relativism”. That view gets an occasional airing in the American press but it has become a hard corner to fight in a time of general suspicion towards Islam.

Equally abrasive, to some American ears, is the pope's insistence that not all forms of Christianity (let alone all religions) are equally valid. His American itinerary includes a multi-faith consultation in Washington. But compared with his predecessor, John Paul II, he seems warier of ceremonies or events that might imply that all paths to God are fine and dandy.

The American Protestants who join him for an act of pan-Christian worship in New York will like the pope's line on social issues, from abortion to homosexuality. But they may dislike his view that a Christian community isn't really a church without a traditional view of the sacraments.

And in his dealings with American Judaism, Benedict will tread on thin ice. He has won credit with his courteous intellectual exchanges with Jacob Neusner, an American Jewish scholar whose work is cited in the pope's recent book on Jesus. But as Mr Neusner has said, this relationship rests on respect for deep divergences. The Jewish writer has studied the claims of Jesus to override an earlier view of religious law, and rejected them; the pope naturally takes the opposite view, though he finds Mr Neusner's methodology useful.

On another front, Jewish Vatican-watchers are expecting some move from Rome to counter the negative impression created when the pope reauthorised an old Latin Mass that includes a prayer for the Jews to recognise Jesus as the Messiah. Mr Neusner has defended the Catholics' right to use this prayer, but his friend Benedict cannot count on similar emollience from other prominent American Jews.

Election outcomes

When voters settle nothing

Apr 3rd 2008
From The Economist print edition

Why more and more ballots are inconclusive

AP

Electoral passions in Pakistan

“PEOPLE have given their verdict, we respect it.” When, in February, a spokesman for Pakistan's ruling party made that stoical analysis of a parliamentary election, cynics braced themselves for a long struggle: despite his party's self-denying words, President Pervez Musharraf would resist all efforts to dislodge him. And that is what has happened.

Whatever the final outcome of last weekend's ballot in Zimbabwe, it too could be followed by an ever-lengthening set of wrangles that determine nothing quickly. In a typically inconclusive election, results take ages to trickle out, the outcome is disputed by the opposition and by foreign observers; and, most important, the outcome is (at best) one element in a broader political settlement, or (at worst) a catalyst for even more power struggles.

In theory, votes should be decisive. People are consulted; a new government is formed; the losers accept the result and political discussions begin again on a new basis. The recent elections in Spain, Taiwan and Malaysia conform to that ideal.

But even in the most stable countries, it does not always happen that way. In rare cases, voters are so evenly split that they cannot decide who should form a government—as happened in America's 2000 presidential election. But normally vote tallies and the shape of the new government are clear pretty soon. And that is true even in countries with proportional representation and traditions of coalition-building. People in such places can usually guess who will head the new coalition and what its overall complexion will be.

Recent months have seen an increasing number of elections in which the vote itself is only a small factor in the eventual outcome. The Kenyan poll in December 2007 is the best case. There was a vote and, in principle, a new government. But the link between the two was tenuous. Tribal violence, internationally sponsored power-sharing talks and constitutional amendments had as much to do with the shape of the deal as the election did.

This was an extreme case, but not a unique one. Two recent polls in the Caucasus failed to bring stability: after Georgia's presidential race in January, the opposition staged a hunger strike to contest the results. A far bloodier outcome followed Armenia's ballot in February: eight people were killed when the police laid into supporters of an aggrieved opposition.

Two parliamentary elections in Asia—in Thailand in December 2007, and then Pakistan's—have helped to remove the power base of military dictators but left a lot of what might be called ordinary politics undecided. If you include Belgium, where a new government took nine months to settle and seems to have been formed with scantish reference to the poll result, you find that of 21 countries which have elected new governments in the past four months, the result of the vote itself was less than decisive in at least six.

The number seems to be rising. In 2006, four or possibly five elections fell into the “inconclusive” category: parliamentary votes in Thailand and Fiji were both overridden by the army; a general election in the Czech Republic produced a long stalemate; the presidential election in the Congo was disputed, though eventually accepted. The loser also disputed Mexico's presidential result and staged street protests, though the Federal Electoral Tribunal confirmed the outcome. There were 70 national votes for president or parliament that year (excluding referendums).

The year 2000 saw roughly the same number: the American presidential election, plus five other such votes, out of 64 in total (the others were in Thailand again, Peru, Côte d'Ivoire, Ethiopia and Serbia). Going back further, all but three of the 48 national elections held in 1990 had clear, accepted results (exceptions were Myanmar, Grenada and Suriname). In 1980, all the national elections were decisive.

So the number of inconclusive elections seems to be rising. Why? One simple answer is that there are more elections now, and that some go off at half-cock. According to Freedom House, an American think-tank, the number of electoral democracies has risen from fewer than 70 in the 1980s to almost 100 in 1992 and to 121 in 2007. Many recent polls took place in new democracies where those in power are reluctant to step down (because ceding power risks losing everything) and opponents balk at accepting the result because they (rightly) mistrust their rulers.

Another factor: the prevalence of election monitors may have changed the way elections are rigged. Instead of claiming to have won by 99% before lunch, new democracies put on a show of sophistication and claim modest victories by, say, 53% to 47%. (Sceptics note that 53% was the winning share claimed in both Armenia and Georgia; but in the Georgian case observers did agree that the incumbent, Mikheil Saakashvili, had clearly topped the poll.)

When the margin is slim, counting disputes increase and challenges are more likely. Sometimes this produces dramatic outcomes: the uprisings in Georgia, Ukraine and Kyrgyzstan in 2003-05 all sprang from disputed polls. And sometimes it merely prolongs political machinations.

Elections, in fact, are just one part of the network of institutions (like honest courts) that need to be in place for democracy to work properly. Without those institutions, voting sometimes seems, at least in the short term, to make things worse.

The NATO summit

With allies like these

Apr 3rd 2008 | BUCHAREST
From The Economist print edition

The world's mightiest defence club fractures over plans to expand

THE NATO summit in Bucharest was meant to be a celebration of France's full return to the fold and a show of long-term commitment to stabilising Afghanistan. Instead it turned into a particularly rancorous dispute about matters closer to home: how far and how fast NATO should continue to expand, and how it should deal with a more aggressive Russia.

Illustration by Claudio Munoz

The meeting became a battle of wills between Angela Merkel, the German chancellor, cast in a naysaying role that is usually reserved for French leaders, and George Bush, attending his last NATO summit and hoping to be remembered for extending “the circle of freedom”.

On the face of it, the issue was arcane: whether Ukraine and Georgia should be upgraded from “intensified dialogue” with NATO to a “membership action plan” (MAP), essentially a promise to join NATO after meeting a set of political and military benchmarks. But to many, particularly America and ex-communist states, this was a question of principle: NATO had to keep its vow to welcome fragile democracies, and should give no veto to Russia, especially in its current aggressive mood.

Germany says Russia's president-elect, Dmitry Medvedev, should get time to settle in without being forced into a spat with NATO. “What is the rush?” asked one senior official. Earlier the French prime minister, François Fillon, said his country opposed granting MAP “because we think it is not the right response to the balance of power in Europe”. Britain, too, was sceptical. But observers reckoned that, should Germany yield to American pressure, other resistance would melt.

At a bad-tempered foreign ministers' meeting on the opening night, Germany's foreign minister, Frank-Walter Steinmeier, told colleagues Georgia would not be fit to join until it had resolved the “frozen conflicts” over two Russian-backed statelets on its soil. Condoleezza Rice, his American opposite number, retorted that these conflicts were “not Georgia's problem, but Russia's”. She added that Germany's own NATO membership in 1955 had come at a time when that country was divided.

After much haggling, the allies declared that the two countries “will become members of NATO” eventually—but that a decision on MAP would only be taken by foreign ministers in December. Even that could be a humiliation for the Georgians, whose volatile president, Mikheil Saakashvili, privately compared anything short of MAP to appeasement of the Nazis.

Even the enlargement that was supposed to be straightforward—expanding membership of NATO (and later of the European Union) to the Balkans—turned ugly because of an old row over Macedonia's name, shared by a Greek province. Macedonia had agreed to the formulation “Republic of Macedonia (Skopje)”; Greece wanted a compound formula such as “Upper Macedonia” or “New Macedonia” and blocked the invitation. The allies said Macedonia would join once the issue of the name had been settled.

NATO invited Croatia and Albania, boosted ties with Montenegro and Bosnia, and offered Serbia a friendly hand. Franco-American friendship took a big step forward as France offered more troops to fight the Taliban and signalled its intention to return in 2009 to NATO's integrated military structure. Mr Bush compared Mr Sarkozy's arrival with the “latest incarnation of Elvis” and endorsed an EU plan to develop stronger defences.

With Vladimir Putin due to join the summit on April 4th, and then to host Mr Bush the next day in the resort of Sochi, the American president was balancing the need to maintain working relations with the Kremlin while not being seen to yield to threats. “The cold war is over. Russia is not our enemy,” said Mr Bush, restating his assurance that America's plan to set up its missile-defence shield in Poland and the Czech Republic was not aimed at Russia.

To America's delight, its allies embraced missile defence, recognising its “substantial contribution” to their security, and agreeing to seek ways to extend a shield to countries like Turkey. American sweeteners—offering to accept Russian liaison officers, promising not to switch on the system until a threat (from Iran) emerges, and holding out for Russian participation—impressed European sceptics.

Yet at its core, the dispute within NATO is about the renewed threat from Russia. Members of “old Europe” may hope to avoid a clash with the Kremlin, but many countries of “new” Europe say the struggle has already begun. For them security lies in expanding the frontiers of what was once the transatlantic alliance to the Black Sea and ultimately to the Caspian.

Even its strongest advocates recognise that such expansion raises questions about the purpose of the alliance: should it be mainly a military organisation, or a political club of democracies? Radek Sikorski, the Polish foreign minister, questioned whether the promise of mutual defence from armed attack enshrined in Article 5 of NATO's charter was becoming “diluted”.

Mr Sikorski wants NATO to move military infrastructure east. He complains that NATO hesitates even to make intelligence assessments of perils from Russia. Others want more attention to non-conventional threats, given last year's cyber-attack on Estonia, blamed on Russia. “We do a disservice to Russia by not taking it seriously,” said Toomas Ilves, Estonia's president.

The next generation

Apr 3rd 2008
From The Economist print edition

Flash90

Israel at 60 is as prosperous and secure as it has ever been, but its future looks increasingly uncertain, says Gideon Lichfield (interviewed here). Can it resolve its problems in time?

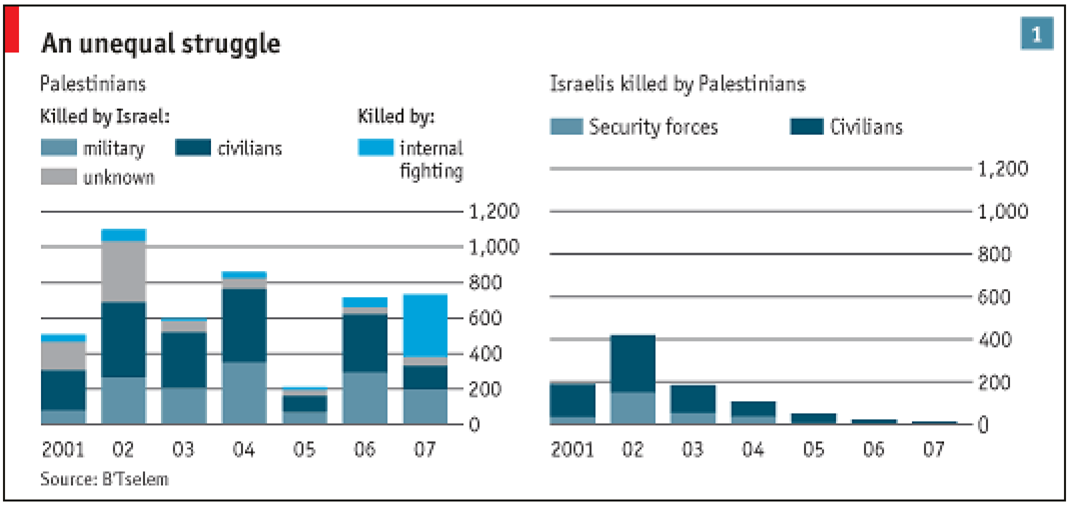
THREE years ago, in a slim volume entitled “Epistle to an Israeli Jewish-Zionist Leader”, Yehezkel Dror, a veteran Israeli political scientist, set out two contrasting visions of how his country might look in the year 2040.

In the first, it has some 50% more people, is home to two-thirds of the world's Jewry and, as today, is four-fifths Jewish itself. The other fifth, its Arab citizens, have accepted the state's Jewish identity, thanks to efforts to end discrimination against them and to the creation of a viable Palestinian state next door. The country enjoys a flourishing knowledge-based economy, a thriving cultural life and a just society, and has good relations and strong trade links with most of the Middle East. A serene balance of Zionist and humanist values infuses both state affairs and everyday life. Reforms have stabilised the political system. Fast public transport has minimised the country's already small distances, encouraging mobility, and many of its citizens happily divide their lives between Israel and other countries.

In the second scenario, Israel has only half the world's Jews, their majority in Israel itself is down to two-thirds and shrinking, and “Zionism” has become a term of ridicule among the young. Jews abroad see Israel as increasingly backward and irrelevant to them, and Jews of different streams within Israel are at loggerheads. Pressure is rising, both at home and abroad, for Israel to become a fully democratic, non-Zionist state and grant some form of autonomy to Arab-Israelis. The best and brightest have emigrated, leaving a waning economy. Government coalitions are fractious and short-lived. The different population groups are ghettoised; wealth gaps yawn. Israel is in conflict with a hostile Palestinian state that was declared unilaterally; Islamic fundamentalism in the region is on the rise; and any peace deals between Israel and its neighbours—some of which now have weapons of mass destruction—are looking shaky.

Mr Dror's future dystopia at first sight looks closer to today's Israel. That, of course, is because he wants to catch his readers' attention and unsettle them. The way he associates failure with more Arabs and fewer Jews in Israel also reflects the audience he is aiming at (“If you are in fact a 'post-Zionist'...then this epistle is not meant for you, and don't bother to read it,” he explains in the introduction).

Yet whether Jewish or Arab, Zionist or otherwise, Israelis have good reason to wonder what their country will look like in 2040—or, for that matter, in 2020. Compared with much of its past, Israel's present is prosperous and secure. But its future is as uncertain as at any time in its 60 years of history.



The country has emerged stronger from the second Palestinian *intifada*, which between 2000 and 2004 killed 946 Israelis and over 3,100 Palestinians. Israelis are now much safer, though Palestinians certainly are not, thanks to aggressive security measures in the West Bank and Gaza (see chart 1). The Gaza disengagement in 2005 broke a taboo on removing Israeli settlements from the occupied territories. The war against Hizbullah in south Lebanon in 2006 was botched, but served to shake up the army. In the autumn of last year peace talks with part of the Palestinian leadership began again for the first time in seven years, though as this report went to press they were looking increasingly shaky.

Meanwhile, the high-tech boom that began in the 1990s has not only survived the *intifada* but gone from strength to strength, fuelling impressive economic growth. Tourism is rebounding and property prices have shot up. The massive influx of immigrants from the former Soviet Union is melting slowly but smoothly into Israeli society. Even some of the social conflicts of the early years—between religious and secular, and between eastern and European Jews—seem to be settling down.

On the other hand, economic growth has widened wealth gaps rather than easing poverty. And growth will slow inexorably unless several serious structural weaknesses are fixed, including a faltering education system, low workforce participation and a sometimes sclerotic public sector. A volatile political system makes these reforms hard to achieve.

Moreover, talks on a Palestinian state look doomed to failure. If they do succeed, the need to give up the West Bank will re-ignite internal Jewish conflicts, but if they don't, fears will grow that a separation from the Palestinians may no longer be possible, forcing Israel to choose between enshrining a form of apartheid and relinquishing its Jewish character. Arab-Israelis are increasingly angry about being treated as second-class citizens.

Many Jews from the diaspora already view Israel as spiritually impoverished and uninviting. And when Israelis look at their neighbourhood, they see looming threats: a potential nuclear bomb in Iran; one of the world's most powerful guerrilla armies in Lebanon; growing extremism among the Palestinians; and everywhere the rise of popular Islamist parties that threaten to topple reluctantly pro-Western Arab autocrats. For the first time since 1948, real existential threats to Israel, at least in its Zionist form, are on the horizon.

Some of these things are out of Israel's hands, but Mr Dror reckons that what happens to the country in future will depend mostly on its own decisions. This report will consider how well equipped it is to take the right ones.

Fenced in

Apr 3rd 2008
From The Economist print edition

Short-term safety is not providing long-term security, and sometimes works against it

A STRIKING new construction has sprouted on King George Street, in the centre of West Jerusalem, the Jewish side of the city. It is round, glass-walled from floor to ceiling, and set back from the road so as to leave plenty of room for outside tables. It is a café.

A few short years ago, only a lunatic would have contemplated building such a thing there. The second *intifada*, following from the failure of the Oslo peace process of the 1990s, was raging. Suicide-bombings had emptied the city's restaurants and brought security guards to every door. Yet since then the bombings have dropped to an average of one a year, and the most recent two were in the south, far from most Israelis' consciousness. The guards are still there, but now they look bored.

The reasons are several. At the *intifada*'s height Israel reoccupied the West Bank towns that had been under Palestinian Authority (PA) control. Since then it has been energetically killing or arresting militants. At various points some militant groups have observed their own ceasefires.

The "security barrier"—part fence, part concrete wall—that Israel began building around and through the West Bank contributes too, though less than Israel likes to claim. Not only is it still incomplete, but security checks at many of its crossings are extremely lax, so as not to inconvenience the settlers who commute between their homes and Israel proper. Instead most would-be bombers are caught or deterred by over 550 checkpoints and roadblocks within the West Bank itself, much of which is off-limits to Palestinians (see map). The gunman who shot dead eight students at a Jewish seminary in Jerusalem in March had Israeli residency, which allowed him to move freely.

This system is born of the post-peace era. The collapse of the Oslo process and the subsequent *intifada* convinced most Israelis that it was best to shut themselves off from the Palestinians and pull out of the occupied territories unilaterally, as they did from Gaza in 2005. If the PA could not deliver security, Israel would instead.

But nearly three years after the Gaza disengagement, that too has proved a false hope. The Islamists of Hamas, which offers a long-term ceasefire but not full-fledged peace with Israel, wrested Gaza from the PA forces loyal to the more secular Fatah last June. Crude rockets are fired from Gaza on to neighbouring Israeli towns almost daily, causing few casualties but keeping the population terrorised.

And for the new peace process now under way, the system that keeps central Israel safe is proving a liability. The talks launched at the Annapolis summit in November between Israel and Fatah's Mahmoud Abbas, the Palestinian president, who remains in charge of the West Bank, are based on a simple theory.

If they reach an agreement to create an independent Palestinian state in most of the occupied territories, and if Israel allows the West Bank's economy to thrive while imposing a near-total blockade on Gaza, then Mr Abbas will grow stronger whereas Hamas will be weakened.

The practice is something else. Leaving aside the fact that collectively punishing 1.5m Gazans in a crude attempt at electoral engineering is cynical, unethical and prohibited by international law, the very workings of Israeli security doom the plan to failure. Between June 2007 and mid-March 2008 at least 170 Palestinian civilians were killed, 70 of them children, as unlucky bystanders or mistaken targets of what Israeli military jargon breezily calls “targeted elimination”. All of them will serve as martyrs to the extremists' cause. So do the more than 8,000 Palestinians in Israeli jails. Some are indeed murderers, but many are serving long sentences on minor or dubious charges.

The checkpoints in the West Bank hugely increase travel times between Palestinian cities, turning them into virtual enclaves and stifling the economy. Promises to remove even a handful of the checkpoints have gone largely unfulfilled, partly because local army commanders, who enjoy considerable autonomy and fear getting the rap if a suicide-bomber slips through, err on the side of caution.

Meanwhile, the peace talks are floundering. One rightist political party, Yisrael Beiteinu, has already left Ehud Olmert's governing coalition and another, the religious Shas, threatens to do so if the talks broach the sharing of Jerusalem, as they eventually must. Israeli officials, contradicting what Mr Olmert signed at Annapolis, now say that the aim is not a full peace treaty, just the outline of one.

All this makes it politically hard for Mr Abbas's forces to crack down on militants, which Israel insists on as a precondition to implementing any peace deal. But it is just as politically hard for Israeli leaders to hand over responsibility to PA forces that cannot do the job as well as the Israeli army can. With foreign aid, getting the Palestinian forces up to scratch would take at least three years and cost around $5.4 billion, of which only a few hundred million have been pledged.

Hamas, for its part, has turned the starvation of Gaza to its advantage. When widespread power cuts turned the world's media spotlight on to the Gazans' plight, militants blew down the border wall with Egypt, a move they had been plotting for months under the nose of Israeli surveillance. As hundreds of thousands of desperate Gazans flooded across the border to buy supplies, Hamas's standing across the Arab world swelled. Recent polls show its popularity among Palestinians once again catching up with that of Fatah.

Helping the extremists win

Hamas won parliamentary elections in 2006 by a landslide partly because Israel had spent years sidelining Fatah's leader, Mr Abbas, and before him Yasser Arafat, for their failure to crack down on militants. Hamas took control of Gaza after Fatah, backed by Israel and America, tried to destabilise the Hamas government. Israel assassinated two centrist Hamas leaders, Ahmed Yassin and Abdel Aziz Rantisi, during the second *intifada*, and led an international boycott of the Hamas government elected in 2006, which was headed by another centrist, Ismail Haniyeh. As a result, those now calling the shots in Gaza are from the group's hardline wing.

Similarly, Israel's attempt to destroy the Palestinian leadership in exile by invading Lebanon in 1982 fuelled support for Hizbullah, a Shia group that shooed the army out of Lebanon 18 years later and gave it a drubbing in the summer war of 2006. And Israel's killing in 1992 of Abbas Musawi, Hizbullah's leader, opened the job to the charismatic Hassan Nasrallah.

Though Hizbullah took a severe beating in 2006, it showed that Israel was sorely unprepared for the new kind of war being waged in the Middle East, against a guerrilla force supplied with the weapons of a conventional army. The Israeli forces, after years of dealing with Palestinian militants, thought they were facing the same sort of thing in Lebanon. The Winograd commission, which probed the army's performance in painstaking detail, concluded that it fought most of the war as a series of routine anti-terrorist operations. The UN-supervised ceasefire has kept the border quiet since, but has not stopped Hizbullah from re-arming.

However, the rise of Hamas and Hizbullah is also part of a trend that Israel cannot control. Political Islamism is growing across the Middle East, stoked by anger with corrupt local autocrats, resentment of the West, schisms within Islam and the Arab-Israeli conflict itself. George Bush's “war on terror”, by deliberately blurring the distinction between political Islamism and the nihilist jihadism of people like

Osama bin Laden, adds to the enmity.

This is starting to chill Israel's already lukewarm peace with two of its neighbours. Egypt's ageing president, Hosni Mubarak, now looks fearfully over his shoulder at the Egyptian Muslim Brotherhood, Hamas's parent organisation. Jordan's King Abdullah, likewise, cannot ignore the rise of the Islamists in his own mostly Palestinian population. Israel has refused to hold peace talks with the autocratic but less ideological Syrian president, Bashar Assad, unless he first renounces ties to Israel's arch-enemies, Iran and Hizbullah. But finding a peace partner will become even harder if the Muslim Brotherhood in Syria—brutally repressed by Assad's father—revives, destabilising the already much weaker son.

Farther afield, Israelis are worried that America's next president will be less slavishly pro-Israel than George Bush. Public opinion in Europe has shifted against Islam, which many Israelis think is to their advantage. But like Mr Bush's backing, a more supportive European position also risks turning Israel into more of a target. A real peace deal with the Palestinians could yet sap the Islamists' power, but as long as it is predicated on eliminating Hamas first, it seems unlikely to happen.

A few senior Israelis therefore say that it is better to talk to Hamas and even agree, for now, to peace on its non-binding terms. Ami Ayalon, a government minister and a former head of the Shin Bet, the domestic intelligence agency, argues that Hamas has already shown the potential to become more moderate. “There has been a movement in its priorities from 'education, charity and *jihad* now' to 'education, charity and *jihad*-can-wait',” he says.

Within the establishment, though, that remains a minority view. And in any case, thanks to Israel's energetic efforts to keep Hamas down, there may not be any influential moderates left to talk to. At the other end of the spectrum from Mr Ayalon, Moshe Ya'alon, a former head of the army, argues that the only way to deal with Hamas is to send the army in to retake the Gaza Strip—sector by sector, street by street, house by house, the way it did in the West Bank during the *intifada*.

And then? “Wait until the Palestinians are capable of running it themselves. For as long as it takes.” It sounds extreme. But as long as talking to Hamas is off the table, anything less than a total assault will not change the strategic balance.

Perhaps Israel can contain the Palestinian problem indefinitely—though at a terrible cost to the Palestinians, and also to its own army that used to be the glue of Israeli society (see article). Would it be able to contain a nuclear Iran?

Israeli hopes that the United States would lead an attack on the suspected Iranian weapons facilities have dimmed. Within the Israeli government, secret debates rage over whether, and when, Israel should strike Iran alone. Outside it, squadrons of ex-spooks and retired generals hold conferences on the future of a polynuclear Middle East. Soothing voices counsel that for all the inflammatory statements about wiping Israel off the map, Iran wants a bomb for national pride and self-defence, not unprovoked aggression.

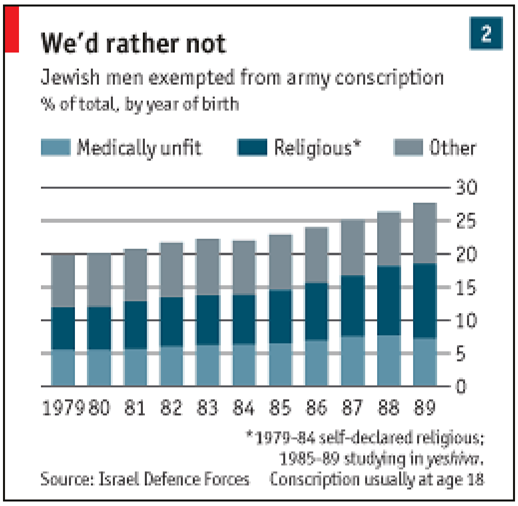
But in a country obsessed with security, the hawks tend to have more sway. Shmuel Bar, a former agent of the Mossad, Israel's foreign-intelligence service, and an Iran expert at the Interdisciplinary Centre (IDC) in Herzliya, points out that “the most volatile period in the cold war was the first ten years, when mutually assured destruction hadn't been established yet.” Besides, he argues, that kind of deterrence will not work in this region. The chain of command over Iran's nuclear programme is too diffuse, other states will want to get their own weapons, and the Middle East's multiple fracture lines—Sunni versus Shia, Iran versus Arabs, Israel versus the rest—make for an unstable balance of forces.

However, the more probable threat to Israel is not that Iran will bomb it. It is the risk that an Iranian bomb, even if it seems likely to stay in its silo, will prompt the best and brightest Israelis, who are also the most mobile, to emigrate and tip the economy into an irreversible decline. A survey commissioned for the IDC's annual Herzliya policy conference this year found that 14% of Jews in Israel (and some 40% of Arabs there) would consider leaving the country if a hostile state acquired nuclear arms. The country's greatest vulnerability is not military but economic.

To fight, perchance to die

Apr 3rd 2008
From The Economist print edition

Policing the Palestinians has eroded the soul of Israel's "people's army"



THE army medical test had given N, an 18-year-old from Jerusalem, a clean bill of health, making him eligible for a combat unit. But he did not want to fight. "So I went and cried to the mental health officer, told him I had some kind of problem." When he began his military service recently, he landed a desk job.

More and more people are finding ways to evade tough duty, or duty altogether. Medical, psychological and religious exemptions are on the rise. Army sources estimate that around half of those who obtain a medical certificate to avoid or cut short their service are actually shirkers. The statistics for the 2006 Lebanon war show that religious Zionists and soldiers from *kibbutzim*, the crucibles of secular socialist Zionism, were over-represented among the dead.

It has always been these, the most ideological, who were the readiest to die for their country. But with the ultra-Orthodox (who get religious exemptions) and Arab populations swelling, and qualms growing among the secular centre, the institution that has traditionally been Israel's melting pot is slowly becoming less and less so. Major-General Elazar Stern, the army's head of personnel and a skullcap-wearing religious Zionist himself, is a living testament to it; in the past people like him were few and far between in the top ranks. Religious Zionists tend to be pro-settlements, and there is concern that the army is becoming more sympathetic to the settlers.

Not that it is hostile now. Military collusion was crucial to the establishment of many West Bank settlements that were built without permission and made official only later. There are also over 100 small settlement "outposts", unauthorised but nonetheless enjoying mains water, electricity and army protection. The army's defiance of the law can be shocking, as when it waited nearly a year before heeding an order by the Supreme Court to take down a barrier that cut Palestinians off from their land in the West Bank.

Moshe Hager Lau, who runs a *mekhina*, or pre-army academy, for religious cadets in the southern West Bank, strongly opposes the removal of settlements. Not that he tells his young charges to refuse an order to evacuate settlers: "I tell them to use their conscience." But the number of young Israelis who spend a year in a *mekhina* before military service is growing, and their consciences are bound to be affected.

General Stern, who came under attack from fellow religious Zionists for taking part in the Gaza disengagement, believes such refusals will remain rare. For him the changes in conscription patterns carry other dangers: they contribute to the atomisation of Israeli society and leave him short of good soldiers. His recipe for restoring the "people's army" includes more sparing use of exemptions, dishonourable discharges for suspected shirkers and preferential treatment at universities for ex-combat troops.

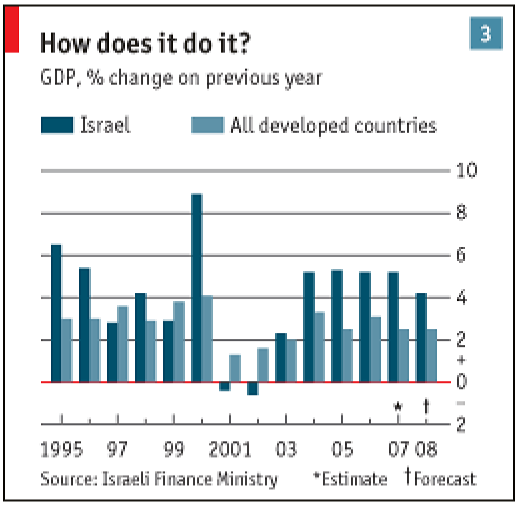
Most controversially of all, he complained publicly that the army's ethos of self-sacrifice had deteriorated to the point where it valued soldiers' lives too highly to get the job done. He was roundly criticised. But later the Winograd commission investigating the second Lebanon war reached the same conclusion.

Miracles and mirages

Apr 3rd 2008
From The Economist print edition

A strong economy built on weak fundamentals

FOR a country with so many wars, Israel still has an economy with the power to astonish. Having taken a beating during the *intifada*, GDP growth per person has stayed above 3% for the past four years, well above the rich-country average (see chart 3), despite the costs of the 2005 Gaza pull-out and the 2006 Lebanon war.



Israel has spent years peeling back layers of its once-socialist economy. In 1985 reforms to the central bank and finance ministry reined in hyperinflation. In the 1990s a heady mix of military communications technology, policies that encouraged entrepreneurship, a wave of immigrant engineers and technicians from the former Soviet Union and the then-promising peace process allowed Israel to hitch its fortunes to the global technology boom. It now has the most NASDAQ-listed companies after Canada and America.

More recently privatisations, pensions reforms and deregulation have contributed their bit. Benefits were cut in 2003 in favour of a welfare-to-work scheme dubbed the “Wisconsin programme”, after the American state that pioneered it. A capital-markets reform in 2005 reduced the banks' dominance and boosted national savings. The government has introduced commercial budget-management systems, put a 1.7% cap on budget growth and committed itself to gradual cuts in taxes, thus providing a cushion against Israel's chronic political instability. According to Yarom Ariav, the finance ministry's director-general, this is one reason why the economy rode out the shocks of the 2005 Gaza disengagement and the 2006 Lebanon war so well; businesses now have confidence that “even if the leaders change, basic policy doesn't.” Last year Israel was invited to join the Organisation for Economic Co-operation and Development (OECD), official confirmation of its status as a developed country.

However, the engines of growth are punier than they look. Israel excels at creating start-ups, but is less good at turning them into big companies. “Our main natural resource is human capital,” says Israel Makov, a former CEO of Teva, the world's biggest generic-drugs maker, “but we treat it just like other natural resources: we export it at a low point in the value chain.” In the other direction, global technology giants such as Intel have long been putting advanced production facilities like chip-wafer fabrication plants in Israel, but now other countries are nipping at its heels. The tech sector employs a small proportion of the workforce, and its workers can most easily leave the country if things get sticky.

And beneath its gleaming high-tech skin, the body of Israel's economy is slightly worn. True, the country has some successful industrial giants and does well in a few export niches such as generic drugs, weapons systems and agricultural and water-treatment technology. Water scarcity has already led Israel to build the world's biggest desalination plant, and around ten more are planned. However, much of the country's traditional industry (eg, machinery, chemicals, clothing and food), which accounts for more than half of its jobs, is lacklustre. Average industrial productivity is around half that in America. One reason: Israel leads the world in R&D spending as a proportion of GDP, but this is heavily concentrated in high-tech. In more traditional industries the rate is just a quarter of America's.

Moreover, Israel's ability to capitalise on the internet boom was a lucky one-off. The big innovations of this century, argues Ze'ev Tadmor, of the Technion, a university in Haifa, will be in biotech, nanotech, smart materials, alternative energy and other things that the army's well-funded research units are not particularly interested in. Much of this kind of work must be done in academia, where Israel is weaker. Its seven big universities have a combined government research budget of around $100m, whereas America's Massachusetts Institute of Technology alone gets $950m from the federal government.

Doing his bit to reduce income inequality

The power of prayer

Israel's workforce also has its peculiarities. Overall, the proportion of the population in the labour market is 56%, considerably lower than in America, though almost the same as in the first 15 European Union members. However, in two subgroups it is much lower than that: *haredim* (ultra-Orthodox Jews), many of whose young men spend years in the *yeshiva*, the religious seminary, and then find it hard to get jobs because they have no secular training; and Arab-Israelis, whose women are less likely to seek work, and who also suffer job discrimination. Officially, only about 40% of these two groups take part in the labour market, although the counting method is flawed and the real rate may be a bit higher. Together they account for 29% of the population, and rising. Economists fear that unless more of them start working, growth will be sluggish and the taxes of those who do work will have to support an ever heavier burden.

Lastly, the country's bureaucrats still have a lot of catching up to do. In its latest annual ranking for the ease of doing business in different countries, the World Bank found vast disparities in Israel (see table 4): credit and investor protection are excellent, but bureaucracy is overweening. The World Economic Forum's global-competitiveness index rated Israel 17th out 131 countries last year, but again found big gaps between the high quality of innovation and technological readiness on the one hand and mediocre institutions, infrastructure and labour-market efficiency on the other.

Part of this is a legacy of the socialist past. For example, 93% of Israel's land is owned by the state, so everybody leases. Part dates back to the centralised control of the British Mandate. Moti Sasson, the mayor of Holon, a satellite city of Tel Aviv, has spent ten years trying to pass a by-law that would allow him to tow away illegally parked cars, as other cities do. He is still waiting for approval from the interior ministry. “You go to the ministry and you find an official with papers on his desk piled so high you can't see him, and more on the floor,” he fumes. “It drives me nuts.”

Mixed bag 4

How businesspeople see Israel

2007

	Ranking*
Overall ease of doing business	29
Starting a business	17
Dealing with licences	109
Employing workers	87
Registering property	152
Getting credit	7
Protecting investors	5
Paying taxes	69
Trading across borders	8
Enforcing contracts	102
Closing a business	40

Source: World Bank *Out of 178 economies

Perhaps the most serious threat to Israel's long-term prosperity, and the one that most troubles ordinary Israelis, is the state of the education system. Israel's spending per student is close to the OECD average, yet in the OECD's PISA rankings of 57 countries in 2006, which focused on science education, Israeli 15-year-olds came 39th overall. Israel also had the biggest gap between the best and the worst students. Both are bad signs for a country with few natural resources that relies on a knowledge-based economy. “What they learn here in 9th grade is what I was doing in Moscow in 7th grade,” grumbles a teenager who recently arrived from Russia (ranked 34th).

What is needed, said the government-appointed Dovrat commission in 2004, is not more money but better-quality teaching. According to a study published last autumn by McKinsey, a consultancy firm, that is what has made all the difference in many other countries. The Dovrat recommendations included giving school principals the right to sack poor teachers and reward the better ones with higher pay, which they currently lack. But such moves have been blocked by Israel's two teachers' unions, one of which has paralysed secondary schools with a series of long strikes over the past few years. At the end of last year it settled for a wage rise in return for token increases in flexibility, but other reforms remain blocked.

In higher education, teaching is in better shape, but research funding is inadequate and thinly spread. Central-government bodies have tight control over salaries, hiring and firing, and universities were only recently given the right to decide on launching new study programmes. As a result, says Mr Tadmor, they cannot compete globally by attracting the best staff to excel in particular fields. Tenured lecturers held their own three-month strike last autumn over a pay dispute with the finance ministry.

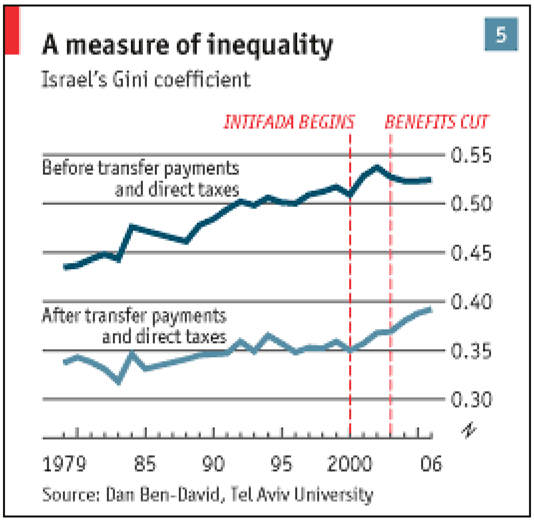
The unions' powers of disruption are another socialist legacy. Israel's Histadrut union federation used to run most of the health-care system, the pensions system and the schools, as well as some of the biggest firms in banking and construction. Today it is far weaker but still holds a lot of sway in the public sector. Ports, airports and other essential services all suffer periodic strikes. The government deals with the unions by working around them, says Ozer Carmi, a professor of business administration at the Ono Academic College. Israel's public sector is a world leader in employing contract workers, who have fewer benefits and less job security.

The Gini is out of the bottle

All this means that Israel's new wealth is highly concentrated. Despite four years of strong growth, the proportion of families below the poverty line (defined as 50% of the median net income per person) has remained the same, at around 20%. That of children living in poverty has actually grown, reaching 36% last year, because as part of the benefit reforms of 2003 extra payments for families with five or more children were abolished.

Israel's Gini coefficient, a measure of income inequality, has also climbed steadily to reach one of the highest levels in the developed world. For years the government tried to contain inequality, but when benefits were cut to keep a ballooning welfare budget in check, it shot up again (see chart 5). In theory, reducing benefits in favour of welfare-to-work was a wise move which even many civil activists supported. But in practice, although the Wisconsin scheme has got people into jobs, it has not made them better off. In the past five years the proportion of poor families with at least one wage-earner has risen by a third.

The government professes to be very worried about poverty. It is adopting a range of social measures that includes better enforcement of the minimum wage, negative taxation for the poorest and employment schemes targeting both Arabs and *haredim*. “The way to close gaps is through the labour market,” says Mr Ariav.



Middle-class discomfort

But there is evidence that even the labour market is not delivering the goods. Yedid, a network of citizens' advice bureaus across Israel, was set up in 1997 to be easily reached by public transport so that the poor could get there. Now, says Yuval Elbashan, Yedid's deputy director, “we have so many people coming by car that the neighbours complain about the streets being blocked.” The reason: more and more middle-class people are dropping in too, for things like legal advice and workshops on budget management. (“The poor”, Mr Elbashan notes, “don't have budgets to manage.”) According to the housing ministry, new mortgages in 2006 were 50% down on 2003, a sign that the squeeze has affected much of middle Israel too.

It is probably too early to say whether these problems are caused by delays in the impact of reforms or signal a longer-term trend. Yaron Zelikha, a former finance-ministry official who helped to draw up the current set of policies, argues that reforms still in the pipeline, including privatisations and infrastructure upgrades, should make industry more efficient and bring down supply costs to launch the next wave of growth.

In addition, says Mr Ariav, there are plans to turn Israel into an exporter of financial services by harnessing its high-tech expertise to further capital-market reforms; as an added bonus, this might entice some of the many Israelis who work in finance abroad to come home. The government also wants to cut red tape by putting more services online and keep reducing public-sector debt (which reached over 100% of GDP in 2003 and is still a hefty 80% today).

Will all this be enough? Yossi Hollander of the Israeli Institute for Economic Planning calculates that the country's GDP per person needs to grow at a bracing annual rate of 4.5% for the next two decades to raise it to three-quarters of the American level, from less than half now, while coping with Israel's changing demography. Over the past 20 years average growth per person has been just 1.8%. His target is not impossible, he says: Ireland managed over 5% a year between 1986 and 2005. But he calculates that Israel's industrial investment will have to rise to three times its level over the past two decades. Encouraging that money to flow will require far-reaching reforms.

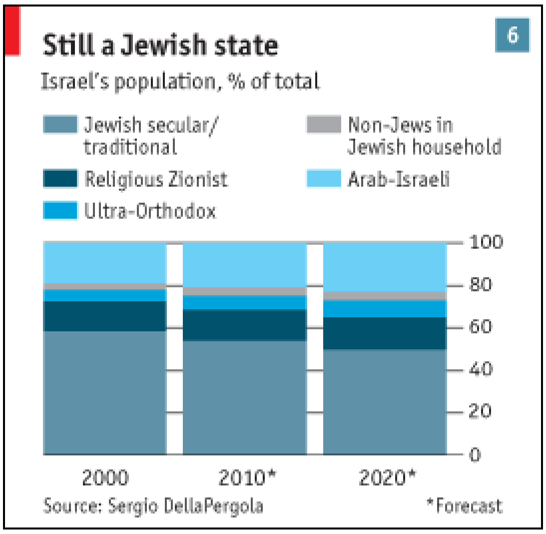
There is no shortage of plans and ideas. The trouble is carrying them out. “Implementation is a science in itself, and in the current Israeli reality it's not possible to carry out long-term, top-down reforms,” says Shimshon Shoshani, a former director-general of the education ministry. Political instability, frequent staff changes, over-centralisation, lack of long-term planning by bureaucrats, aggressive unions and the occasional war all get in the way. And in Israel, where wealth gaps coincide with ethnic and social ones, economic policy is about a lot more than malnourished children and bad housing. It also affects the country's political and social stability.

A house of many mansions

Apr 3rd 2008
From The Economist print edition

Israeli Jews are becoming more disparate but also somewhat more tolerant of each other

YARON, as we shall call him, is a secular, left-wing, Jewish resident of Tel Aviv in his mid-30s—intelligent, cosmopolitan, well-connected and clearly destined to be a member of his country's elite. But in about ten years' time, he says, he and his partner might well leave. “By about 2025, Arabs and religious Jews are going to be a majority, people like us will be a minority—and ten years from now is about when all the other people like us are going to start realising it.”



He fears that the religious will gradually force the rest to accept more of their restrictions, such as bans on Sabbath trading and the sale of non-kosher food. The rising cost of supporting ultra-Orthodox *yeshivas* and unemployed Arabs will push up taxes. The conflict with the Palestinians will grind on. Inter- and intra-ethnic conflicts will intensify. And the secular Jewish elite will trickle abroad, leaving the economy in the dumps.

The divides between religious and secular date back to the foundation of the state, when David Ben-Gurion enlisted the support of the rabbis (who were sceptical of Zionism) by giving them authority over “life-cycle events” such as marriage and burial. Leftists are furious when right-wingers describe Palestinians as “backward”, “dirty” or “fanatical”, but they themselves can be heard saying the same about the ultra-Orthodox. For their part, the *haredim* do plenty to anger their more moderate co-religionists. Last year a former chief rabbi suggested that the Holocaust was a punishment for Reform Judaism, a liberal stream born in pre-Nazi Germany. It is an old joke that Israel's real troubles will begin only after it has made peace with the Palestinians and has to start making peace among the Jews.

Yet the joke is already less fashionable than it once was. And Yaron's vision of the future is based partly on out-of-date assumptions. First, the demographic balance is not shifting all that fast. Though Arabs and ultra-Orthodox Jews do indeed have more children than the rest, the birth rate even among Jews broadly defined as “secular” is 2.4 children per family, as against less than 1.5 in much of western Europe.

The battle of the bulge

Meanwhile, birth rates among both Arabs and *haredim* have dropped, particularly in the past few years. There is much argument over whether the abolition in 2003 of child benefits that favoured larger families played a part in this. Studies by Sergio DellaPergola, a demographer at the Hebrew University in Jerusalem, and colleagues suggest that the availability of things like flexible working hours for mothers, mortgages and child care affect people's family planning much more than do benefit payments. Whatever the reasons, although by 2020 secular Jews are likely to make up only half the population, as Yaron fears, the share of the *haredim*—who might wish to limit his secular freedoms—will still be just 8%.

Also, *haredi* society is changing. Rabbi Israel Eichler, a former member of parliament for an ultra-Orthodox party, is keen to dispel what he sees as some slanderous myths. First, most men leave the *yeshiva* by about the age of 25; only in certain hardcore sects was a lifelong “society of learners” ever considered the ideal. Secular youth who do army service (most *haredim* are exempt) and then go to university often take just as long to enter the workforce.

Second, *haredi* men are not unemployable; although they are barred from most government jobs, supposedly because their spiritual education ill prepares them to work in the real world, they have had no trouble reaching the top tiers of the private sector. Israel's richest man, Lev Leviev, is a *haredi* businessman. And third, there are now many employment schemes that take account of religious restrictions, such as women-only software companies and paralegal firms.

Flash90

Please hold, God will be with you shortly

As *haredi* society has been forced into contact with modernity it has become more worldly and open, while often finding ingenious ways to impose its own limits. Rabbi Eichler sports a “kosher mobile phone” on which internet access is disabled, stamped with the rabbinical council's seal of approval. There is also a “kosher internet”, which allows people to browse only websites that have been officially vetted.

The rest of society is changing too, says Ruth Calderon, the director of Alma, a Jewish study centre in Tel Aviv aimed at secular Jews. She and Rabbi Eichler, from their different vantage points, both detect a softening in the fervent anti-religionism of the early state. Liturgy has penetrated the work of leading pop musicians. Bible study has become “cool” among a younger generation of show-business personalities and public intellectuals. Israelis who used to channel their spiritual energies into Eastern philosophies they had picked up on their post-army backpacking trips are now returning to the fold of Judaism.

Finally, the growth of the ultra-Orthodox seems to have made them more self-confident and less militant. It has also led many to concentrate in segregated communities, including a couple of big new settlements in the West Bank, where their conservative, tight-knit lifestyles do not clash with anyone else's.

True, this segregation carries costs. The most notable is the decline of Jerusalem. The ancient city that both Israelis and Palestinians claim as their capital is now populated mostly by Palestinians with Israeli residence permits, religious Jews of various kinds, aid workers and foreign journalists, and is one of the country's poorest municipalities. Tel Aviv types like Yaron say they find the atmosphere suffocating.

But the separation of public spaces has also calmed things down. Seas of angry, black-garbed *haredim* demonstrating against cinemas and Sabbath-breaking are a thing of the past. The annual Jerusalem gay-pride marches have caused riots, but last year they were already more muted. The rabbis, says Kimi Kaplan, a sociologist who studies the *haredim*, have belatedly realised that the best way to keep their young men from the temptations of homosexuality is not to mention it. For their part, gay activists have debated whether they should insist on marching in Jerusalem or relinquish the holy city and confine themselves to tolerant and open Tel Aviv.

Rejewvenation

Society is fragmented in other ways too. Besides Arab-Israelis, who have always lived mostly separately, the post-Soviet and Ethiopian immigrants have not been absorbed as seamlessly as earlier waves. They hold on to their language and culture and often clump together in their own neighbourhoods. Russian-language radio advertises visiting Russian pop stars and adult circumcision services. Ethiopian teenagers make hip-hop and African roots music. Around 4% of Israelis are immigrants or their children who were given citizenship because they had a Jewish relative, but who are not technically Jewish themselves. These even include home-grown anti-Semites, alienated youth whom the press, with a touch of sensationalism, has labelled “neo-Nazis”.

This is not the uniform collective that the early Zionists dreamed of. But it is culturally richer, and "there's a certain comfort in the fragmentation," says David Landau, the editor of the daily *Haaretz* and himself an unusual combination of religious and leftist. "We have a mosaic of minorities, and this gives each of them a certain self-confidence."

These ethnic boundaries will also slowly blur. Already much reduced is the gulf between Ashkenazi Jews, immigrants from Europe, and Mizrahim, who came from the Middle East. The elitist Europeans looked down their noses at the "Arab Jews", who watched the state's Holocaust-centred identity erase their own rich cultural history. For years the neglect of the Mizrahim was one of Israel's most burning social issues. Today, says Amnon Rubinstein, a law professor and former government minister, "I have students who can't tell me whether they are Ashkenazi or Mizrahi because each of their grandparents is from a different country."

Yet like Yaron, Mr Rubinstein still worries about the secular-religious divide. Thanks both to the growing religious population and the widening wealth gap, Shas, a right-wing, populist party with a reputation as the champion of the poor, has been broadening its appeal beyond its traditional base of ultra-Orthodox Mizrahi voters. It is using its weight in the current coalition to demand more benefits for religious Jews and to obstruct the peace talks with the Palestinians.

Another concern is a slow convergence of interests between the ultra-Orthodox and another stream of Israeli Judaism, the religious Zionists, who pioneered the settlements in the occupied territories after 1967. These two groups have traditionally had quite different views of the role of the state. The *haredim* want it to promote Jewish learning and religious observance. The religious Zionists rely on it to support the settlements, which to the *haredim* are less important.

But their gradual integration into Israeli society has made some *haredim* more nationalist. A few of the more extreme younger settlers have adopted a sort of hybrid identity known as *hardali* (see article). If in future the settlers manage to enlist broader support among the ultra-Orthodox, letting go of the occupied territories will become even harder. And the longer the conflict with the Palestinians stays unsolved, the more it will alienate a group of Israelis known as the "other fifth".

Hanging on

Apr 3rd 2008
From The Economist print edition

AFP

Extra-hot mustard

The settlers are regrouping from their defeat in Gaza

ON ISRAELI independence day, when most of the country goes picnicking, two groups of citizens have adopted a curious ritual. They commemorate their country's birth by visiting places that no longer exist.

Growing numbers of Palestinian-Israelis have for the past decade congregated at the sites of villages in Israel destroyed in the aftermath of what they call the *nakba*, or catastrophe, and what Jews call the war of liberation. Last year thousands gathered at al-Lajjun, just north of the West Bank, where a thick pine forest shelters the ruins of stone houses whose owners and their descendants now live a few minutes down the highway in Umm al-Fahm.

The other group is religious Jewish settlers. Unlike the more numerous but less ideological "quality-of-life" settlers, most of whom live in large communities close to the Green Line (the pre-1967 border), they resemble the Palestinians more than they do their fellow Jews in their near-fetishistic attachment to particular bits of land. They used last year's anniversary to march to Homesh, one of four small northern West Bank settlements dismantled at the same time as those in Gaza in 2005. Permission for the march had been denied and troops closed the roads, but stood by as banner-waving teenagers and couples with prams clambered past.

It was just one small example of how the settlers have subverted government decisions and co-opted local army commanders over the past 40 years, contriving to align the state's security interests with their own plan to populate the occupied territories. Many commentators saw their failure to stop the unilateral Gaza withdrawal as a mortal blow to their power. But they have staged a comeback.

True, militant youth of the Gaza barricades were disillusioned and a few renounced their beliefs. A few others moved in the opposite direction, adopting a hardline ideology that combines religious Zionism's passion for the land with the *haredi* disdain for the institutions of the state; its acronym is *hardal*, which also means "mustard". But some who had spent years cut off from mainland Israel took their eviction from Gaza as a divine hint and moved to Israel proper rather than to the West Bank, to try to spread their ideology there.

Also, says Rabbi Yoel Bin-Nun, one of the spiritual leaders of the early settler movement, "the second Lebanon war put all the internal conflicts into perspective." It brought some of the settlers who had rejected the state back to reality. It also convinced more of the Israeli general public that the settlers had been right and unilateral withdrawals (Israel had pulled its army out of southern Lebanon unilaterally six years earlier) were a mistake. The rain of rockets that has emanated from Gaza since the disengagement has only heightened that feeling.

There will be strong resistance to such withdrawals in future. The founders' generation of settlers grew up in Israel proper; their children and grandchildren have grown up in the settlements, bubble-like communities of like-minded people. “A threat to their homes there is a threat to their only homes,” says Dror Etkes, a left-wing anti-settlement activist. Violent clashes between young settlers and police marred the first attempt after Gaza to evacuate an “unauthorised” West Bank outpost.

At the same time, Mr Etkes notes, the Gaza pull-out and the building of the West Bank barrier have made mainstream Israelis more aware that these territories will, ultimately, not be in Israel. The settlers who resist that notion will be an increasingly radical bunch, but also an increasingly isolated one.

Economist.com SPECIAL REPORTS

How the other fifth lives

Apr 3rd 2008
From The Economist print edition

Flash90

We could do with a bit of multiculturalism

Arab-Israelis are increasingly treated as the enemy within

WHETHER you call it Shafa Amr, as the residents do, or Shfaram, its name in Hebrew, is already a political statement. This sleepy, hilly Arab town of 33,000 people in northern Israel was where a 19-year-old Jewish soldier, Eden Natan-Zada, boarded a bus in August 2005 and shot dead four people before being overpowered and lynched.

The town is populated by a mix of Muslim, Christian and Druze Arabs and has an ancient Jewish history too. It still has a small and rarely used synagogue, the keys to which are entrusted to one of the Christian neighbours. Just up the hill is a Jewish-Arab peace centre, the House of Hope. Its founder, the perpetually sunny Elias Jabbour, is proud of the way the townspeople kept their calm in the aftermath of the killings and welcomed Jewish dignitaries to the funerals. Ariel Sharon, the then prime minister, took the unusual step of calling Mr Natan-Zada a “terrorist” and ensuring that the families of the dead got the state compensation usually reserved for victims of Palestinian terrorism.

But increasingly, Palestinian-Israelis (as distinct from the Druze, around 9% of the country's Arabs, who are traditionally closer to the state) feel that their government is hostile to them. Their status had gradually improved since the early years of martial law and explicit budgetary discrimination against their towns, but the *intifada* has made things worse again.

Thus, a law making it next to impossible for West Bankers and Gazans to get Israeli residence or citizenship through marriage has made it much harder for Palestinians in Israel to marry their own kind in the occupied territories, as they used to. Earlier this year the attorney-general finally ruled out any prosecutions against police suspected of killing 13 Arabs during riots in October 2000, citing lack of evidence. Several other killings by police since then have remained unsolved.

Talk of the “demographic threat” has led more Jews to believe in a Palestinian state, but has also made them see Arab Israelis as part of the threat. It has become less taboo to talk about “transfer”: stripping Palestinian-Israelis who live near the West Bank of their citizenship and redrawing the borders to include them in a Palestinian state, in return for Israel keeping some of its West Bank settlements.

All this serves to remind Palestinian-Israelis of the many other ways in which they are treated as second-class citizens—for example, that their refugee relatives abroad cannot return to Israel whereas Jews automatically qualify for citizenship, or that they find it near-impossible to get jobs in “strategic” state industries such as energy and water. The government has stonewalled in the face of a decision by the Supreme Court that the Jewish National Fund, a quasi-state body that owns 13% of Israel's land, must stop its practice of leasing only to Jews. Some 70,000 Bedouin Arabs live in villages without official recognition that lack basic services. In the private sector, attempts by various business leaders and co-existence organisations to end job discrimination have made a difference, but change is achingly slow.

Our state as much as yours

Which is why, at the Adalah legal-advice centre a few minutes' drive from the House of Hope, sedition is brewing—at least as Jews see it. Last year, after the Israel Democracy Institute, a Jerusalem think-tank, issued a “Constitution by Consensus” drafted by a group of experts that included a wide range of Jews but not one Arab, Adalah and several other Arab organisations responded with a series of documents calling for a more democratic kind of state, including equal immigration rights for everybody, giving minorities autonomy in certain spheres like education, giving them a veto over new laws that could affect them, and including non-Jewish elements in the state's symbols and anthem; in sum, making the state multicultural rather than preferentially Jewish.

This caused a furious Jewish backlash. The head of the Shin Bet security agency described Israel's Arab citizens as “a strategic threat”. Liberals, on the other hand, wrung their hands and called for redoubled efforts to end discrimination against Arabs. Both groups insisted that the documents were the work of radicals and did not reflect Arab-Israeli opinion.

Hassan Jabareen, the head of Adalah, is a radical. He believes that a two-state solution cannot work and that Israel and the occupied territories should become a single state with equal rights for all, a minority view even among Palestinians. But according to polls by Sammy Smooha, a sociologist at Haifa University, the multiculturalist proposals for Israel itself have widespread support among Palestinian-Israelis. He points out, though, that they emphasise legal, non-violent methods and show that Palestinian-Israelis want to realise their ambitions as Israeli citizens.

And yet it would be dangerous to underestimate the alienation that even the less politicised among them are feeling these days. Yusuf Abu Warde is one of those rare Israelis who truly straddles the cultural divide. A prominent actor, born in 1953, he has spent most of his career playing Hebrew roles. Like about a fifth of Palestinian-Israelis, he comes from a family that was evicted from its village at Israel's founding. As a teenager he rejected the Jewish state, but when the Oslo peace process began, “I felt more Israeli than ever.”

But with the *intifada* and the atmosphere that followed, he says, “I realised I would never be able to be equal, never be able to get my land back, because the whole tendency is to present me as a potential enemy or demographic threat...there is some kind of improvement from time to time, but not from a vision of allowing me to live here as an equal citizen, but rather so it won't hurt me too much to live here.” He sees a younger generation with little belief in integration; he notices that his Jewish and Arab friends' pages on Facebook, a social-networking website, are almost totally segregated. He tries to empathise with his Jewish friends, “but we don't rejoice and we don't cry about the same things. For them, [Israel] going into Gaza to murder someone is a victory, and for me it's terribly painful and sad. And this cannot be bridged.”

It is ironic that the fundamental disagreement between Jews and Palestinians today is not about whether there should be a Palestinian state; most Israeli Jews accepted that long ago. It is about whether there should be a Jewish one.

But this isn't Denmark

To Jews the answer is obvious. There are over 20 Arab states but only one that is Jewish. Why, especially if the Palestinians will eventually get a state of their own, should they want special recognition in the Jewish state too? “The Jews in Denmark don't insist that the Danes put the star of David on their national flag,” scoffs A.B. Yehoshua, one of Israel's most eminent novelists.

Besides, the frequent claim by Israel's critics that the nation-state is obsolete is clearly nonsense, as demonstrated by anti-immigrant feeling and ethnic separatism in Europe. Kosovo's recent secession, says Mr DellaPergola, the demographer, “is a good example of a phenomenon that is widening, not disappearing.” To Israel's Jews it is an uncomfortable reminder of why they wanted a state in the first place.

To Palestinian-Israelis, on the other hand, to be the poorest group in a state that is Jewish in its symbols, holidays, ethos and historical narrative is not merely to be second-class citizens, or to be treated like immigrants in a country where they are actually natives. It is to be, in a way, non-persons. Unlike Jewish identity, a hardy blend of history, religion and culture that has survived two millennia of exile, Palestinian identity is a fragile thing, rooted largely in the land that they, their parents or their grandparents lost. Ethnic nationalism provides a kind of substitute. “Zionism threatens my existence,” says Mr Abu Warde. He does not mean his physical survival, but his sense of who he is. If a Palestinian state does come to pass, Israel's Palestinians will face a grim choice: move there and lose their homes, or stay in Israel and lose themselves.

Their multiculturalist proposals are an attempt to pre-empt that dilemma by creating a space for a Palestinian identity in Israel. Even in Mr Jabareen's vision of a combined binational state, Hebrew would be an official language, Judaism an official religion and the star of David an official symbol—just not the only ones.

But for most Jews, the idea of a state that guarantees both numerical and cultural Jewish dominance is essential to its being a safe haven against future Holocausts. It is hard to reconcile these concepts. But it is also hard to imagine Arab-Israelis putting up with second-class status for ever.

A systemic problem

Apr 3rd 2008
From The Economist print edition

Many of Israel's troubles stem from its political system. But can politicians fix it?

AP

How long has Olmert got?

THE new wing of the Knesset, Israel's parliament, is an impressive attempt to project the authority of the state together with the openness of democracy. Outside the committee rooms, brushed steel and blond wood grace wide, curving public foyers that look out on the gardens through a three-storey wall of floor-to-ceiling glass. Here, Menahem Ben-Sasson and his colleagues on the constitution, law and justice committee are trying to weld all of Israeli society into a seamless whole.

The idea is to write, for the first time in Israeli history, a constitution. Mr Ben-Sasson believes that setting down, in plain Hebrew, a consensus on what sort of country Israel is meant to be, on the boundaries between religious and secular authority, on the status of minorities and on a raft of other basic issues could help Israel leave behind old disputes and get on with living.

It isn't going well. Arabs are boycotting the discussions because they reject the starting assumption of Israel as a Jewish state, but are not numerous enough to challenge it. Ultra-Orthodox Jews want more power for rabbinical courts. The “Russians”, as post-Soviet immigrants are known, want it to include the right to civil marriage, to cater for the 300,000-odd non-Jews among them, which would break the rabbis' monopoly.

Moreover, not everyone agrees that the time is ripe. “It's no accident that we haven't had a constitution for 60 years. It's not that we forgot,” remarks Ami Ayalon, the ex-head of the Shin Bet, now a Labour minister without portfolio. “A constitution is an expression of agreements that don't exist yet.” He argues that if written in a rush, it risks either being vacuous or imposing the will of majorities on minorities. And once it is passed, crucial flexibility will be lost.

Indeed, after six decades of dithering, why the hurry? One reason is that some feel the flexibility has gone too far. The absence of a constitution, combined with Israel's fractious politics, left a vacuum of authority that Israel's Supreme Court, under its activist former chief justice, Aharon Barak, filled by interpreting certain “basic laws” as quasi-constitutional.

Unusually, Israel's Supreme Court is also a court of first instance for claims against the state. This has turned it into a guardian of civil liberties. But it has clashed more and more with the other branches of government. Rightists and religious Jews too are critical of its secular and liberal views. “A group that represents 3% of the voters sets the tone for the judicial system,” complains Rabbi Eichler, the *haredi* ex-legislator.

Both its critics and its cheerleaders tend to overstate the court's influence. In the 13 years since Mr Barak became its president, it has overturned laws as “unconstitutional” only a handful of times. It has done a lot for human rights in Israel, but when it comes to Palestinians it rarely rejects the state's security arguments. And though it has been openly at war with Daniel Friedmann, the justice minister appointed after Mr Barak stepped down, much of the hostility was the result of personal animus.

The court still enjoys the highest public approval rating of any Israeli institution, but its popularity, too, is dropping—a symptom of the general decline in public faith in the state. Politics has been beset by corruption scandals. Ehud Olmert's term as prime minister has seen criminal probes into various officials, two ministers, Mr Olmert himself and the then president of the state, Moshe Katsav. Growing accountability, with unusually energetic (some say publicity-seeking) officials in the comptroller-general's and accountant-general's offices, have also brought more dirt out into the open.

At a deeper level, however, it is the political system itself that is chronically dysfunctional. When Israel was a newborn country fighting for survival, it had no time to devise an appropriate political model, so it went for pure proportional representation, practised almost nowhere else in the world. In a recent edition of *Azure*, a liberal-right Israeli journal, Amotz Asa-El, a former editor of the *Jerusalem Post*, summed up the results:

> This system has been depleting Israel's political energies for decades: it radicalised the territorial debate, debilitated the economy, obstructed long-term planning, derailed government action, distracted cabinets, diverted budgets, weakened prime ministers, destabilised governments, enabled anonymous and often incompetent people to achieve positions of great influence and responsibility and blurred the distinctions between the executive and legislative branches of government. Perhaps most crucially, it has led talented, accomplished, moral and charismatic people to abandon the political arena to the mediocre, unimaginative and uncharismatic people who currently populate it.

There are 12 parties in the current Knesset, and over 140 have sat in its plenum in the past six decades, many of them one-hit wonders formed for bargaining purposes. To gain a majority a coalition must typically include four or five parties, spanning a wide ideological spectrum. Usually at least one is a religious or populist party that makes its support conditional on expensive budget handouts.

At its mildest, this means that ministers in the same cabinet publicly squabble all the time. More seriously, politicians are accountable to their party but not their voters. Parties that are brought in to make up the coalition numbers wield disproportionate clout, so extremists set the agenda. Pork-barrelling is rife. And important reforms are distorted by political haggling.

At its worst, the system threatens national security. The ability of a few tens of thousands of settlers to set Israeli policy in the occupied territories for four decades is the most glaring example. A more recent one was the 2006 Lebanon war. When Mr Olmert became prime minister as head of the centrist Kadima party, he brought Labour into the coalition by appointing its leader, Amir Peretz, a former trade-union boss, as defence minister. Mr Peretz would have preferred the finance portfolio, but Mr Olmert did not want a political rival holding the purse-strings, and defence was the only other job senior enough for the second-largest party. It was the first time the top two posts had been filled by people with no real experience in security matters. Four months later the war broke out. Its failures, found the Winograd commission that investigated it, were in large part due to the combination of an ill-prepared army and the politicians' inexperience.

Gidi Grinstein, the head of the Re'ut Institute, a policy think-tank, suggests that political volatility may even be responsible for preventing Israel's economy from catching up with other countries. Until 1977 a coalition headed by one party had more or less continuous control. Since then the average government has lasted around two years, the average minister 18 months. At about the same time Israel's GDP per head relative to America's stopped climbing; it has stayed at roughly the same level ever since.

All this has helped to spread the belief that a proper constitution and a new electoral system could solve Israel's woes. In an attempt to speed things along, the Knesset constitution committee is also holding separate talks on electoral reform.

They are not going well either. Several previous attempts have been blocked, usually by religious parties that feared losing the influence of their swing vote. The one reform that was passed, in 1996, proved a disaster. It aimed to increase stability by separating the ballots for prime minister and Knesset, but lots of people split their vote, causing even more fragmentation than before. It was reversed five years later.

This time the three Arab parties, who between them muster 11 of the 120 Knesset seats (and are ideologically poles apart), want to block an increase to the threshold for representation in parliament, because that would force them either to merge or accept that they would get no seats at all. So far Mr Ben-Sasson has managed to raise the threshold of votes needed from 2% to 2.5%. Shas, the rightist religious party of the poor, is also against the change, which would give it less clout.

The animals building the zoo

Even those who favour change hotly debate what kind would work best. Besides a presidential or semi-presidential system, proposals include increasing the threshold to exclude all the small parties; expanding the Knesset, which is not big enough to be an effective check on the executive; and electing some or all of the Knesset members directly by constituency instead of by party list, to make them more answerable to their voters. A simple and useful change, says Mr Grinstein, would be for the biggest elected party always to be asked to form a government, rather than having to cobble together a coalition with a majority first. This would encourage parties to try to attract voters rather than other parties.

One of the parties' best arguments against change is that a country with so many distinct minorities cannot afford to have a political system that disenfranchises any of them. That is true, but also misleading. Mr Asa-El argues that since most minority groups live clumped together, electing at least some of the Knesset by constituency would force the mainstream parties to choose representatives who would actually serve those groups.

Nor is it necessarily true that minority parties are the best representatives of minority interests. Some ultra-Orthodox rabbis have long argued that the *haredi* parties alienate secular Jews from the religion. “If the Jews set up a party in Britain,” says Rabbi Eichler, “the resulting anti-Semitism would catalyse all the other parties to run against it.” Moreover, the mainstream parties ignore the *haredim*'s needs except to buy coalition votes. “If they got rid of the religious parties it would improve the state of both the *haredi* sector and of the Jewish population as a whole,” he concludes. The problem is that the *haredim* have to feel more secure before they are willing to risk losing their collective bargaining power.

There is no doubt that the current electoral system fails accurately to represent the forces that make up Israeli society. Changing it could be a far more effective way of easing domestic tensions than trying to legislate them away via a constitution. Still, it is politicians, not their voters, who will have to approve a change in the system. The risk is that whatever they agree on will continue to serve their own interests better than the country's.

If things stay roughly as they are, where is Israeli politics heading? Over the past 20 years the public at large has successively believed that Israel should hold on to the occupied territories, give them up in a peace deal and give them up unilaterally. But when the pull-outs from Lebanon in 2000 and from Gaza in 2005 failed to create calm, unilateralism too became discredited. Mr Olmert's solution was to revive the peace process, but few Israelis believed in that from the start.

One step to the right, three steps back

As a result, the public is moving right, sparking intense competition among Shas, Yisrael Beiteinu (a party for Russians and secular rightists) and the centre-right Likud for the growing segment of Israelis who are angry at the Palestinians for the violence, but also at their own government for an economic boom that has left them behind. Even Ehud Barak, the leader of the centre-left Labour Party and now the defence minister, has tried to present himself as more hawkish than Mr Olmert to build support. Further right still, an extremist camp in the Likud led by Moshe Feiglin, a prominent settler, is competing with the traditional religious-Zionist parties for the voters who, in the words of Mr Etkes, the anti-settlement activist, “identify the contradictions between democracy and settlements and opt for settlements.”

With Mr Olmert's government approaching the two-year average lifespan, the Likud has had a comfortable lead in the polls for some time. A few months ago pundits were predicting that its support would collapse come the election, because most voters would still reluctantly prefer to give the peace process a chance. Now that seems less certain. These days its leader, Binyamin Netanyahu, argues that Israel needs to revive the West Bank's economy and improve life for the Palestinians, but not talk peace just yet. Unless there is a genuine breakthrough in the coming months, more Israelis will be inclined to agree. Mr Netanyahu's main handicap is that as finance minister in 2003 he designed the reforms that impoverished so many of them. But it's nothing that a little coalition-building can't fix.

Paradoxically, it was right-wing governments that made the big territorial withdrawals, Sinai in 1982 and Gaza in 2005, because they were able to convince right-wing voters that this was the right thing to do. Yet as long as the Palestinian leadership remains split between the West Bank and Gaza, it will be impossible to reach a deal in which Israel's security comes before Palestinian independence. At some point, and perhaps quite soon, the political cost of being exposed to daily rocket fire from Gaza may outweigh that of losing dozens of troops in a massive operation to destroy Hamas's power there. That, in turn, could be the death knell of Mahmoud Abbas's leadership in the West Bank and possibly of the Palestinian Authority itself. *In extremis*, Israel could find itself back in charge of the occupied territories, with nobody to give the keys to, and the wheel will have come full circle.

It may be idle to imagine that something as prosaic as a new electoral system could prevent this. The breakdown of the Palestinian polity may have gone too far already. But if a moderate Israeli leader could take on the settlers without fear of the government collapsing, perhaps he could start a process of gradual disconnection from the West Bank to convince Palestinians that most Israelis really do want to let them build a state of their own.

The next Zionist revolution

Apr 3rd 2008
From The Economist print edition

Zionism is nearly twice as old as Israel. The debate about what it means continues to shape the country

Flash90

It's all right, you don't have to stay

THERE is “an ethical problem”, says Mr Yehoshua, the novelist, when religion and nationality are bound up as one, as they are for the Jews. In biblical times, during the period of the second temple in Jerusalem, religious and nationalist interests often clashed, most notably when religious zealots started an unwinnable uprising against the Roman occupation that led to the destruction of the temple and the start of 2,000 years of diaspora. But diaspora, suggests Mr Yehoshua, allowed the Jews to escape the internal contradictions of a state run on religious lines.

Israel's birth, however, recreated a Jewish nationalist framework based on land, language, culture and everyday life. And once again it is in conflict with demands rooted in religious belief. To avoid repeating the cycle, argues Mr Yehoshua, nationalism and religion have to be disconnected. He calls this separation “the next challenge of the Zionist revolution”.

Like it or not, Zionism is Israel's official ideology and will probably remain so as long as Jews are in the majority there. But it has always been a mishmash of evolving and often conflicting ideas rather than a coherent creed. The secular socialist Zionism of the state's founders is no longer in vogue. To today's *haredim* a Zionist state means one that upholds Jewish law; to the religious-Zionist settlers, one that returns the Jewish people to all of their biblical lands; to the secular left, a state that is democratic and liberal yet manages to maintain a Jewish majority. Others champion secondary goals for Zionism, like setting an example in what Jews call *tikkun olam* (“world repair”, ie, do-gooding). Mr Jabareen, the Palestinian-Israeli lawyer, argues that the Israeli left's current weakness stems from its inability to resolve the increasingly visible contradiction between being a Jewish and being a democratic state, whereas the right is happy to resolve it in favour of being Jewish.

Jews outside Israel, meanwhile, are questioning all the traditional Zionist assumptions about what the country should mean to them. Israel as the gravitational centre of the Jewish world? Not necessarily, say the Jews of America, who are about equally numerous. Israel as a hothouse of Jewish spiritual and cultural life? It is more diverse here, say Jews in America, where Orthodox rabbis lack the hegemony they have in Israel; growing faster here, say Jews in Russia, where the proselytising Lubavitch movement has engineered a post-Soviet resurrection of Jewish life; more vibrant here, say Jews in western Europe, where these days lots of non-Jews are studying Hebrew, Yiddish, Torah and Jewish cultural history. Israel as a Jewish safe haven? You must be joking, say Jews almost everywhere, eyeing the rest of the Middle East.

As a result, traditional forms of Jewish support for Israel are changing. Some of the wealthy foreign Jews whose names adorn almost every Israeli university building, museum wing, hospital ward and public garden now wonder if this is the best use for their money. American Jews raised over $340m in emergency aid during the 2006 Lebanon war, but Isaac Devash, an Israeli philanthropist and entrepreneur, argues that they need to stop compensating for the state's failings and instead strengthen it by strengthening the society that upholds it. One of his own projects, Atidim, helps bright people from poor areas get a good education so they can go back and revitalise their home towns. Sizeable Jewish donations also support Arab-Israeli advocacy groups like Mr Jabareen's Adalah.

For its part, Israel is starting to rethink what it expects of the diaspora. Ze'ev Bielsky, the chairman of the Jewish Agency, the main body responsible for promoting *aliyah*—Jewish immigration—still claims to believe in a goal set in 2001 of attracting a million new immigrants by 2020, which would mean quadrupling the current immigration rate with immediate effect (in fact, last year it reached its lowest level in 20 years). It is the kind of fantasy that sets some diaspora Jews' teeth on edge. But behind the scenes Mr Bielsky's agency and the government are also discussing a new “partial *aliyah*”. This would allow people to enjoy most of the benefits of citizenship but still spend the majority of their time abroad, and allow Israel to reap the most from a globalised workforce.

Can Zionism evolve enough to allow Israel's non-Jewish citizens to feel truly part of the country? Mr Yehoshua envisages that with time, the growth of an inherently Israeli, post-diaspora culture could permit the separation of church and state. Arab-Israelis, while maintaining their own distinct culture, would then feel they belonged to Israel as much as British Jews, say, feel they belong to Britain. But that, he says, is “in the distant future”. And it certainly will not happen unless Israel can ease its other problems: the structural weaknesses in the economy, the wealth gaps, the social divides and, most importantly, the conflicts with its neighbours.

An end and a beginning

“The first Israeli republic has outlasted itself,” says Yehezkel Dror, whose two visions of the future opened this report. But he is less sure what a new system might look like. Mr Dror opposes enshrining Israel's current contradictions in a constitution; he believes that the continuing debate about what the country should be is “a source of strength; it encourages creativity.” But, he acknowledges, “in politics it leads to a blocked society.”

It is this blockage, not Palestinian missiles or an Iranian nuclear bomb, that is the main threat to Israel's well-being. As this report has argued, Israel's survival in the long term will depend on decisions taken in the near future, which will make the difference between growth and stagnation, harmony and social strife, intelligent self-defence and self-destructive belligerence. To take the right decisions it needs a system that reduces the power of special-interest groups without riding roughshod over minorities and allows long-term goals to override short-term politics.

Can it create this system in time? Looking at today's political quagmire, it seems doubtful. Mr Dror notes that the first few decades of American history were beset by ideological struggles as intense as those in Israel, and that it took a civil war to begin to resolve them. So he remains an optimist: “Sixty years is nothing.”

Sources and acknowledgments

Apr 3rd 2008
From The Economist print edition

Most of those mentioned in this report, though quoted only briefly, gave the author long interviews. Equally generous with their time were several others who are not quoted at all: Chagai Alon; Yoav Arad; Gavri Bar-Gil, secretary-general of the Kibbutz Movement; Gidon Bromberg, co-director of Friends of the Earth Middle East; Carsten Damsgaard, Denmark's ambassador to Israel; Menachem Friedman of Bar-Ilan University; Adel Manna of the Van Leer Institute; Anshel Pfeffer of *Haaretz*; Avia Spivak of the Van Leer Institute; Yossi Wasserman, head of the Israel Teachers' Union; Stef Wertheimer, founder of ISCAR; and Ephraim Yaar of Tel Aviv University. The author is grateful to all of them.

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B'Tselem has statistics on casualties in the intifada and other human-rights issues.

Dan Ben-David publishes his economic and social research on his webpage at Tel Aviv University.

Yehezkel Dror and Sergio DellaPergola are based at the Jewish People Policy Planning Institute which produces research on demographics and the development of Jewish society.

The Israel Democracy Institute publishes the Constitution by Consensus and other material on Israeli politics and society.

The Adalah centre publishes the Democratic Constitution and other information on the legal status of Arabs in Israel; the Mossawa Centre has an annual survey on racism and the Equal Constitution for All; see also the Future Vision document.

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Renewable energy

German lessons

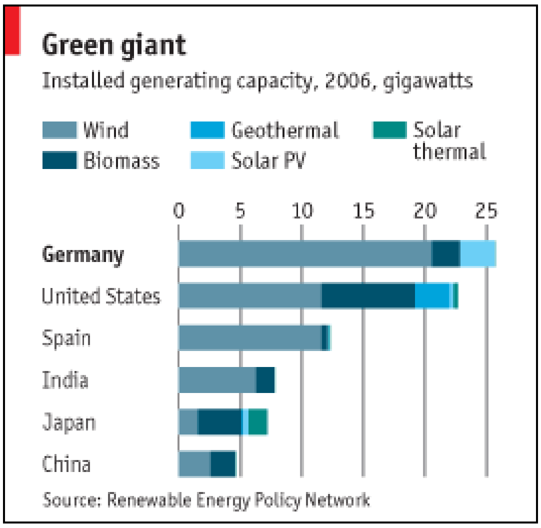
Apr 3rd 2008 | ERFURT AND WOLFEN
From The Economist print edition

An ambitious cross-subsidy scheme has given rise to a new industry

EPA

Q-CELLS, based in Wolfen, just north of Leipzig, is the world's biggest maker of the photovoltaic cells used in solar panels. It overtook Sharp of Japan last year and announced big jumps in sales (up 59%) and profits (up 69%) on March 27th. Germany, which is not known for being sunny, seems an unusual place to find this industry leader. But the country leads the world in its installed capacity of renewable energy sources (see chart), and is the third-biggest producer of solar panels, after China and Japan.

The environment ministry's latest report on the state of the industry, released on March 12th, shows how quickly it is growing. Renewables now account for 6.7% of energy consumption, up from 5.5% in 2006 and 3.5% in 2003. The industry's turnover was €24.6 billion ($32.9 billion) in 2007, up 10% on 2006 and nearly four times the figure for 2000. The share of electricity generated from renewable sources reached 14.2%, a big jump from 11.7% in 2006, owing in part to stronger-than-usual winds last year. This means Germany has already met the European Union's national target that 12.5% of electricity should come from renewable sources.



Andreas Düser of Enercon, a wind-equipment maker in Lower Saxony, believes that renewable-energy equipment will become a big part of the country's manufacturing industry, alongside cars and machine tools. Employment in the renewables industry will increase from 250,000 in 2007 to around 710,000 in 2030, matching the jobs in carmaking by that time, predicts Torsten Henzelmann of Roland Berger, a consultancy.

Most of Germany's electricity comes from coal-fired and nuclear plants. But the former are unpopular because of their relatively high greenhouse-gas emissions, and the latter because of the fear of a catastrophic accident. So in 1991 Germany adopted a renewable-energy law, now known as the EEG, which encourages investment by cross-subsidising renewable electricity fed into the grid. The law is popular with those who support the rapid introduction of new clean technology. Stefan Schurig of the World Future Council, a green think-tank in Hamburg, calls it “the best law of its kind worldwide”.

The law says electricity produced from renewable sources must be purchased by utilities according to a generous “feed-in tariff” that sets higher-than-market rates and fixes them for 20 years. Roof-mounted photovoltaic systems installed in 2007, for example, can sell power at €0.49 per kilowatt-hour, or about seven times today's wholesale price, until 2027. The fixed rate allows investors to calculate returns and removes uncertainty over financing.

The utilities that buy power at these higher rates pass the extra costs back to their customers in the form of higher electricity bills. This added an average of 1 euro cent per kilowatt-hour to the price of electricity last year, increasing the typical household electricity bill by 5%, or €3 a month. For the country as a whole, the cost was €7.7 billion in 2007, up 38% on the year before. Enthusiasts consider that a small price to jump-start a new industry and start decarbonising the power supply.

Clouds on the horizon

But the government is not so sure. It has proposed a revision to the EEG, which calls for a shift away from solar and towards other forms of renewable energy, and offshore wind in particular. As things stand, the feed-in tariff for solar goes down by 5% every year. But new proposals call for a cut of 9.2% next year, and 7-8% thereafter.

The problem is not just the expense of the existing law. Cheerleaders for solar had hoped that the increased demand for panels would help manufacturers reduce unit costs, and thus make solar more competitive in the long run. Instead, the rush into solar has led to a shortage of the high-grade silicon used to make the cells, which has soared in price from $25 per kilogram in 2003 to around $400 today.

Indeed, such is the demand for solar panels in Germany that it has kept prices high globally. This is wonderful for manufacturers, but makes it more expensive to install solar capacity in sunnier parts of the world, where it would generate more electricity. The EEG's generous rates for solar amounted to “picking winners on a grand scale”, says Dieter Helm, an expert on energy policy at the University of Oxford. A euro in cross-subsidies spent on wind power, rather than solar, produces more generating capacity and a larger reduction in carbon emissions.

“Of course we want solar energy to pay for itself,” says Anton Milner, the chief executive of Q-Cells. But for some years it will not be competitive with conventional power sources, which are also subsidised, he says, since the cost of carbon emissions is not properly priced. Fans of solar also note that wind cannot expand for ever. Kurt Rohrig of ISET, a solar-research institute at the University of Kassel, predicts—somewhat heroically—that wind power in Germany will reach saturation by 2038. “Then solar will take over,” he says.

As the government tweaks the feed-in tariffs, manufacturers are also thinking ahead. Many expect silicon-based cells to be overtaken by new “thin film” technology. Inside the 300-strong R&D department at Q-Cells, they are working on both kinds. Ersol, a smaller company which is bent on mass-production, prefers to outsource research to institutions in Erfurt, Konstanz and Hameln. Throughout Germany, around 160 institutions are doing research on solar technology.

In the long run, the hope is that Germany's clean-tech industry will be able to survive without any subsidies, and will do its bit to preserve the country's status as an industrial titan. Yet unless solar power becomes competitive with cheaper forms of generation, it will never make much of a dent in the nuclear and coal-fired power on which Germany relies. And then there is the problem of storing it for use on cloudy days and at night. Meanwhile, the unlikely flowering of solar panels beneath Germany's cloudy skies continues.

The drinks industry

Santé and Skål!

Apr 3rd 2008
From The Economist print edition

France's Pernod Ricard buys Vin & Sprit of Sweden

“IF WE run, it is to win,” says Patrick Ricard, chairman and chief executive of Pernod Ricard, a French drinks group. In the past four months Mr Ricard has done a lot of running. He wanted to capture Vin & Sprit (V&S), which was put up for sale by the Swedish government in December and owns Absolut, a premium-vodka brand. And he won. On March 31st, Pernod Ricard announced its takeover of V&S for €5.6 billion ($8.9 billion) including debt.

Initially almost two dozen bidders showed interest in Absolut, one of the drinks industry's most successful brands. Clever marketing campaigns have propelled it from its Swedish home to leadership of the world's premium-vodka market—a fast-growing segment, especially in America, the world's biggest market for spirits. The field eventually narrowed down to Pernod Ricard; Bacardi, a family-controlled drinks company; Fortune Brands, a consumer-goods conglomerate; and EQT, a private-equity company controlled by Sweden's Wallenberg family.

All of them remained keen, even when credit markets turned sour. Bacardi wanted V&S to bolster its position against unwanted takeover offers. Fortune is close to V&S: it distributes its products in America, and the two are partners in Maxxium, a distribution firm. For their part the Wallenbergs, who control many of the companies listed on the Swedish stock exchange, are always trying to keep their country's corporate jewels in Swedish hands.

Pernod won because it made the best offer. It promised to keep production in Sweden and to give local management lots of autonomy, as it has always done with its brands. Yet the price is high: 21 times V&S's earnings before interest, tax, depreciation and amortisation last year. And Pernod is taking on lots of debt. On April 1st Fitch, a credit-rating agency, changed its verdict on the firm's creditworthiness to “junk” and said the outlook was negative.

Mr Ricard says his bankers are confident that the firm can shoulder the debt. Pernod Ricard has made two debt-heavy acquisitions in the recent past and has paid down the debt faster than predicted both times. In 2001 it acquired 38% of Seagram, a Canadian conglomerate with a large spirits portfolio. Four years later came Mr Ricard's biggest coup, with the €11.4 billion takeover of Allied Domecq, a British drinks group. On that occasion banks underwrote a €10 billion debt package; this time, six banks are backing a €12 billion syndicated package to fund the takeover and refinance Pernod's existing debt.

Mr Ricard wanted to buy a vodka brand to plug a gap in his portfolio. The group already owns big brands in whisky (Ballantine's and Chivas Regal), champagne (Mumm and Perrier-Jouët), cognac (Martell), rum (Havana Club), wine (Jacob's Creek) and gin (Beefeater). Diageo, its big rival, controls 20% of the American vodka market with Smirnoff vodka. Mr Ricard has been trying for years to take over Russia's Stolichnaya vodka, which his firm distributes outside Russia. This agreement will now come to an end.

Analysts say Stolichnaya would have been less expensive, and the brand is less developed, giving it greater growth potential. But Absolut gives Pernod good exposure to America. The integration of V&S as a whole is forecast to yield €125m-150m in annual cost savings, though these will only be achieved after Pernod bails out of Maxxium, which will take two years, and from the distribution agreement between Fortune and V&S, which will take another four years.

Pernod Ricard has come a long way from its origins as Ricard, a maker of pastis, an aniseed drink, founded in 1932 near Marseille. After buying Allied Domecq, Pernod Ricard said it thought it could become the world's biggest drinks group over the next decade—though without any further big acquisitions. This week's deal means that if all goes well, the vodka-fuelled French group may accomplish that feat rather sooner than expected.

Economist.com BUSINESS

Internet advertising

The case of the missing clicks

Apr 3rd 2008 | SAN FRANCISCO
From The Economist print edition

What does it mean when people click on Google's ads less often?

DID Google, the world's largest web-search engine, peak last November 6th, when its share price hit an all-time high of $742? Some people on Wall Street seem to think so. They now value the firm at around 40% less. Part of the blame belongs to the general turmoil in the stockmarket. But the bigger part, investors fear, is that Google, at the ripe old age of nine, might already be over the hill.

The scare started when comScore, a research firm, reported in late February that Google's “paid clicks” had decreased by 7% during January, and were flat compared with the same month a year earlier. In other words, surfers who searched the web via Google itself, or who visited websites that belong to Google's advertising network, clicked slightly less frequently on the little text advertisements that Google often places on these pages. The idea that this disappointment was some sort of seasonal blip faded on March 26th when comScore reported that the numbers for February were no better.

Alas, as so often in the nebulous business of online advertising, the devil is hiding somewhere underneath the numbers, and probably planning some mischief. The first possibility is that web users performed fewer web searches, leading to fewer results pages, ads and clicks. This turns out not to be the explanation. Web searches on Google grew in January, and dipped only slightly in February. Google's market share of searches also continues to grow. This means that the ratio of paid clicks to searches dropped even faster than the number of paid clicks: it was down by 16% in the month of January.

Perhaps America's foreclosure crisis and fear of recession among consumers have caused a downturn in advertising? That is possible, but unlikely, at least so far. eMarketer, another research firm, projects that online advertising in America will grow by 23% this year, economic troubles notwithstanding, because the measurability of the medium is too compelling for marketers to ignore. More to the point, users of rival search engines such as Yahoo! or MSN actually clicked more often on search ads during January and February. For the explanation to be economic, consumers using Google would therefore have to be more worried than those using other search engines. This makes no sense.

According to comScore, the likeliest explanation is instead that Google itself is to blame—by, paradoxically, increasing the quality of its ads. Google does this in two ways. First, it offers fewer ads on each results page, and often none at all. This reduces visual clutter and pleases both users and any remaining advertisers. Second, Google seems to be trying harder to weed out those advertisers who bid low in the auctions it conducts for advertising slots linked to particular keywords. Low bids indicate that advertisers do not expect the ads to generate much business. With less space devoted to ads, and only higher-bidding advertisers getting through, there are fewer ads to click on.

But would users not click just as often, or even more often, on those remaining ads, since they are now presumably easier to see and more relevant? Perhaps not. From Google's point of view, a perfect system would result in each ad not only being clicked each time but also leading to a sale by the advertiser. Google interprets lots of clicking without subsequent purchasing to mean that its ads are not very good.

So if the drop in paid clicks turns out to coincide with more conversions into actual sales, Google's revenue for each individual click ought to shoot up, since the marketers would be prepared to pay more. That in turn might mean that aggregate revenue growth for Google could still be healthy. In a nutshell, this is what drove Google's revenue last year: it grew by 56% on the back of a 21% increase in revenue per paid click. Since Google does not disclose its revenue per click, however, Wall Street won't know whether the click data are good news or bad until April 17th, when Google reports on its first quarter. Until then, the case of the mysterious missing clicks remains unsolved.

India's fashion industry

Stepping out

Apr 3rd 2008 | MUMBAI
From The Economist print edition

The world beckons, but the biggest market for Indian designers is at home

A RAVEN-HAIRED model slinks down a catwalk in Mumbai, wearing a tiny orange top trimmed with gold lamé. The garment, in a style usually worn demurely under a sari, is quintessentially Indian. Less traditional are the bare expanse of taut stomach, the skin-tight hipster trousers and the six-inch stilettos. Fusions of Indian dress and edgier Western styles were the most popular trend on the catwalks of Mumbai's fashion week, which ended on April 2nd. Only eight years after the country held its first fashion show, India's fledgling designer-fashion industry is stepping out into the international market, with silhouettes designed to appeal to the foreign buyers who are given the best front-row seats at the twice-yearly shows in both Delhi and Mumbai.

At Delhi's fashion week in March—a rival and larger affair, with 82 designers to Mumbai's 57—some 70 of the 150 buyers came from abroad. In Mumbai, more than 30 of the 150 buyers were foreign.

They are not yet spending a lot of money. India boasts only a handful of designers that sell well overseas. In the past year several, including Manish Arora, known as “the John Galliano of India”, have begun to show at Paris fashion week, the most prestigious event in a global fashionistas' calendar. But Indian designer-wear is estimated to generate just $50m-250m of sales in a market worth some $35 billion.

It is India's potential as a source of future design stars that attracts the foreigners. In Mumbai Albert Morris, a consultant for Browns in London, said he was looking for that “polished diamond” able to combine Western cuts with India's talent for embellishment—and its famously fine textiles. But foreign buyers complained that although the fabrics were gorgeous, the cuts were often poor, and it was difficult to spot a single trend amid the riot of styles, even within one show. Many Indian designers also lack the organisational skills and infrastructure needed to handle large orders. Veronique Poles, a fashion consultant from Paris, said producing half a dozen of the same frocks could be a stretch for some Indian designers, “and then getting it delivered on time—pah!” But as Indian designers attract investors, their business skills will no doubt improve.

EPA

Pretty in pink

Although many emerging designers have their sights on the global stage, their biggest and fastest-growing market by far is at home. Some 85% of sales at Delhi fashion week were to Indian buyers, who like more traditional subcontinental styles. This presents a quandary for Indian designers and their financial backers. In Mumbai, even those who set their sights on the global market could not quite leave India behind. Narendra Kumar Ahmed, a rising star, sent his models onto the ramp in resolutely Western designs: dresses (pictured), structured jackets and trousers. But almost every piece was pink, a tribute to Rajasthan's “pink city” of Jaipur.

Tsukiji

Fishy business

Apr 3rd 2008 | TOKYO
From The Economist print edition

Tokyo's landmark fish market is under threat

BELLS clang and the cries begin. It is 5.30am and the tuna auction is starting at Tsukiji, the largest fish market in the world, located in the heart of Tokyo. Every day hundreds of tourists visit the stalls and eat at the sushi shops that line the market. At a recent pre-dawn auction, around 150 tourists ogled the massive fish and the bidders' mysterious hand signals, from European bankers capping a night on the town to a tour-group of elderly Americans.

But the anarchy and openness that makes Tsukiji (roughly pronounced “skee-gee”) such a magical place is under threat. New rules introduced on April 1st restrict visitors' access. Watching the auction will only be permitted from a cramped, designated area; other sections will be closed to tourists, though the gory stalls where the fish are cut and sold will remain open (but only to groups of five or fewer). Hideji Otsuki, Tsukiji's director, says he has asked hotels and tour groups to refrain from sending too many people. The problem is Tsukiji's popularity. Some tourists touch the fish or use camera flashes that interfere with the buyers' inspection or bidding, says Hiroshi Okada, a small wholesaler who has worked at Tsukiji for 55 years.

Yet the restrictions imposed by Tsukiji's manager, the Tokyo Metropolitan Government, may be killing the fish that spawned the golden roe. It is one of Japan's most popular tourist destinations, and as sushi becomes more popular around the world, Tsukiji is arguably an international brand. Many fish companies tout links to Tsukiji in their marketing. Interbrand, a branding consultancy, estimates that the “Tsukiji” brand could be worth $3 billion.

Other forces are also putting pressure on Tsukiji. Tuna stocks are declining precipitously due to overfishing. On March 28th the International Commission for the Conservation of Atlantic Tunas, an intergovernmental group, signalled that it may tighten the quotas on bluefin-tuna catches in the eastern Atlantic and Mediterranean at its meeting in November. Japan buys around 25% of the global tuna catch; the shortage has pushed up prices of bluefin (the best sort for sushi) by around 30% in two years. The volume and overall value of fish passing through the market has been falling since 1990. This is due mostly to the rise of supermarkets in Japan that buy directly from trading companies. Moreover, tuna has come under scrutiny in recent years because of health fears about its high mercury content—though just how much is dangerous is unclear.

But the biggest threat facing Tsukiji is a plan by the Tokyo government to move the market to a man-made island outside the city centre by 2012. The idea is that a new market can overcome the current one's dire problems. Tsukiji, which opened in 1935, is housed in crumbling buildings, some stuffed with asbestos. There are frequent collisions between motorised carts and pedestrians in its narrow, curving alleyways, the vestige of a former railway line; an ambulance needs to be called almost every day. Meanwhile, property developers are eyeing the land, just a few blocks from the ritzy Ginza district.

The site chosen for the new market, called Toyosu, is contaminated with benzene. A clean-up is under way and is expected to cost ¥67 billion ($672m), on top of ¥440 billion to build a new marketplace. Big wholesalers favour the move, but the 1,677 stall merchants mostly do not.

Recreating a market from scratch is hard. Tourists may be reluctant to journey farther out to a place that lacks the charm of its predecessor, and the move risks undermining the Tsukiji brand. “Bureaucrats are not on the ground and don't understand the flow of goods, flow of money and flow of information,” says Ted Bestor of Harvard University, who is the author of “Tsukiji: The Fish Market at the Centre of the World” (2004). But Mr Otsuki is unconcerned. He notes that the new site's name means “bountiful isle”—whereas Tsukiji essentially means “landfill”.

Economist.com BUSINESS

Business in the Navajo Nation

Capitalism's last frontier

Apr 3rd 2008 | WINDOW ROCK, ARIZONA
From The Economist print edition

America's biggest Indian reservation tries to stimulate private enterprise

JUST outside the south-east border of the Navajo Nation, along highway 264 in New Mexico, there is a string of shops. It is not much—a bank, a couple of fast-food outlets, a petrol station and a garage. Compared with what lies across the border, though, it feels like a boom town. Cross into the Navajo reservation and the shops abruptly disappear, to be replaced by a scruffy trailer park. As Mike Nelson, a Navajo entrepreneur, puts it: “This is the last frontier for free enterprise in America.”

When Americans talk about Indian businesses, they generally mean casinos. Since 1988, when the Supreme Court ruled that states could not ban gambling on Indian lands, a few, mostly coastal, tribes have become stupendously rich. But most big Indian reservations are in the interior, miles from potential punters. More than twice the size of Massachusetts, and with a growing population of about 200,000, the Navajo Nation is the biggest of the lot—and the most in need of private enterprise.

There are only about 400 businesses in the Navajo Nation. With a few exceptions, such as a coal mine, they are tiny. The official unemployment rate is about 50%, and the median income is less than half the American average. What little money is generated in the reservation tends to leak out. Three times a month—when the welfare cheques arrive, and when government workers are paid—Navajos stream out of the reservation to stock up on groceries, car parts and alcohol in border towns. The local joke goes that the tribe's biggest export is dollars.

The reservation has produced plenty of entrepreneurs. Navajo silversmiths and weavers are justly famous. But the tribe's division of economic development lists more Navajo-run outfits off the reservation than on it. One of these is the garage on highway 264. Its owner, Donald Dodge, did not want to leave the Navajo Nation. He did so because he could not afford to wait years to obtain a business licence.

Anybody who wants to set up shop in the reservation must conduct an archaeological survey, obtain a letter of support from the tribe's president and jump through up to a dozen other hoops. These regulations, put in place to protect Indians from white traders, now bind native entrepreneurs large and small. Timothy Halwood recently obtained a permit to take small groups of tourists into the Canyon de Chelly. The process took two years.

Another problem is land. Like other reservations, most of the Navajo Nation is held in trust by the federal government. Because Navajos do not own their land, they cannot use it as collateral to finance a business. To make matters worse, almost 8,000 people claim grazing rights over land that often extends into towns. These rights have no paper value and so cannot normally be sold to developers. The result is a paradox: a vast, underpopulated area where it is hard to find a commercial site.

A third problem is politics. The Navajo Nation has an 88-member legislature and 110 local chapters. “It's a lot of chiefs,” says Joe Shirley, the Navajo president. This is a big reason the Navajos have been slow to get into the casino business. Plans to do so were approved in 2001, but feuds over how to divide the spoils between tribal and local governments led to delays. The Navajos' first casino is expected to open this autumn, some 150 miles from the nearest big city, in a market that has been saturated by smaller, nimbler tribes.

The dysfunctional politics of the Navajo Nation does have one good effect: it forces the tribe to concentrate on private enterprise. In other reservations almost all businesses are run by the tribe, either directly or through a corporation. Although such firms can be profitable, they are as susceptible to political meddling as any nationalised industry is (see article).

Under Mr Shirley, the first president to serve two consecutive terms since the 1970s, the Navajo government is steadily hacking away at the red tape. In 2006 it took control of business-site leases from the Bureau of Indian Affairs. As a result, it now takes a year or two to obtain a lease—down from as many as five years in the 1990s. Alan Begay, who is in charge of economic development, reckons it will eventually be possible to grant a business lease in about a month.

Some of the Navajo Nation's local governments are going further. Since 2002 the town of Kayenta, near Monument Valley, has levied a 5% sales tax and spent much of the proceeds on housing and infrastructure. The town has a land-use plan and a long-term strategy for attracting businesses. All of which would be taken for granted outside Indian country, although it seems radical here. But nothing happens very fast in Navajo country. Ask a bureaucrat how he intends to remove one of the many obstacles to business, and the first answer is usually “slowly”.

Trouble at Ho-Chunk

Ho dear

Apr 3rd 2008 | OMAHA
From The Economist print edition

Problems for one of the most successful Native American businesses

NESTLED in the hills of eastern Nebraska is Ho-Chunk Inc, owned by the Winnebago nation. For years visitors from other tribes have come to study the firm—one of Indian country's success stories, and a model for how tribal businesses can move beyond casinos. But these days Ho-Chunk is more popular off the reservation than on it.

On April 4th Ho-Chunk's chief executive, Lance Morgan, was due to meet with tribal leaders to defend his company. The spat was caused by a financial review, leaked to the Associated Press on March 14th, which questioned the company's stability. Mr Morgan, not one to mince his words, says the review is a politically motivated “crock of crap”.

Ho-Chunk was born from the fear that gambling money—the Winnebago have a small casino in Iowa—would dwindle. In 1994 the tribe gave Mr Morgan, a Winnebago and a graduate of Harvard Law School, $9.7m in casino money to start a new venture. Ho-Chunk now has 16 subsidiaries, from tobacco and petrol distribution to government contracting and a news website, Indianz.com. Revenue for 2006, the most recent year available, was $113m. Mr Morgan admits that Ho-Chunk has ventured into industries where it lacked an obvious edge, and some businesses are stronger than others. But he insists that its debt, $12.7m in 2006, is sustainable.

Until recently, Ho-Chunk's structure insulated it from tribal politics. The tribal council appoints a board of directors to oversee Ho-Chunk, but Mr Morgan runs the firm, which pays the tribal council a 20% dividend. In 2006 the company paid the tribal council about $86,354 in dividends and $436,472 in taxes. But some council members wonder why these figures are not higher. There is also concern that the firm has too few Indian employees (127, about 30% of the total). Mr Morgan says he would hire more, but that “people with doctorate degrees and MBAs aren't falling out of trees here.”

The board of directors suspended Mr Morgan and his chief operating officer for two days last August for allegedly failing to co-operate with financial reviewers. But tribal members then ousted the board in October. Now the financial review's release has stirred tensions once more. Ken Mallory, who serves on the new board, fears that the conflict will deter investors.

Regardless of the financial review's accuracy, perhaps the worst outcome of all this would be for the tribal council to take control of Ho-Chunk. The Harvard Project on American Indian Economic Development conducted surveys of some 125 tribally owned companies, and found that when daily operations were shielded from tribal politics, they were five times more likely to be profitable.

Face value

The higher they climb

Apr 3rd 2008
From The Economist print edition

Swiss bankers are paid to be cautious, but Marcel Ospel wanted UBS to be king of the hill

AFP

A YEAR ago Marcel Ospel, the chairman of UBS, and his chief executive, Peter Wuffli, surveyed the financial world from the very heights. As well as having the biggest wealth-management operation on the planet, their Swiss bank was a force to be reckoned with in big-league investment banking. It had turned in profits for 2006 of SFr12.3 billion ($9.8 billion). Mr Ospel was handsomely rewarded, to the tune of SFr26.6m.

It was an impressive vantage point for a poor boy from Basel, who had clawed his way up without the benefit of a university degree or the near-mandatory rank of officer in the Swiss military reserve. On his third marriage and having put the red Range Rovers and green Ferraris behind him, Mr Ospel had climbed at last to the top of his world.

Mr Ospel's ascent had been matched by the no less striking transformation of the lacklustre number-three bank in Switzerland, Swiss Bank Corporation (SBC), through merger and assimilation, into a global powerhouse. From 1996 Mr Ospel had presided over the hitching of SBC to such illustrious names as S.G. Warburg, a British merchant bank; Union Bank of Switzerland, then Switzerland's biggest; and two American brokers, PaineWebber and Dillon Read. Mr Ospel's ambition was paired with ruthlessness and ability. When he bought Warburg in 1995 he sacked 1,000 employees outright. His critics said integration would not work, but it did. Moreover, SBC, which changed its name to UBS in 1998, had a reputation for highly effective risk management. Its motto: if you don't understand the business, you don't do it.

On April 1st this year it became clear just how completely those words had been forgotten. On that day the bank suddenly doubled its write-down on American mortgage-backed securities to $37 billion. The bank predicted a loss of SFr12 billion for the first three months of the year. A chastened Mr Ospel, who had already faced calls for his resignation at the most recent general meeting, on February 27th, said he would quit. He might have had to go anyway, because of a report, expected on April 7th, that was to explain to the Swiss bank supervisor exactly how the bank had got it so terribly wrong.

With hindsight, Mr Ospel and Mr Wuffli made their fatal error in 2005, when they tried to retain John Costas, the head of investment banking, by letting him set up an in-house hedge fund called Dillon Read Capital Management (DRCM). Unfortunately Mr Costas went headlong into American subprime mortgages. Worse still, the dealers at UBS, bedazzled by his genius, followed him into the quagmire. DRCM was unceremoniously closed in May 2007, with a published loss of SFr384m, and Mr Wuffli was fired. UBS was saddled with huge toxic positions on which it has continued to take losses.

Mr Ospel survived the first wave of subprime write-downs. He thought he had saved the day when in December he recruited two new shareholders, the Government of Singapore Investment Corporation, and an unnamed Middle Eastern investor, who together put in SFr13 billion of new capital. That has proved inadequate. This week the bank's shareholders were asked to pump in SFr15 billion more.

Big or strong, but not both

Perhaps Mr Ospel's ambition for UBS to count in the world appealed in a country that has to shout to make itself heard. But the risks he needed to take were hard to reconcile with those other Swiss virtues of prudence and sobriety—virtues on which the banking industry had been founded. The damage to UBS, and to the reputation of Swiss banking in general, has been palpable—though UBS is not alone in getting caught out by the American mortgage market. Understandably EBK, the Swiss banking watchdog, has made it clear that prudence and sobriety are to be the watchwords once more. When UBS and Credit Suisse, the other big Swiss bank, recover from this crisis it will put tougher controls and higher capital charges on high-rolling investment banking. If that sends the business offshore, says Daniel Zuberbühler, director of the regulator and the self-styled Rhett Butler of supervision, then “frankly...I don't give a damn”.

For UBS, the most important task is to save its franchise as a world-beating wealth manager. Investment clients have been leaving UBS, and Credit Suisse too, because of fears that subprime woes will somehow contaminate the banks' wealth-management arms. Even Bank Vontobel, a private bank with a small investment-banking division, has been feeling the pinch. Meanwhile “pure” Swiss private banks such as Pictet, Lombard Odier, and Bank Julius Baer have been picking up business.

These are strong arguments for UBS to scale down, sell or shut its investment-banking business. Mr Ospel's designated successor, Peter Kurer, a corporate lawyer by background, is no friend of investment bankers. But getting out is easier said than done. Both UBS and Credit Suisse have plugged the “one bank” model, whereby seekers and placers of investment-banking products are matched internally. Breaking the one bank into its components without bloodshed, great internal resistance, or more losses would be difficult.

Mr Ospel remains a paradoxical figure. He built a great bank, but was always an outsider. He is not well-connected in business and politics, unlike his counterpart at Credit Suisse, Walter Kielholz, who is also vice-chairman of Swiss Re, a big reinsurer. Mr Ospel shunned offers of seats on corporate supervisory boards. He fostered a dress-down, geekish culture at UBS. That seemed to pay off, until the bank got American mortgage derivatives so spectacularly wrong. Surely UBS's 3,400 risk managers should have spotted the rocks ahead? The dangers hardly showed as a blip on their elaborate risk charts. Mr Ospel put too much faith in them and in his ambition, and he had to pay the price.

Financial literacy

Getting it right on the money

Apr 3rd 2008 | NEW YORK
From The Economist print edition

Illustration by James Fryer

A global crusade is under way to teach personal finance to the masses

“EVERYBODY wants it. Nobody understands it. Money is the great taboo. People just won't talk about it. And that is what leads you to subprime. Take the greed and the financial misrepresentation out of it, and the root of this crisis is massive levels of financial illiteracy.”

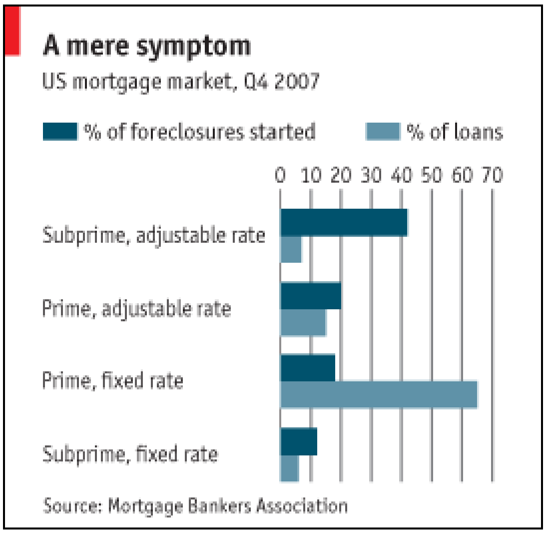
For years John Bryant has been telling anyone who will listen about the problems caused by widespread ignorance of finance. In 1992, in the aftermath of the Los Angeles riots, he founded Operation HOPE, a non-profit organisation, to give poor people in the worst-hit parts of the city “a hand-up, not a handout” through a mixture of financial education, advice and basic banking. Among other things, Operation HOPE offers mortgage advice to homebuyers and runs “Banking on Our Future”, a national personal-finance course of five hour-long sessions that has already been taken by hundreds of thousands of young people, most of them high-school students.

That many poor people do not have a bank account—and that few of them understand why this puts them at a disadvantage (let alone other essentials of personal finance)—is at the heart of “the civil-rights issue of the 21st century”, says Mr Bryant. He calls the attempt to help people help themselves out of poverty through financial literacy and economic opportunity the “silver-rights movement”.

In January George Bush appointed Mr Bryant vice-chairman of his new President's Council on Financial Literacy. This was launched as part of his administration's increasingly frenetic response to the financial crisis that followed the meltdown in subprime mortgages, many of them given to borrowers who may not have understood the risks. Often borrowers did not even realise that their monthly payment would rise if interest rates went up, says Mr Bryant. Subprime borrowers on adjustable interest rates, whose mortgages make up just 7% of the total, accounted for more than 40% of the foreclosures begun in the fourth quarter of last year (see chart).

The council is not short of expertise. It is chaired by Charles Schwab, eponymous boss of a broking firm. Its other members include the head of Junior Achievement, which has been teaching children about money since 1919, and a co-author of “Rich Dad, Poor Dad”, a self-help bestseller. Already, it has approved a new curriculum for middle-school students, “MoneyMath: Lessons for Life”. (Lesson one: the secret to becoming a millionaire. Answer: save, save, save.) It is starting a pilot programme to work out how to connect the “unbanked” to financial institutions. And it is supporting what, echoing the

Peace Corps, is called the Financial Literacy Corps: a group of people with knowledge of finance who will volunteer to advise those in financial difficulties.



April has been declared Financial Literacy Month by Congress. The need to make this more than a slogan is especially apparent this year. But America is not the only country where doing something about the widespread ignorance of personal finance is on the agenda. Governments from Britain to Russia are declaring their commitment to financial education. This month the World Savings Banks Institute, which represents retail and savings banks from 92 countries, will hold a summit in Brussels about financial education in the light of the subprime crisis.

Meanwhile, on March 17th a new campaign to promote financial literacy in the developing world was launched at a conference in Amsterdam. Called Aflatoun ("Explorer"), after a cartoon character based on a Bollywood star, it is the brainchild of Jeroo Billimoria, a social entrepreneur who previously worked with street children in India. Among other things, she founded a successful emergency 24-hour telephone service, called Childline. She found that many of the children she helped were entrepreneurial (indeed, such spirits may have played a part in their decision to leave home) and became convinced that, given better education, they would have done well in life.

Ms Billimoria addresses herself to children aged between six and 14, whom most educators consider too young to understand money. Having begun with experiments in rural India, her non-profit organisation, Child Savings International, has piloted the Aflatoun course in 11 countries, including Argentina, South Africa, Vietnam and Zimbabwe, since 2005. It is now extending the course to 35 developing countries. Only recently, after suggestions from the Dutch central bank and the European Commission, has Ms Billimoria started to adapt Aflatoun for rich countries such as Britain, the Netherlands, Ireland and perhaps America. "My mistake. I never thought it would be needed in developed countries," she says. If only.

Fools and their money

It is a "well-established fact" that "a substantial proportion of the general public in the English-speaking world is ignorant of finance," writes Niall Ferguson, an historian at Harvard University, in his forthcoming book about the history of finance, "The Ascent of Money". He produces a long list of evidence to support this conclusion. According to one survey last year, four in ten American credit-card holders do not pay the full amount due every month on the credit card they use most often, despite the punitive interest rates charged by credit-card companies. Nearly one-third said they had no idea what the interest rate on their credit card was.

There is similar evidence elsewhere. For instance, a survey in 2004 by Cambridge University and Prudential, a big insurer, found that some 9m Britons are "financially phobic", meaning that "they shy away from anything to do with financial information, from bank statements to savings accounts to life assurance." Research by the British regulator, the Financial Services Authority, found that one-quarter of adults did not realise that their pensions were invested in the stockmarket.

Financial illiteracy is not limited to subprime mortgage borrowers, then; it is pervasive in all age groups, income brackets and countries. "Subprime is a mere symptom," says Mr Ferguson, noting that many of the students he has taught in the "best universities in the world, including MBA programmes, don't even know the difference between the nominal and real interest rate." This problem is more pressing than ever, he adds, because governments and businesses have pushed more of the responsibility for financial well-being onto individuals, whether by encouraging homeownership or by promoting personally-managed retirement accounts rather than defined-benefit pensions.

The education system deserves much of the blame, says Mr Ferguson, who recalls having learnt nothing about personal finance at school in Scotland. In the 2007 survey of American credit-card holders, over half of the respondents said they had learnt "not too much" or "nothing at all" about finance at school.

Americans still leave school not knowing much about money. A sample of high-school pupils aged 17 or

18 gave correct answers to barely half of a set of questions about personal finance and economics posed in 2006 by researchers at the State University of New York, Buffalo. Less than one-quarter knew that income tax could be levied on interest earned in a savings account. Three-fifths did not know the difference between a company pension, Social Security and a 401(k) savings account.

The same survey, undertaken every two years for Jump$tart, a coalition of 180 organisations in America that promote financial literacy, found that one in six had taken part in a course dedicated to personal finance. A further one-third said they had learnt a bit from studying other subjects, such as business or economics. Laura Levine, the head of Jump$tart and a member of Mr Bush's financial-literacy council, says things are moving in the right direction, but that progress is slow. The results of the 2008 survey, which are unlikely to show much change, are due to be published on April 9th.

At present only three American states require that students take a course in personal finance. Another 15 insist that it be incorporated in other courses. Beyond that, it is a case of persuading schools one at a time. “Personal-finance education is not a hard sell conceptually,” says Ms Levine, “but only when it comes to getting it prioritised.” School principals will usually agree that financial literacy is worth teaching, but they are reluctant to give it time and resources.

Even when personal finance is taught, the right lessons are not necessarily learnt. “Wherever you look in America or the OECD, classes in financial literacy don't do much good,” says Lewis Mandell, an economist at Buffalo. “As an educator, I'd like to believe you can teach people to do anything right, but clearly the way we are going about teaching personal finance needs to be improved.”

To Mr Mandell's frustration, the only classroom method that seems consistently to raise financial literacy among high-school pupils is playing a stockmarket-investing game—which rewards taking high-risk bets. Most other approaches tend to show only short-term increases in financial literacy, he says.

According to Mr Mandell, one problem is that if financial literacy is taught, it tends to be before a student's final year—before she has faced any important financial decisions, such as buying a car or taking out a credit card. Another is that teachers are often financially illiterate, too. Financial literacy may be less about acquiring knowledge than forming good habits, something that is arguably better done before high school, let alone adulthood.

This is where Aflatoun comes in. Ms Billimoria encountered a great deal of scepticism when she developed her financial-literacy programme for six- to 14-year-olds. Yet she was convinced that starting with youngsters would be more effective, because that is “when their concept of themselves is developing and by 14 most of their habits have formed.”

An important part of the teaching is getting the children to start saving, ideally by opening bank accounts. Typically, they have only tiny amounts, but this is enough to get them used to handling money properly. At first this faced a lot of resistance, as people asked, “How can young children handle money?” recalls Ms Billimoria, but “it soon caught on and parents started giving children money to save.” To demonstrate its broad applicability, Aflatoun was piloted in economies beset by different difficulties. Zimbabwe, for example, was selected for its astronomical inflation rate. The course was adapted to encourage children to save by buying assets such as pencils, which, unlike the country's money, could be a store of value.

A nudge in the right direction

“The depressing truth is that financial literacy is impossible, at least for many of the big financial decisions all of us have to take,” says Richard Thaler, a behavioural economist at the University of Chicago. Aptly for someone who has built his career on the study of irrational financial behaviour, Mr Thaler admits that even he finds it hard to know the right thing to do. “If these things are perplexing to people with PhDs in economics, financial literacy is not the right road to go down.”

Instead, policymakers should “focus on making the world easier”, he argues in a new book, “Nudge: Improving Decisions About Health, Wealth and Happiness”, written with Cass Sunstein, a law professor (and an adviser to Barack Obama). By this he means defining more carefully and simply the financial choices that people have to make, and building “sensible default options” into the design of financial products, so that the do-nothing option is “financially literate”. Today, the best choice typically requires some working out and an active decision.

This does not mean that the same choice is right for everyone. The growing complexity of financial choices in part reflects remarkable innovation, much of which has benefited consumers. As Operation HOPE's Mr Bryant points out, thanks to the availability of subprime mortgages, “homeownership has lifted many poor people out of poverty; the challenge is to make the product better.”

Sweden's system of saving for old age contains an example of what Mr Thaler means. It offers Swedes a choice of funds to invest in, but includes a well-designed low-cost default option, which has become the choice of 90% of the people. The same approach might be taken to America's company 401(k) retirement plans, in which today's choices require a high degree of financial literacy. Employees might also be automatically enrolled in savings plans, with a right to opt out, instead of today's under-used opt-ins.

Mr Thaler deserves to be taken seriously, as one of his earlier attempts to apply behavioural economics to saving has had impressive results. Recognising that people find it harder to save money they already possess than to promise to put aside what they might have one day, he designed the Save More Tomorrow scheme, which gets people to commit themselves to saving a slice of any future pay increases. Where implemented, the plan has already brought about sharp increases in saving rates.

Another idea would make it easier for people to choose a suitable credit card, by obliging card companies to supply customers with two downloadable files, perhaps once a year. One would explain the issuer's charging rules; the other would list the charges the consumer has actually incurred. The consumer could then upload this to one of several websites that Mr Thaler believes would soon appear. With one click, the most suitable card would be recommended. A similar system could work for America's Medicare prescription programme, in which preliminary research suggests that matching the drugs a person needs with the right insurance plan would save on average $700 a year, he says.

Better product design and financial education need not be alternatives, points out Mr Mandell. They can work in tandem. He is enthusiastic about schemes such as the Child Trust Funds introduced in Britain. These “baby bonds” give every child a fund that matures at adulthood, letting everyone start out with a nest-egg. Mr Mandell is particularly excited by the curriculum being designed to be taught in conjunction with these funds, starting when children reach the age of seven. “Teachers will be able to talk about money realistically, because the kids will have ownership of wealth.”

If you can make it there

One of the most interesting attempts to combine teaching and superior products is taking place in New York, championed by a mayor, Michael Bloomberg, who made his fortune selling financial information. He has created an Office of Financial Empowerment, which is trying to use the powers of government to promote both financial education and better design of financial products.

The city's regulatory powers mean that it can crack down on firms that exploit financial literacy, and educate the public at the same time, says Jonathan Mintz, New York's Commissioner of Consumer Affairs. It has found that many tax-preparation agencies are offering “rapid refunds” which, as many consumers do not realise, are in fact loans in anticipation of refunds. Its publicity blitz about these loans led to coverage on news programmes “in 22 states and Canada”, allowing the city to promote the message that “anyone promising a tax refund within two days is selling a loan—don't do it.”

Another initiative is to use the city's system of helping people to apply for the earned income-tax credit as a chance to encourage them to open a bank account. As well as explaining to applicants the importance of saving, the city is working with banks to offer carefully designed accounts, and has even persuaded some philanthropists to provide matching funds for the first $250 someone saves. “You are not just educating me, you are allowing me to nod my head and say yes, and get a windfall,” says Mr Mintz. “Financial education is much more effective when it is connected to something real that is happening.”

With Miami, San Antonio, San Francisco, Savannah and Seattle, New York has formed the Cities for Financial Empowerment Coalition, which met for the first time to share ideas on March 18th. There was general agreement that education and better product design should go hand in hand. Most big banks have started to sponsor financial-literacy efforts, if only to cover their backs. However, Mr Mandell remarks, by increasing the charges for bank accounts with only small balances they have in effect deprived children of what was traditionally the best practical educational tool, an account of their own.

Indeed, one of the biggest problems may be the illiteracy of financial-service firms, which often fail to provide the products that poor consumers most want. That, at least, seems to be the conclusion of a recent survey in two of New York's poorer neighbourhoods. Many people were using fringe financial products such as pay-day loans or money orders rather than the services of mainstream banks.

The mainstream financial providers are “missing genuine markets”, says Mr Mintz. “One of the open secrets in this industry is that when people are engaged in behaviour that seems irrational, often it has a rational basis.” Which only goes to show that consumers are sometimes only as literate as the products the financial-services industry chooses to sell them.

Mr Bryant makes the same point more colourfully, noting that some of the first people to be hit by the subprime-mortgage crisis were the very brokers who had sold people inappropriate mortgages. Having drunk their own Kool-Aid, they found themselves with enormous debts and no job. “It takes less credentials to be a mortgage broker than a pimp on a street corner in Harlem,” he says. “Because a pimp needs references.”

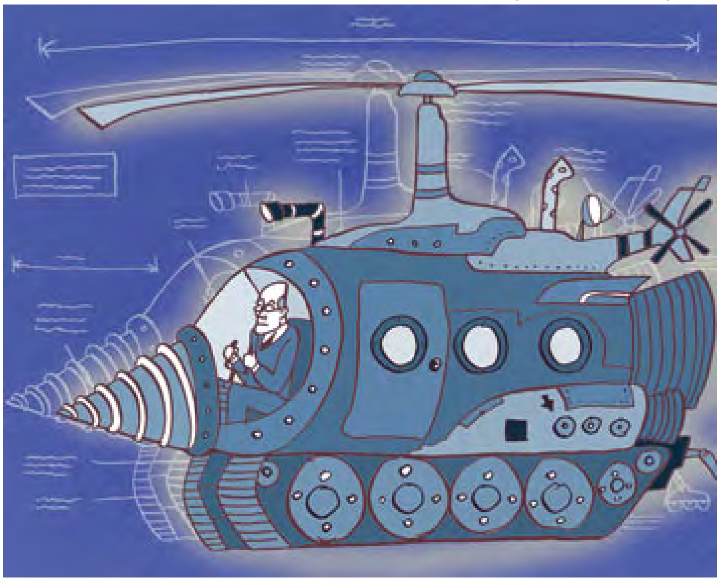
Economist.com FINANCE & ECONOMICS

Financial regulation

Will it fly?

Apr 3rd 2008 | NEW YORK
From The Economist print edition

Illustration by Satoshi Kambayashi



Hank Paulson kicks off what promises to be a long and bruising debate about how best to police America's financial firms

BIRD-WATCHING is high on the list of Hank Paulson's leisure pursuits. This week America's Treasury Secretary made it quite clear which avian creature his country's system of financial regulation most resembled: the albatross. His “blueprint” for change, presented on March 31st, is the boldest attempt to overhaul the rulebook since the Depression, when much of it was written. Most of the proposals are long-term, and will thus be pulled around by the next administration and Congress. But the plan marks an important first step in a much-needed facelift for an outdated regime. “He's teed it up in a way that can't be ignored,” says James Lockhart, director of the Office of Federal Housing Enterprise Oversight, which regulates America's quasi-official mortgage giants, Fannie Mae and Freddie Mac.

Though the proposals are entwined with the credit crisis, they predate it: the original impetus, a year ago, was fear over America's waning capital-markets competitiveness. The finished product is thus an odd mix of streamlining and tougher regulation, such as a new oversight body for mortgage markets. The timing struck some as odd too, but the Treasury says it wants to provoke debate, not distract from market woes. The report may also have been timed to head off what one official calls “very silly” new banking rules threatening to emanate from Congress.

Political pressure had been growing to revamp regulation, after bank supervisors were deemed to have been asleep at the switch as the credit bubble inflated. Mr Paulson's motivation was broader: he has long argued, correctly, that the present set-up is Balkanised and inefficient. None of the half-dozen federal regulators, which sit atop hundreds of state rulemakers, sees the whole map. Supervision has not always been divided up for the best reasons: the Securities and Exchange Commission (SEC), for instance, won oversight of big investment banks four years ago, not because it was best placed to do so, but as part of a compromise following legal changes in Europe.

The Treasury plan envisages several phases of reform. Short-term goals include the expansion of the President's Working Group (PWG), now a club for only select large regulators, and the creation of a federal Mortgage Origination Commission. This would consolidate oversight of a process that has wreaked havoc on balance sheets. It is also seen as a partial solution to the problem of dodgy securitisation, as the commission would grade the underwriting of loans going into pools. Critics point out, however, that it would create another layer of bureaucracy, since regulation of mortgage brokers and many lenders would stay with the states.

In the long run, say between two to eight years, Mr Paulson hopes to see a new regulatory architecture, with today's hotch-potch folded into three “objectives-based” agencies that some see as similar to the Australian system. That means a remodelled Federal Reserve with an eye on overall market stability; a prudential regulator for banks and thrifts, which would mean the demise of the Office of Thrift Supervision (OTS); and a business-conduct agency, taking in much of the SEC's oversight of disclosure and the like.

The eagle-eyed Fed (and its blind spot)

The first of these is the most important—and most controversial. Though the Fed would lose long-cherished supervisory authority over big banks such as Citigroup and JPMorgan Chase, its overall power would be greatly expanded. The role, which the Fed rehearsed with its rescue of Bear Stearns, would allow it to hunt anywhere for systemic risk, including among the entangled roots of hedge funds and investment banks.

Some at the Fed worry this may be a poisoned chalice. Spotting crises in advance is not easy—witness the central bank's own failure to ring alarm bells as house prices soared. One pundit, inspired by scandals in New York politics, likens its proposed role to “putting Eliot Spitzer in charge of a morals division”.

Now that the Fed has extended emergency funding to investment banks, they can expect tougher regulation. But the Treasury plan stops short of proposing that this arrangement be made permanent. As for the new regulation, it calls for further consideration by the PWG, which is taking a lead in a host of other areas, including reform of credit ratings and the derivatives-trading infrastructure.

Nor does the plan deal with regulation of Fannie and Freddie, where vast portfolios of mortgage-backed securities have soured, leaving them short of capital. However, Mr Paulson can reasonably argue that this crucial issue is already close to resolution. A bill to strengthen oversight of the two unwieldy enterprises has passed through the House and should soon be heard in the Senate.

You may think a plan this sweeping would be welcomed at a time when the old order had been found so wanting. But, this being an election year, and regulation being as emotive as it is arcane in America, it is being attacked from all sides. No wonder Mr Paulson talks of an “almighty battle” ahead.

Some on the right think it is not radical enough. The Treasury resisted the temptation to propose a single super-regulator along the lines of Britain's Financial Services Authority, leaving itself open to criticism that turf wars will persist. Admirers of the FSA's broad, principles-based approach to regulation contrast it with the lawyer-stuffed SEC, which values strongly enforced rules over guidelines. But the Northern Rock fiasco has tarnished the British agency's image. Moreover, regulatory competition is not always bad, says Allan Meltzer of Carnegie Mellon University. The Fed has been coaxed forward by more proactive agencies many times over the years, for instance.

Those on the left, meanwhile, attack the plan on two fronts. They complain that it does little to alleviate the crisis—even though that was not the intention—or to tighten the rules. Christopher Dodd, head of the Senate's banking committee, dismissed the reforms as “a wild pitch...not even close to the strike zone.” Others gripe that it is too kind to Wall Street: Mr Paulson, a former head of Goldman Sachs, included its biggest firms in the crafting of the plan. Not so, say the investment banks, which could well face higher capital requirements to redress their follies.

Super-regulated out of existence

Then there are the regulators and constituencies who fear losing out. The plan to merge the OTS out of existence prompted its head, John Reich, to write to employees declaring his opposition—though Christopher Cox, head of the SEC, which faces the same fate, has reacted more equivocally. State insurance regulators, which would be scrapped in favour of a federal regulator within the Treasury, are hopping mad. Small financial firms, such as credit unions and community banks, are none too pleased either, fearing that their voices will be drowned out under the new prudential regulator. Associations such as the Independent Community Bankers of America pack plenty of lobbying clout and could cause mischief.

One form of attack will be to point out that we have been here before: a number of the reforms, including both the federal-insurance charter and the dissolution of the OTS, have been discussed and rejected over the years. Reducing the power of the states could also prove incendiary. During the last boom, state regulators alerted the Fed to shenanigans in the subprime-mortgage market but were rebuffed.

Pro-regulation critics say Mr Paulson is cheekily trying to push through a largely deregulating package in disguise. He rejects such “simplistic bumper stickers”. The problem is not too much or too little regulation, he says, but the clumsiness of the system's design, which means rules are not applied effectively. With industry regulators obsessed with patrolling their own turf, for instance, important bits of the market have been missed at the edges. Think of mortgage brokers.

Still, the political mood increasingly favours more regulation, and many expect the reforms to be tugged in that direction. Hal Scott of Harvard Law School, director of an independent commission on capital-markets regulation, fears a repeat of Sarbanes-Oxley, the corporate-governance act rushed through in the wake of the Enron and WorldCom collapses, amid a similar “something must be done” atmosphere. Parts of that law put an intolerable burden on auditors and managers. They have since been pared back.

Frank Partnoy of the University of San Diego notes that Washington has a tendency to produce rules in fits and starts, especially after crises, and that these “often grow into monsters”. This is not a purely American thing, to be sure. The governments of Britain, Germany and others hard hit by the credit crisis are pushing for an urgent overhaul of banking regulations. However, the Financial Stability Forum, a group of global regulators which is due to issue a report to the G7 finance ministers on April 11th, is mindful that regulating too zealously does more harm than good.

Indeed, no regulatory regime is perfect. However sensible the rules, the market is always a step ahead of those who police it. As Mr Paulson concedes, better regulation is no guarantee against blow-ups “every five or ten years”. At which point, there will be a new clamour for change.

Mortgage bail-outs

Itching to act; unsure what to do

Apr 3rd 2008 | WASHINGTON, DC
From The Economist print edition

Congress struggles with ways to help homeowners

NOTHING focuses politicians' minds more than angry voters and upcoming elections. So it is no surprise that as America's housing crunch worsens in a presidential-election year, the pressure to help homeowners is growing. All the more so in the wake of the Federal Reserve's rescue of Bear Stearns. If the government saves Wall Street, goes a common refrain in Congress, it should do something to help homeowners too. But does that something make sense?

For the moment, the answer is not clear. This week's most frenetic action was in the Senate. Senators from both parties returned from their Easter break determined to hammer out a housing-assistance package, and quickly. On April 2nd they agreed on a draft compromise. Though the details were sparse as *The Economist* went to press, and there could still be amendments, the package seems more a pot-pourri of modest initiatives than anything dramatic.

It includes $4 billion to help states and local governments buy and do up repossessed houses; an increase in the amount of tax-exempt bonds that states can issue to refinance subprime mortgages; some $100m more to offer advice to homeowners facing foreclosure; and a $7,000 tax credit for anyone who buys a repossessed house.

There are also a set of business tax breaks that were excluded from Congress's original fiscal-stimulus package in early February; builders and other loss-making firms will be able to claim back earlier tax payments. More usefully, the bill includes some tinkering with the rules of the Federal Housing Administration (FHA), so that it can insure more mortgages. The plan is that the dollar limit on FHA-insured loans, for instance, will rise.

Tellingly, however, the compromise included none of the more ambitious housing proposals that have been touted by politicians in recent weeks. Many Democrats have pushed a plan to amend America's bankruptcy laws so that mortgage debt could be crammed down in bankruptcy court. Republicans have steadfastly opposed this change, arguing it would raise borrowing costs for future homebuyers. For the time being, at least, they have prevailed.

More surprising was the omission of another ambitious idea—to allow the FHA to reinsure between 1m and 2m defaulted mortgages provided that lenders agree to sell them at a discount. Two top-ranking Democrats, Chris Dodd, the chairman of the Senate Banking Committee, and Barney Frank, chairman of the House Financial Services Committee, want to allow the FHA to reinsure some $300 billion-$400 billion of defaulted housing loans if lenders write down the mortgage to 85% of the current value of a house. This plan has been gaining momentum on Capitol Hill. Even the Bush administration has been sounding less hostile. But the proposal was too controversial to push through quickly—and speedy action mattered most to the senators this week. All of which suggests that if the housing bust worsens, this rescue package will not be the end of Washington's efforts.

Buttonwood

Hung, drawn and first-quartered

Apr 3rd 2008
From The Economist print edition

After a painful period, investors face a stark choice

OWNERS of risky assets suffered agonies in the first three months of the year. Almost without exception, stockmarkets lost ground while the price of corporate debt fell sharply (or to put it another way, spreads widened). Only those who bought the unlikely combination of government bonds and commodities will be looking fondly at their portfolios.

For dollar-based investors, it did not matter much what kind of equities they owned. The MSCI World index was down 9.5%, the American market 9.9%, Europe 9.2% and emerging markets 11.3%. The supposedly uncorrelated Tokyo market (it has tended to go down when others went up) decided to become correlated again at the least helpful moment, dropping 7.7% in dollar terms. And even those numbers are flattered by the decline of the greenback; in local currency, Japan was down 17.8% and Europe 16.2%.

“Be greedy when others are fearful” is one of Warren Buffett's aphorisms and it is possible that this is one of those times. After all, most people are convinced that the American economy is in recession, and sentiment is depressed. The demise of Bear Stearns could mark the bottom of the crisis, and the cavalry are finally on their way: the Federal Reserve and the American Treasury are supplying both a monetary and a fiscal stimulus.

The first day of the second quarter started with a big rally in share prices when the ability of UBS and Lehman Brothers to raise new capital (see article) was taken as a sign of confidence. Another ray of light came from housebuilding stocks, which outperformed the S&P 500 index by more than 20 percentage points in the first quarter.

Perhaps the most encouraging sign has been an incipient rebound in the corporate-bond market. Some investors seem to have decided that, just as the spreads on corporate and mortgage-backed debt were driven down too far during the credit bubble, they may be too high now.

Michael Mauboussin of Legg Mason, a fund-management group, reckons that less than 20% of all market crises arise from external events like terrorism or elections; most are internally generated. In this case, the problem has been the symbiotic relationship between investment banks, hedge funds and other parts of the “shadow banking system” such as conduits and structured investment vehicles. The banks created assets and lent money so that others could buy them. Once this system faltered, it broke down completely; when the banks restricted lending, there were no buyers for the assets.

But the optimists hope that, if central banks can restore confidence to the financial sector, the crisis will not spread from Wall Street to Main Street. After all, despite the fall in house prices, there has been no collapse in American consumer demand. America may suffer a mild recession but that is already discounted in share prices, which look cheap relative to profit forecasts and to government bonds.

The pessimists think this view is deeply misguided. They believe the outlook for the markets is like an earthquake in Imelda Marcos's closet; there are a lot more shoes to drop.

For a start, consumer demand has yet to feel the full effects of the housing collapse. In addition, after the dismal first quarter investors are also, according to Citigroup, facing an $8.4 trillion decline in their equity wealth.

The pessimists also argue that forecasts for corporate profits in both 2008 and 2009 look too upbeat. Analysts are often slow to adjust their estimates as the cycle turns; they are still looking for double-digit profits growth. This time there is another worry; profits have been at their highest levels, relative to economic output, for a generation.

David Bowers of Absolute Strategy Research points out that firms outside the finance industry were also helped by the credit bubble, which boosted demand for their products and allowed them to enhance earnings per share by issuing debt to buy back stock. Investors may be disappointed once they find out companies cannot return as much cash to shareholders as they did during the boom.

The extreme bears fear that a long-running debt-financed boom is about to unravel. Low interest rates have allowed consumers to spend beyond their means and have allowed investors to buy assets with borrowed money. Unwinding this process will be long and painful.

That presents investors with a stark choice. If they believe in the apocalypse, they hoard gold and hard currencies like the Swiss franc. If they believe in business as usual, they pile back into equities. Fortunes are won at such moments. And they are lost, too.

Bank capital

Rights and wrongs

Apr 3rd 2008
From The Economist print edition

Having lost fortunes, banks such as UBS now have to raise money again

THE story of global banking in the past year has been one of riches to rags. On April 1st it became clear that this might be a good time for a whip round.

That, in a nutshell, was the message UBS and Lehman Brothers transmitted to their troubled banking peers when the Swiss bank announced plans to raise SFr15 billion ($15 billion) through a rights issue, and Lehman raised $4 billion from selling additional shares.

Far from balking at the new calls on their cash, shareholders leapt at the opportunity—Lehman raised $1 billion more than it had initially sought and its battered shares rose 18%. UBS's share price also climbed steeply, even though it announced another $19 billion in write-downs on subprime-related and other mortgage securities. Part of the price paid by UBS to its long-suffering shareholders was the head of Marcel Ospel, its chairman and architect of the 1998 merger that transformed the bank into one of the world's biggest. It was little consolation, however, that he will be replaced by Peter Kurer, the bank's general counsel, rather than an outsider untainted by the mess.

Under normal circumstances, rights issues are no cause for celebration. At times of duress, they can sound suspiciously like a mobster's “cough up or else” (“or else” meaning severe share-dilution).

But these are not normal times. For one, the near-collapse of Bear Stearns has shown that some banks' very survival may be at stake. If a rights issue makes survival more likely, shareholders may prefer to pay the price rather than risk everything—or almost everything. Secondly, investors are now so underweight in banks that share offerings may be a good opportunity to get back in if a corner has been turned. Better a bank that is acting conservatively than one that is in denial.

But has a corner been turned? The liquidity line thrown to investment banks by the Federal Reserve has given bullish investors the hope that the authorities will do what it takes to prevent any big bank going bust. On the other hand, first-quarter profit warnings from UBS and Germany's Deutsche Bank were anything but encouraging. UBS still has $31 billion of subprime and other ropy American mortgages on its books, not far below the $37 billion that it has already written down. Morgan Stanley and Oliver Wyman, a consultancy, estimate there could be up to $80 billion of additional mark-downs among the top 20 banks this year. Returns will be further hit by the need to raise new capital and use it more conservatively.

Already, there is a growing acceptance among investors that banks need to recapitalise, either by selling assets, reducing dividends or issuing new shares. Regulators are increasingly letting it be known that once the worst of the crisis is over, higher levels of capital will be an essential *quid pro quo* for the liquidity support they have provided to banks since last year.

There is a danger of moving too quickly, however. A senior European banker expressed concern this week that onerous new capital requirements could have a crippling effect on lending, especially when fair-value accounting may be exaggerating the losses. That, he said, could cause the crisis to deepen further.

The euro-area economy

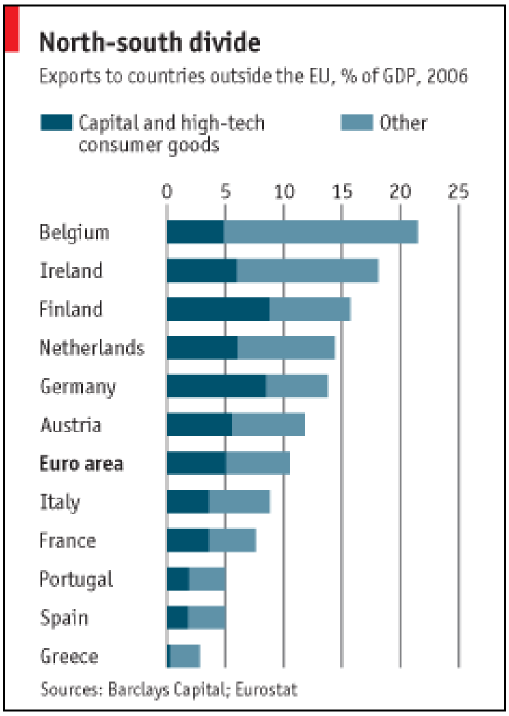
Bearing up

Apr 3rd 2008
From The Economist print edition

Some exporters are doing well despite the surging euro

WHEN rate-setters of the European Central Bank (ECB) gather for their monthly policy meeting on April 10th, they will feel they have every reason to resist calls for a cut in interest rates. Inflation in the euro area rose to 3.5% in March, the highest rate since the euro's launch in 1999 and well above the target of 2% or below. The economy is showing new signs of life too. German business confidence rose for a third month in March, according to Ifo, a research group. French firms are more cheerful. Futures markets, which had bet on a rate cut by June, now do not see one until December, says Christoph Rieger at Dresdner Kleinwort.

One puzzle is why the euro's strength has not dampened spirits. Yet it is too soon for the recent surge in the currency to affect trade volumes much. In the short term, profit margins will shrink unless exporters are insured against a rising euro. But currency hedges expire and it is unlikely that profits will be sacrificed for ever. In time firms will try to rebuild margins by raising prices. The more sensitive sales are to price increases, the more exports will suffer.



Julian Callow at Barclays Capital reckons the euro area has thrived in the face of a strong currency, partly because foreign demand for its wares is not very price-sensitive. Exports to countries outside the European Union are around 10% of GDP (see chart), of which just under half are capital equipment or high-tech consumer durables. These goods are eagerly sought in still-buoyant Asian economies and when their prices go up, it is hard for these buyers to find alternatives of the same quality. So export demand has been sticky—especially in Germany, where high-tech products are a big part of sales.

France derives less of its GDP from outside Europe than Italy does but is better placed to benefit from Asian demand, because a larger share of its exports are high-tech goods. Spain, Portugal and Greece are vulnerable on two fronts. They rely more heavily on spending at home or within the euro area, which is faltering; and their limited exports to markets beyond the EU are mostly in commoditised products—where competition with low-cost producers is made tougher by a strong currency.

The fortunes of the region's big economies are diverging along these lines. The mood of German and French firms has lifted, but Italian business confidence is at its lowest since August 2005, according to ISAE, a Rome-based research institute. The March survey of purchasing managers showed that manufacturing picked up in Germany and grew moderately in France. But in Italy activity is shrinking and in Spain the manufacturing gauge fell to its lowest level since December 2001.

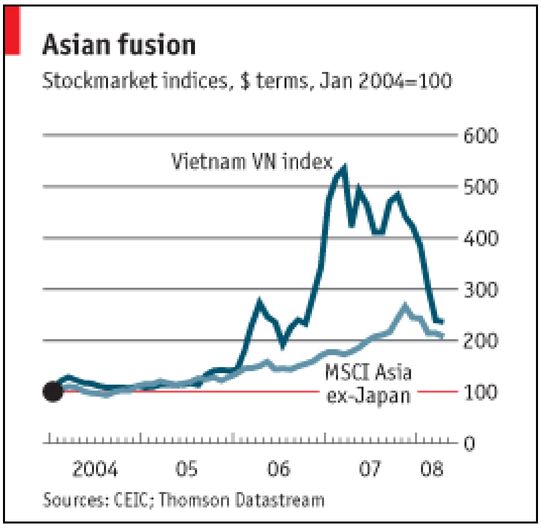
These frailties and the still-fragile state of consumer confidence suggest that the euro area's new-found resilience cannot be relied upon. The ECB has struggled to keep market interest rates, which determine the costs of borrowing for firms and households, aligned with its policy rate of 4%. The benchmark rate for three-month lending has recently been closer to 4.75%, adding to the tighter monetary conditions from a strong euro. Inflation should start to ease from April, though it may not fall decisively until the autumn. For the moment, though, worries that high inflation will persist will stay the ECB's hand.

Vietnamese shares

The fall of Ho Chi Minh City

Apr 3rd 2008 | BANGKOK
From The Economist print edition

The bursting of Vietnam's first stockmarket bubble



IN VIETNAM, as elsewhere in South-East Asia, almost everything has been going up in price—food, fuel, housing. But shares have been heading the other way. The region's stockmarkets had a rotten first quarter, their worst in six years. None has suffered as badly as Ho Chi Minh City's market, the region's youngest, which fell 44% over the quarter (see chart). Small investors in nominally communist Vietnam enthusiastically embraced capitalism after the stockmarket was created in 2000. But in the past few months they have experienced its downside, as the market's first ever bubble has popped.

The gloomy mood in stockbrokers' offices is in sharp contrast to how things were early last year, when they were crammed with excited small investors, eyes glued to the giant display screens as shares hit ever more extravagant highs. The IMF urged the country's regulators to cool the market. They did, instructing banks to stop lending to people and companies borrowing to speculate on shares. This let some air out of the bubble and, in January this year, the measure was partly rescinded.

However, the stockmarket then began to suffer from worries about domestic inflation and a downturn in America, which is a big buyer of Vietnam's exports. To rein in roaring inflation—almost 20% in the year to March—the authorities have had to reimpose lending curbs, this time much broader ones than those to reduce speculation. This added to the anguish in the stockmarket.

In recent weeks, as the slump intensified, banks that had lent to unsuccessful investors found themselves holding shares that had been put up as collateral—and dumped them on the market, making things worse. The government began worrying that this might put its huge privatisation programme at risk. It told the State Capital Investment Corporation (SCIC), which holds the state's remaining stakes in part-privatised firms, to buy back shares to bolster the market. Though not unprecedented (Britain did a similar buyback when its privatisation of BP, an oil firm, was hit by the 1987 stockmarket crash), the idea met with resistance from SCIC.

So, on March 27th, a more drastic measure was introduced, restricting daily price movements of individual shares to just one percentage point either way. Banks were also ordered to stop selling shares that they had received as collateral. The measures, intended to be temporary, succeeded in halting the market collapse. On April 3rd, it was announced that the trading band would be widened to two points.

AFP

It seems that, so far, foreign investors in Vietnam, more used to the roller-coaster ride that is stockmarket investing, have held tight. The market regulator, the State Securities Commission, said this week that foreign investors had been net buyers so far this year. It is local punters who have taken fright and pulled their money out. Although some will have lost a chunk of their life savings, their numbers are fairly small—there are perhaps half a million stockmarket investors in a country of 85m—so the overall wealth effect on the economy may be limited.

The dark clouds over the stockmarket may have a silver lining, reckons Dominic Scriven of Dragon Capital, an investment firm in Ho Chi Minh City. Until the crash, companies were finding it far too easy to issue shares and thus were under no pressure to improve standards of corporate governance. The constant stream of rights issues diluted earnings per share, contributing to the market's fall. Too many new stockbroking firms were being opened and non-financial firms were being distracted from their core businesses by the temptations of dabbling in shares. Now, a healthy shake-out seems likely. Braving a smile, Mr Scriven says, “We see a lot of good learning coming out of this.”

A red river of selling

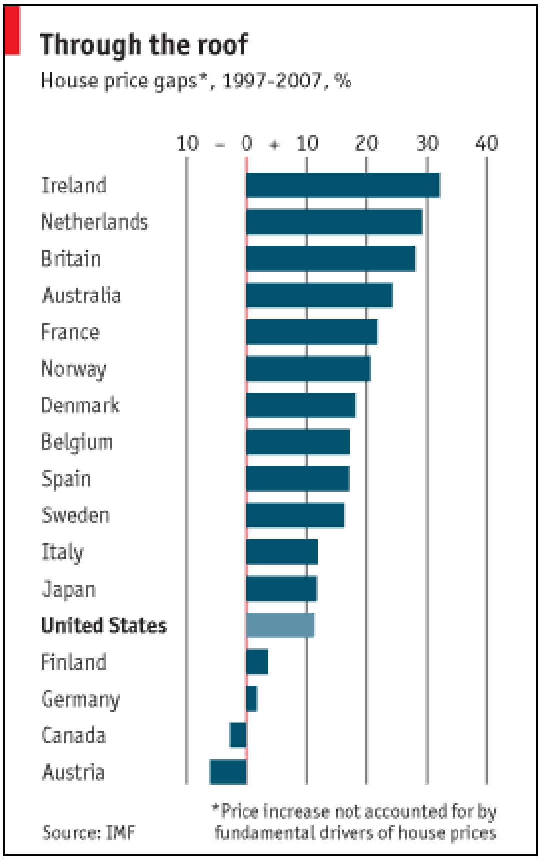
House prices

High-rise living

Apr 3rd 2008 | WASHINGTON, DC
From The Economist print edition

The riskiest housing markets

WHERE are house prices most overvalued? As the rest of the world watches the bursting of America's housing bubble, that question should be at the top of everyone's mind. The answer is not comforting: many countries have had far hotter housing markets than America and are also suffering from tightening lending conditions thanks to the credit crisis.



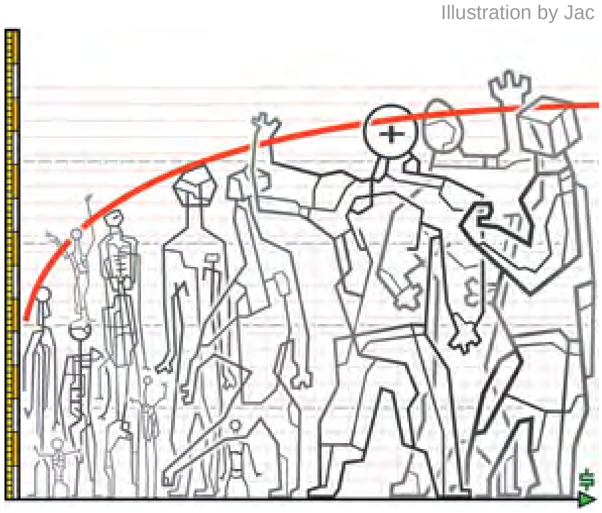
In the latest *World Economic Outlook*, Roberto Cardarelli of the IMF calculates the share of the increase in real house prices between 1997 and 2007 that cannot be accounted for by fundamental factors such as lower interest rates and rising incomes. This “house-price gap” is greatest for Ireland, the Netherlands and Britain, where prices are about 30% higher than can be justified by fundamentals. France, Australia and Spain have house-price gaps of around 20%. In America, where prices were already falling in 2007, the gap is just over 10%.

Economics focus

Feet, dollars and inches

Apr 3rd 2008
From The Economist print edition

Illustration by Jac



The intriguing relationship between height and income

“PALE and haggard faces, lank and bony figures...boys of stunted growth, and others whose long meagre legs would hardly bear their stooping bodies.” Charles Dickens's wrenching accounts of child labour helped to inspire a series of factory laws in 19th-century Britain. Indeed, by the 1870s factory owners claimed that it was they who were stooping under the burden of regulation. The new laws required a medical inspector to certify that a child was old enough and strong enough to work. Unhappy about the cost of these examinations, the manufacturers proposed a cheaper shortcut: a quick measure of a child's height to establish his age and stamina.

In 1876 Charles Roberts, an inspector, reported the statures of about 10,000 children, drawn from the registers of London military hospitals and his own tallies in Lancashire, Yorkshire and Cheshire. It was one of the first sophisticated statistical inquiries into the economics of height. Later scholars have explored the economic determinants of height (rich people are taller, on average), its economic consequences (tall people are richer, on average), and the clues it gives about a society's standard of living.

But Mr Roberts's results disappointed the Victorian bosses. Yes, taller children were older and stronger on average. But he found eight-year-olds as tall as 13-year-olds, and boys of ten who weighed twice as much as others the same age. This distribution was viewed by the 19th-century Belgian mathematician Adolphe Quetelet as God's “curve of error”, as if the tall and the short were deviations from a correctly proportioned “*homme moyen*”, or average man. The variation meant that you could not use the mean to infer anything about an individual: Mr Roberts could say that the average height of 11-year-old boys was 52½ inches, but not that this boy of 52½ inches was 11.

Nonetheless, manufacturers were right to suspect that taller people, on average, were more employable. Surprisingly, this remains true in the knowledge economy of today's America and not just the factory economy of Victorian Britain. The tallest quarter of the population earns 9-10% more than the shortest quarter, according to two recent studies. Nicola Persico and Andrew Postlewaite of the University of Pennsylvania and Dan Silverman of the University of Michigan think this is because height gives adolescents self-confidence and helps them learn valuable social skills. Anne Case and Christina Paxson of Princeton University, on the other hand, argue that people who grow to their full potential are smarter, on average. Both brains and build depend on the care and nourishment a child receives.

Height adds to income, income also adds to height. In countries languishing at a real income of $4,000 per head (in 1985 dollars), boys average less than 145cm. In places that are $6,000 a head richer, boys are 4cm taller, according to calculations by Richard Steckel of Ohio State University. Likewise, Angus

Deaton of Princeton University reports that Indian men of 20 are about 1cm taller than 40-year olds, partly because the country was substantially richer when they were born. In India adults still look up to their parents. But only figuratively.

The relationship between dollars and inches is not, however, straightforward. Uganda, for example, is both poorer and taller than India, where almost half of children under five are stunted, according to United Nations figures. Americans born in the 1880s, as the country's industrial revolution gathered pace, were both richer and shorter than their forebears.

What explains these enigmas? Height rises with prosperity, but at a diminishing rate. It traces an arc, not a straight line, as income increases. Otherwise, Mr Steckel points out, Bill Gates would be a giant. Earning enough to buy plentiful calories and protein makes a big difference to stature. But once a person has enough money to free himself from thin gruel and hard labour, extra income has less to add. “Stature,” Mr Steckel writes, “is a good measure of deprivation but not of opulence.”

Tall men are created equal

This arc has an interesting implication: the stature of society may reflect equality as well as prosperity. Extra resources add more to poor people's growth than they add to rich people's. So if two societies, with the same income per head, were to line up next to each other, the more egalitarian society should be taller.

This may be one explanation among many for the shrinking America of the 19th century. Tax records show that wealth gaps widened in America as industrialisation took hold. From 1820 to 1900, the Gini coefficient (a standard measure of inequality) in Massachusetts rose by 24%, according to Mr Steckel. Even as average heights fell, the stature of senior students at Yale and Amherst rose from 171cm to 173cm.

In India the starkest divisions are sometimes within the household. Indian women tend to have less clout than their African counterparts. Their claim on a family's resources may be weak, even as the demands made on them are heavy. Many women are consequently underfed or overworked during pregnancy. Their offspring, especially their daughters, are also undernourished during infancy. India may be growing taller as it grows richer. But, Mr Deaton shows, the average height of Indian men is rising three times faster than that of Indian women.

Some Indians deny this enigma, writes Meera Shekar of the World Bank. If Indians fall short of standard heights, they say, those standards must be an alien imposition, based on foreign populations. But the genetic differences between populations count for much less than the genetic differences within them. The grandchildren of American immigrants, for example, reach similar statures, whatever their ancestry. James Tanner, a giant among growth scholars, puts it this way: the great variation in human height, he writes, is “not a curve of God's errors, but of everyone's possibilities.”

Genetics and lung cancer

Smoking out the smoking gene

Apr 3rd 2008 | NEW YORK
From The Economist print edition

Alamy

Your genes may control how much you smoke—and how likely you are to get lung cancer as a result

THAT smoking causes lung cancer is well established. But what causes smoking? This is the question at the heart of a study published in *Nature* by a group of researchers who work at deCODE, an Icelandic genomics company. They do not, quite, answer it. But they do think they have the answer to the related question of why some smokers smoke in moderation whereas others are rarely found without a fag in their hands—and thus why some people are, genetically speaking, more susceptible to lung cancer than others.

That answer lies in part of human chromosome 15, and depends on what is known as allele T of SNP rs1051730. A SNP, or single-nucleotide polymorphism, to give its full name (the short version is pronounced “snip”), is a place where genomes routinely differ from one another by a single genetic letter. In this case, the variation happens inside a gene for one of the receptor molecules that nicotine attaches itself to when it produces its buzz. Based on a study of 13,945 Icelandic smokers, deCODE's researchers showed that having a T in the appropriate part of the gene correlates very strongly indeed with being a heavy smoker. The team estimates that the chance of their being wrong is less than one in a thousand trillion.

Not surprisingly, having the T variant also correlates with the chance of a smoker getting lung cancer. Each copy (there may be none, one or two, since one can come from a person's father and one from his mother) increases that chance by 30%. The T variant does not, however, increase the likelihood that someone will take up smoking in the first place. That is either a matter of free will or, if it is genetic, is controlled by genes somewhere else.

It all looks neat and simple—and extremely plausible. Genes promote smoking; smoking promotes cancer. However, it might be wrong. For another paper in *Nature*, and a third in its sister journal *Nature Genetics*, report similar studies that have drawn rather different conclusions.

Model T?

Paul Brennan and Christopher Amos both agree that something significant is going on in the part of chromosome 15 studied by deCODE. But they have concluded that genetic variation there acts directly on a person's susceptibility to lung cancer, rather than acting indirectly by modifying his smoking behaviour. That does not mean the gene or genes in question actually cause lung cancer. Rather, it means that they amplify the effects of smoking instead of the amount of smoking.

Like deCODE, both Dr Brennan (who works at the International Agency for Research on Cancer, in France) and Dr Amos (who works at the University of Texas) identified rs1051730 as an important SNP. Unlike deCODE, though, both think a second SNP, rs8034191, is involved as well. That, and the fact that the region of chromosome 15 under scrutiny has two other nicotine-receptor genes in it, suggests the situation may indeed be more complex.

On top of this, Dr Brennan and Dr Amos both used a different method from deCODE's. They compared lung-cancer patients directly with otherwise similar cancer-free smokers, in what is known as a case-controlled study, and concluded that genetic variants in the nicotine-receptor-rich part of chromosome 15 are changing not smokers' behaviour, but their susceptibility to cancer. Moreover, Dr Brennan also claims to have discovered an increased susceptibility to lung cancer in non-smokers with the relevant SNPs, though his sample size is small and his result is not supported by Dr Amos's work.

These contradictory conclusions are both puzzling and intriguing. DeCODE has one further piece of evidence in its favour. Besides the correlation with lung cancer, the T variant also seemed to correlate with peripheral arterial disease, another common side-effect of smoking. On the other hand, the firm also acknowledges that the link it thinks it has discovered does not account for the whole of the risk of smoking-induced lung cancer. What is not in doubt, however, is that there is some sort of a link between genetics and lung cancer.

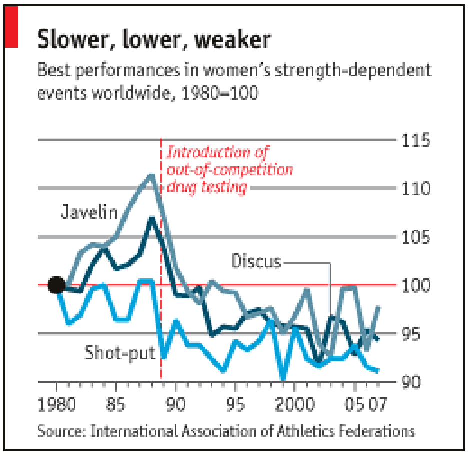
That raises interesting issues, particularly as genetic testing becomes easier. DeCODE has already announced it will add rs1051730 to the standard screen it offers to those who wish to know their susceptibility to diseases. The day is not far off, therefore, when those who take the essentially irrational decision to start smoking tobacco will be able to find out in advance exactly how foolish they are being.

Doping in sport

High hopes

Apr 3rd 2008
From The Economist print edition

An athlete's genes may help determine the results of his dope test



CHEATING in sport is as old as sport itself. The athletes of ancient Greece used potions to fortify themselves before a contest, and their modern counterparts have everything from anabolic steroids and growth hormones to doses of extra red blood cells with which to invigorate their bodies. These days, however, such stimulants are frowned on, and those athletes must therefore run the gauntlet of organisations such as the World Anti-Doping Agency, which would rather they competed without resorting to them.

The agencies have had remarkable success. Testing for anabolic steroids (in other words, artificial testosterone) was introduced in the 1970s, and the incidence of cheating seems to have fallen dramatically as a result (see chart). The tests, however, are not foolproof. And a study just published in the *Journal of Clinical Endocrinology & Metabolism* by Jenny Jakobsson Schulze and her colleagues at the Karolinska Institute in Sweden suggests that an individual's genetic make-up could confound them in two different ways. One genotype, to use the jargon, may allow athletes who use anabolic steroids to escape detection altogether. Another may actually be convicting the innocent.

The test usually employed for testosterone abuse relies on measuring the ratio of two chemicals found in the urine: testosterone glucuronide (TG) and epitestosterone glucuronide (EG). The former is produced when testosterone is broken down, while the latter is unrelated to testosterone metabolism, and can thus serve as a reference point for the test. Any ratio above four of the former to one of the latter is, according to official Olympic policy, considered suspicious and leads to more tests.

However, the production of TG is controlled by an enzyme that is, in turn, encoded by a gene called *UGT2B17*. This gene comes in two varieties, one of which has a part missing and therefore does not work properly. A person may thus have none, one or two working copies of *UGT2B17*, since he inherits one copy from each parent. Dr Schulze guessed that different numbers of working copies would produce different test results. She therefore gave healthy male volunteers whose genes had been examined a single 360mg shot of testosterone (the standard dose for legitimate medical use) and checked their urine to see whether the shot could be detected.

Testing the test

The result was remarkable. Nearly half of the men who carried no functional copies of *UGT2B17* would have gone undetected in the standard doping test. By contrast, 14% of those with two functional copies of the gene were over the detection threshold before they had even received an injection. The researchers estimate this would give a false-positive testing rate of 9% in a random population of young men.

Dr Schulze also says there is substantial ethnic variation in *UGT2B17* genotypes. Two-thirds of Asians have no functional copies of the gene (which means they have a naturally low ratio of TG to EG), compared with under a tenth of Caucasians—something the anti-doping bodies may wish to take into account.

In the meantime, Dr Schulze's study does seem to offer innocents a way of defending themselves. Athletes travelling to Beijing for the Olympic games later this year may be wise to travel armed not only with courage and the “spirit of Olympianism”, but also with a copy of their genetic profile, just in case.

The first Americans

Number one and number twos

Apr 3rd 2008
From The Economist print edition

Ancient faeces have pushed back the date when people first lived in America

A GOOD doctor can tell a lot from a stool sample, but Dr Thomas Gilbert can tell more than many. Indeed, he thinks he can tell when a continent was first populated, and by whom, for the stools he is examining were produced by some of North America's earliest inhabitants.

Dr Gilbert, who works at Copenhagen University, in Denmark, is one of the leaders of a team that has just published its findings in *Science*. The team had examined 14 coprolites, as fossil faeces are termed by polite scientists. These coprolites came from a complex of caves in Oregon. Radiocarbon dating showed some of them to be more than 14,000 years old. And they appeared to be human.

The reason that excites researchers is that it helps to push back the date when humanity arrived in the Americas. Traditionalists have long believed that the first Americans belonged to what is known as the Clovis culture, after a style of arrowhead found first at Clovis, New Mexico, but which has turned up at several other locations. Clovis sites are 13,000 years old at most. However, a lone non-Clovis site in Chile seems to be to 14,600 years old. That suggests the “Clovis first” theory is wrong. But without supporting evidence, some Clovistas have been reluctant to concede.

Dr Gilbert and his colleagues have, it seems, provided that evidence. Their data support the idea that there were people in America before Clovis. They also suggest that at least some of those people were the ancestors of modern Amerindians. That is because the Oregonian coprolites contain DNA that has characteristics which match that of living Amerindians.

This suggests in turn that the people who produced those coprolites were not related to Kennewick man, a skeleton found some years ago in neighbouring Washington State. Kennewick man is a mystery because, although ancient (he is dated to 9,300 years ago), he does not look like a modern Amerindian. Rather, he looks Caucasian, so it is unlikely his DNA would resemble a modern Amerindian's.

A few sceptics have suggested that the coprolites are actually dog faeces, and the DNA is subsequent contamination. That is just about possible, but even if it did turn out to be true, they do contain human hair. That means that whichever animal they emerged from, people must have been around at the time. Clovis Man, it seems, was a Johnny-come-lately after all.

Irrational economics

Look and feel

Apr 3rd 2008
From The Economist print edition

The value of a coin or banknote depends on its familiarity

IF RATIONALITY reigned supreme in economics, travellers would spend their foreign cash based upon its value in the currency of their home country. All too often, however, they actually treat foreign banknotes as though they were Monopoly money. Given the unfamiliarity of other countries' currencies that is not, perhaps, surprising. But a piece of research about to be published in *Psychonomic Bulletin & Review* by Adam Alter and Daniel Oppenheimer, a pair of psychologists at Princeton University, shows that something similar is true even of familiar currencies, depending on the form they come in. In particular, Dr Alter and Dr Oppenheimer have demonstrated that the perceived value of a dollar changes with the form that dollar takes.

For the first part of their study Dr Alter and Dr Oppenheimer picked 37 “volunteers” at random from the university's canteen. They asked them to estimate how many simple objects—gumballs, paperclips and pencils—they could purchase with either a standard dollar bill or a Susan B. Anthony dollar coin that was presented to them. Susan B. Anthony dollars are legal tender but, having been produced only from 1979-81 and then again in 1999, they are rarely seen in circulation.

After the volunteers had made their estimates, they were asked to indicate on a scale of one to seven how familiar they were with either the banknote or the coin. Dr Alter and Dr Oppenheimer were not surprised to find that all participants were less familiar with the coin than with the banknote. Nor were they that surprised to find a difference in how the participants valued coin and note (the expectation that there would be a difference was, after all, the point of doing the experiment). They were, however, flabbergasted by the size of the difference. People offered the banknote believed, on average, that they could use it to buy 83 paperclips, 72 napkins or 46 sweets. Those offered the coin thought 39 paperclips, 51 napkins or 27 sweets. In other words, the note was believed to be almost twice as valuable as the coin.

To check this result was not caused by some prejudice in favour of paper money and against coinage, Dr Alter and Dr Oppenheimer repeated the experiment offering either two single dollar bills or a single two-dollar bill. Like dollar coins, two-dollar bills are rarely found in circulation. The second set of results was virtually the same as the first. And when the study was conducted a third time with a real dollar bill and a subtly doctored version that had had, among other things, George Washington's head reversed, the results were, again, nearly the same. People, it seems, literally value familiarity.

Whether this observation has wider significance is unclear, but it may. Familiarity takes time to build up. It may have been unfamiliarity with the currency itself, rather than with its face value, which caused price gouging (or, at least, allegations of price gouging) when the euro was introduced. With that in mind, it might be wise for America's Federal Reserve to watch retail prices carefully when it introduces a new series of banknotes in August. With money, it seems, it is not familiarity, but unfamiliarity that breeds contempt.

Physics and the law

Stranger than truth

Apr 3rd 2008
From The Economist print edition

Not an April fool, honestly

IN THE weeks before Trinity, the first test of an atomic bomb, some of the physicists in the Manhattan Project fretted that their brainchild might set off a reaction that would burn up the Earth's atmosphere. Similarly, an experiment carried out in Long Island a few years ago, which was intended to produce a form of matter known as strange quarks, caused a few imaginative worrywarts to fear that the entire planet would be converted into subatomic particles called strangelets.

Neither of these things came to pass, of course. But that does not stop people continuing to worry that esoteric phenomena at the edge of physics might spell The End Of Everything in a satisfyingly B-movieish cataclysm. The twist in the latest of these scares is that the worriers seem to think that a court in Hawaii is somehow empowered to stop events happening half a world away, on the Franco-Swiss border.

The bugaboo this time is black holes. A black hole is an object so dense (and thus with such a strong gravitational field) that nothing—not even light—can escape it. Not surprisingly, no such object has ever been observed directly. However, the indirect effects of black holes can be seen all over the place, and the universe would not make sense without them, so there is little doubt that they really do exist.

It would, nevertheless, be nice to have one to hand. And some physicists think that this will happen soon—when a machine called the Large Hadron Collider is switched on later this year. The LHC is the proud creation of CERN, Europe's main particle-physics laboratory, which is located near Geneva. It will create a zoo of new particles for those who study the fabric of reality to get to grips with. Among those objects may be some tiny black holes. The LHC's physicists are particularly excited by these because they will allow for the experimental examination of gravity. They may also allow Stephen Hawking, a well-known British physicist, to receive a much-deserved Nobel prize. That would almost certainly happen if he turns out to have been right in his prediction that tiny black holes will evaporate in a spectacular burst of energy that has come to be known as Hawking radiation.

Luis Sancho and Walter Wagner, however, are excited for a different reason. They fear that, far from evaporating in this way, any black holes created in the LHC will start sucking matter in—and will eventually swallow the Earth. This is despite the fact that if the LHC is, indeed, powerful enough to create such black holes, then so are the cosmic rays that continually bombard the Earth without noticeably sucking it into hideous doom.

This week, Mr Sancho and Mr Wagner put their fears before a federal district court in Hawaii, asking for an injunction on CERN to stop the LHC opening. They also asked, perhaps with a fractionally higher hope of success, that America's main particle-physics laboratory, Fermilab, be forbidden to furnish its European friends and rivals with equipment.

Mr Wagner, a former nuclear-safety officer who now runs a botanical garden on Hawaii, has form in this area. It was he who led worries about the Long Island strangelets, to the extent of trying to get a similar restraining order imposed on Brookhaven National Laboratory, where the strange-matter experiment was to be conducted. Strange matter also features in his worries about the LHC. But his behaviour suggests that strange matter comes in many guises, not all of them within the purview of physicists.

Natural disaster

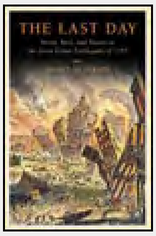
Fire and brimstone

Apr 3rd 2008
From The Economist print edition

Alamy

The great Lisbon earthquake of 1755 was the Hurricane Katrina of its time

The Last Day: Wrath, Ruin and Reason in the Great Lisbon Earthquake of 1755
By Nicholas Shrady



Viking; 228 pages; $25.95

Buy it at
Amazon.com
Amazon.co.uk

AT 9.30 on the morning of November 1st 1755, All Saints Day, an earthquake struck Lisbon while most of the population was at church. “I thought the whole city was sinking into the earth,” wrote a terrified English traveller. Those who could fled to the quayside and took to the boats. Ninety minutes later, a tsunami swept them away. Worse was to come. The cooking fires lit to celebrate the feast day spread in the high winds until almost all the city was ablaze. Within two hours, a European capital had been reduced to rubble, swept by floods and consumed by fire.

“Perhaps the Daemon of fear never spread so rapidly and so powerfully its terror upon the earth,” wrote Johann Wolfgang von Goethe, a German poet who was only six years old at the time but could still recall, when he published his autobiography more than half a century later, how frightened he was at hearing of the earthquake. John Wesley, the founder of Methodism, wrote extensively about it. Britain's parliament gave the victims £100,000, an early example of disaster relief.

The great Lisbon earthquake was the first of a series of natural disasters to strike Europe in the second half of the 18th and early 19th centuries, a period when growing scientific observation was providing new explanations of the natural world to rival those of the church. Because it occurred on a major religious holiday it also set off the sharpest arguments about its cause and significance. Nicholas Shrady, an American travel writer and architectural critic, tries hard to bring to life what happened, though he does not really do justice to the earthquake's impact on contemporary thought. Which is a shame, for this was significant.

Its most influential interpreter was Voltaire. In his satirical novel, “Candide”, published four years later, the eponymous hero arrives in Lisbon as the earthquake begins. He and his tutor, Dr Pangloss, are made scapegoats by the Inquisition. Candide is flogged and his tutor hanged, though he survives the ordeal. Pangloss embodies the view that, if God made the world, He must have created “the best of all possible worlds”. Voltaire used the earthquake to attack deistic optimism.

This slender volume suggests that scientific and technical responses mattered as much as moral and philosophical ones. For the rebuilding, Lisbon's military engineers invented Europe's first earthquake-proof buildings (soldiers marched round them to test reactions to vibrations). The government sent detailed questionnaires to every parish asking, for instance, “Did you perceive the shock to be greater from one direction than another? Did the sea rise or fall?” Modern seismologists used the responses to those questionnaires to reconstruct in detail what happened. The science of seismology springs partly from the disaster. John Mitchell, an English physicist and astronomer, was inspired by it to put forward the first theories of wave motion in the earth.

But Portugal was the main battleground between religious and scientific explanations. The man in charge of reconstruction, Sebastião José Carvalho e Melo (better known to history as the Marquis of Pombal), was one of Portugal's great modernisers. He not only needed, as he put it, to “bury the dead and feed the living”: he also had to save Lisbon from rivals who were urging the king to move the capital to Portugal's main source of wealth, Rio de Janeiro. Pombal reasserted order, organised food and shelter, and approved a rebuilding project now recognised as one of the great 18th-century urban plans.

But parts of the church viewed the earthquake as God's punishment. An influential Jesuit, Gabriel Malagrida, published his “Opinion on the True Cause of the Earthquake”, arguing that rebuilding was an offence against God. The Jesuits sought to prevent reconstruction. The conflict between clerical and secular authorities came to a head with an assassination attempt on the king, organised by a family to whom Malagrida acted as confessor. Eventually, the Jesuits were expelled from Portugal, and Malagrida garrotted and then burned. Pombal went on to reorganise Portuguese education, trade and law.

But modernisation was not to last. On the death of the king, reaction set in. Pombal was stripped of his posts and banned from coming within 20 miles of the new queen. She, it was said, had temper tantrums at the mere mention of the man who had saved her capital.

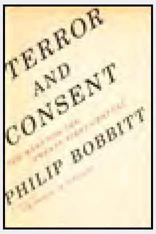
The Last Day: Wrath, Ruin and Reason in the Great Lisbon Earthquake of 1755.
By Nicholas Shrady.
Viking; 228 pages; $25.95

Fighting terrorism

Fresh thought needed

Apr 3rd 2008
From The Economist print edition

Terror and Consent: The Wars for the Twenty-first Century
By Philip Bobbitt



Knopf; 688 pages; $35. Allen Lane; £25

Buy it at
Amazon.com
Amazon.co.uk

SORRY, but who asked for a second helping? In 2002 Philip Bobbitt, an American professor of law, published a great slab of a book, more than 900 pages long, called “The Shield of Achilles” and subtitled, no less portentously, “War, Peace and the Course of History”. A mere six years later, here he is again, with another tome.

In Mr Bobbitt's defence, you could argue that his subject, the so-called war on terror, is indeed complicated and deserves treatment in depth. Furthermore, his ideas are bold. “I believe that almost every widely held idea about 21st-century terrorism...is wrong and must be thoroughly rethought,” he says in his introduction. The promise is redeemed in spades. It is not only the war on terrorism he rethinks in subsequent chapters but also the nature of the state, the shape of international law, the meaning of sovereignty, the structure of the United Nations—you name it. The trouble with all this ambition is that it produces an argument that is confusing, hard to digest and perhaps wrong.

At the heart of this new book is an idea set out at great length and with rather less precision than in the previous one. This is that the nation-state, having displaced the princely state, is at present being supplanted in turn by the “market state”. The legitimacy of such states will be based, it seems, on a new proposition: instead of being a provider or redistributor of goods and services they will maximise citizens' options by deregulating massively, outsourcing many operations to the private sector and giving more autonomy to local, “voluntarily composed” communities.

Maybe. There is not much here that wasn't part of, say, Tony Blair's woolly and now forgotten attempt to redefine the state in his “third way”. But what has any of it got to do with terrorism? A lot, according to Mr Bobbitt. Modern terrorist organisations “uncannily mimic” these market states: the terrorists, too, outsource operations, rely on local, self-forming groups and so forth. As market states increase their wealth, they inadvertently increase their vulnerability. They sharpen inequalities, which can feed anger, which can lead to terrorism. And they enable the “commodification” of weapons of mass destruction (WMD), the technology for which is more readily available to non-state actors.

In light of all this, concludes Mr Bobbitt, it is time to accept that warfare is changing in ways that make it necessary to blur the old boundaries between police behaviour and military campaigns, and the laws of peace and war must change accordingly. America can no longer afford a self-blinding barrier between the CIA and the FBI, for example. Relations between states will need reform as well. Forget the “opaque” sovereignty of the nation-state enshrined in the world's present institutional arrangements. This must give way to a “transparent” or even “translucent” (yes, your reviewer is confused too) sovereignty, which depends on how a state treats its people, whether it acquires WMD or violates international treaties.

The world according to Bobbitt contains “states of consent” and “states of terror”. States of terror can never be sovereign, and other states should be allowed to invade them in order to halt the spread of WMD, prevent genocide or avert humanitarian disaster. But you would have to take care, lest this rule became a pretext for aggression. Perhaps, submits Mr Bobbitt, a “kind of G2” comprising America and the European Union, the two superpowers that enjoy widespread legitimacy, might act as the “energising force” behind this needed change in the world order.

It is too easy to mock ambition. In what is now 1,600 pages of intricate, erudite and often audacious argument, Mr Bobbitt serves up a good number of fresh observations and intriguing ideas. But, reader, you will need time, a stomach for the pretentious, and a very hearty appetite. Lean cuisine this isn't.

Terror and Consent: The Wars for the Twenty-first Century.

By Philip Bobbitt.
Knopf; 688 pages; $35. Allen Lane; £25

V.S. Naipaul

Naked ambition

Apr 3rd 2008
From The Economist print edition

PATRICK FRENCH takes the title of his life of V.S. Naipaul from the first sentence of “A Bend in the River”, one of the 2001 Nobel laureate's best-known books: “The world is what it is; men who are nothing, who allow themselves to become nothing, have no place in it.” It is the kind of statement that makes liberal-minded readers recoil, almost instinctively. Each part of it is a provocation. But it encapsulates the man, his fear of the void, his contempt for the loser. And it is a reason for reading this penetrating, wide-ranging and unflinching biography.

The World Is What It Is: The Authorized Biography of V.S. Naipaul
By Patrick French

Picador; 555 pages; £20. To be published in America by Knopf in November

Buy it at
Amazon.com
Amazon.co.uk

Born in Trinidad in 1932, of Indian descent, V.S. Naipaul, now Sir Vidia (for Vidiadhar) Naipaul, can be fully understood only in the context of his background. A void, as Mr French explains, is at the centre of Trinidad itself. During the 16th century, the Spanish, Dutch, French and English dispossessed and exterminated the island's indigenous people. The hole was filled by immigrants from everywhere—descendants of the exterminators, as well as Greeks, Portuguese, West Africans, Chinese, Indians, Venezuelans and Madeirans—all of them divided by race and language, subdivided by religion and caste, the whole thing finely graded by colour: “white, fusty, dusty, musty, tea, coffee, cocoa, black, dark black,” as a Caribbean jingle has it.

Sir Vidia's Hindu forebears claimed Brahmin status, but they came to Trinidad as indentured labourers, the despised of the despised—shipped over in the 19th century from famine-stricken northern India to fill the gaps in the sugar plantations left by freed slaves. On his mother's side they worked their way up to a big house and a shop from where they could despise in turn. On his father's side, they were still close to the fields. But amazingly, it was his father, Seepersad Naipaul, who made the real escape—not by way of a shop, but by way of language. He taught himself English, landed a job as a journalist on the *Trinidad Guardian*, and wrote short stories with a linguistic mastery that his son always acknowledged as his model.

But living in two worlds is perilous. One day Seepersad looked in the mirror and saw nothing, as though he had vanished down a cultural fault-line. Sir Vidia spent his life morphing across the same divide. In the midst of their large family—two dozen cousins, 40 people sleeping in one house—his father read him Charles Dickens and Guy de Maupassant, William Shakespeare and Somerset Maugham. Trinidad's top school, Queen's Royal College, transformed him into an English public schoolboy. Eight years later, in 1950, he got his chance, as an undergraduate at University College, Oxford, to “beat the English at their own language”.

Clever, charming, impeccably accented, Sir Vidia seemed all set. He courted and won a history undergraduate, Patricia Hale, tough enough to defy her family's racist disapproval. But after Oxford, 1950s England shut its doors. A BBC interviewing panel actually laughed at him. Sir Vidia starved, raged and analysed. He wrote letters to Pat which, in their global reach, foreshadowed his later work. But he never went “home”, to live. He was a writer, not a peripheral Caribbean writer.

Keeping his distance, nursing his status, always alert to slights, Sir Vidia aspired to the centre, wherever that was. Not India, certainly, whose unsanitary poor disgusted him. Nor any of the other continents whose failings became his subject over the following years. An English country cottage was the closest he came. A character in “A Bend in the River” relishes his rootlessness for the choice it gives him—his choice being wherever he could “win and win and win”. England infuriated Sir Vidia, especially its tightening immigration policy, but he stayed and wrote and won many times over.

Some accuse Sir Vidia of betraying his roots and the developing world. Many have borne his almost self-parodying right-wing insults. But there is no question that he knows how to write, to notice, to imagine. Mr French leaves it to the reader to judge. One thing sticks, though: his crushing lordliness over both his wife and the mistress he abandoned after more than 20 years. Pat suffered most, and Mr French writes movingly about her: her patience, her devotion, her utter belief in her husband's work, and his very real dependence on her judgment. The closing pages—about Pat dying from cancer, about Sir Vidia's complicated remorse and his simultaneous pursuit of her successor—are enough to draw tears.

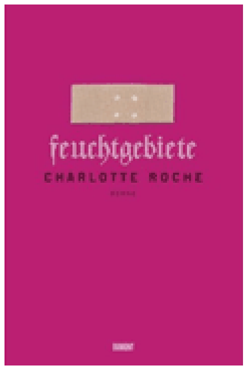
The World Is What It Is: The Authorized Biography of V.S. Naipaul.
By Patrick French.
Picador; 555 pages; £20. To be published in America by Knopf in November

Amazon worldwide bestseller table

Laid bare

Apr 3rd 2008
From The Economist print edition

Fiction in German makes it to pole position



FOR the first time since 2004, when the six Amazon websites—in America, Britain, Canada, France, Germany and Japan—began to offer readers of *The Economist* a monthly snapshot of the books that really fly, the world's biggest-selling novel last month came from Germany.

“Feuchtgebiete” was written by Charlotte Roche, a 30-year-old actress and television presenter, who was born in Wimbledon but grew up in Germany. Miss Roche first made her name working for VIVA, Germany's answer to MTV, taking cameo parts in pop videos and giving readings from other peoples' books and doctoral dissertations.

But it was “Charlotte Roche *trifft*…” (“Charlotte Roche meets…”), a late-night talk-show in which she gets up-close-and-personal with celebrity guests such as Quentin Tarantino, Uma Thurman and Kylie Minogue, that really turned Miss Roche into Germany's queen of popular television. She particularly likes asking her female guests about their sexual fantasies, believing that women are generally far too coy about expressing themselves on this subject. “Women have no language for their desire,” she riles. “When it comes to their bodies, women are uptight.”

“Feuchtgebiete”, which translates as “wetlands” or “damp parts”, is also about sexual fantasy. Some people have called it pornographic. Miss Roche, who sees herself as a campaigning liberationist on the subject, insists it is a novel. But readers and critics prefer to read it as autobiography. At the Leipzig book fair last month she was chased by hordes of schoolgirls, while her book tour around Germany has been extended well into next month. Clearly sex sells, even if it is in German?

1. Feuchtgebiete
by Charlotte Roche

Click to buy from Amazon.de

2. Die Tore der Welt
by Ken Follett

Click to buy from Amazon.de

3. A Thousand Splendid Suns
by Khaled Hosseini

Click to buy from Amazon.com or Amazon.co.uk

4. The Shack
by William P. Young

Click to buy from Amazon.com or Amazon.co.uk

5. Die Letzte Spur
by Charlotte Link

Click to buy from Amazon.de

6. Brisingr

by Christopher Paolini

Click to buy from Amazon.com or Amazon.co.uk

7. Breaking Dawn
by Stephenie Meyer

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8. A Quiet Belief in Angels
by R.J. Ellory

Click to buy from Amazon.com or Amazon.co.uk

9. Lush Life: A Novel
by Richard Price

Click to buy from Amazon.com or Amazon.co.uk

10. Water for Elephants: A Novel
by Sara Gruen

Click to buy from Amazon.com or Amazon.co.uk

Source: Global sales from Amazon.com, Amazon.co.uk, Amazon.ca, Amazon.de, Amazon.fr and Amazon.jp from March 1st-31st 2008

New film

Cry, beloved country

Apr 3rd 2008
From The Economist print edition

In her new film Kimberly Peirce takes on the human cost of the Iraq war

NINE years ago Kimberly Peirce's first feature film, “Boys Don't Cry”, won Hilary Swank an Academy Award for her portrayal of Brandon Teena, a young woman who is murdered for living as a man. The hero of Ms Peirce's poignant second film, “Stop-Loss”, is also called Brandon, but is different in every other respect. A man's man, this Brandon (Brandon King, played by Ryan Phillippe) is a decorated veteran of the wars in Afghanistan and Iraq who returns at the beginning of the film to a hero's welcome from his hometown in Texas.

Ms Peirce displays a rare gift for depicting the camaraderie of young working-class characters. In the film's early scenes Brandon and two of his childhood friends, Steve (Channing Tatum) and Tommy (Joseph Gordon-Levitt), who served alongside him in Iraq, retreat to an adolescent hideaway to deal with the post-traumatic stress that is invading their lives.

Afterwards Brandon reports back to his base, expecting to be mustered out. Instead, he learns that he is being shipped back to Iraq under the army's “stop-loss” programme, a piece of fine print in American military-service contracts under which a soldier can be sent back into combat after completing a tour of duty. Brandon refuses at first to obey the order that John Kerry once described as a “back-door draft”, and his kinship with Ms Peirce's first Brandon starts to become apparent.

Accompanied by Steve's fiancée, Michelle (Abbie Cornish), he sets out on a futile quest for help from his senator in Washington, DC. On the road he meets another “stop-lossed” soldier who, for more than a year, has been living with his family in various crack motels. In the process, Brandon discovers a whole new America, including a modern-day “underground railroad”, similar to the escape routes that developed during the American civil war and the Vietnam war, leading to exile in Canada or Mexico. The film ends with a note that 81,000 soldiers have been “stop-lossed” since the beginning of the conflicts in Afghanistan and Iraq.

But “Stop-Loss” is a tragedy, not a propaganda film. Ms Peirce's hero faces an impossible dilemma. As Brandon prepares to cross the Mexican border, he is faced with losing both his country and his identity. Whatever choices he makes, chances are he will no longer be able to recognise himself or the country he has come home to.

New crime fiction

Murky work

Apr 3rd 2008
From The Economist print edition

Atmosphere is everything in crime fiction, as four new books make clear

IN ITS vivid portrayal of the violence and degradation of the Palestinian enclave of Gaza, Matt Rees's second book, “The Saladin Murders”, is outstanding. His hero, Omar Yussef, a Bethlehem schoolteacher, is a recovering alcoholic in his fifties, physically frail but possessed of a steely moral core. At the start of the book he is sent to Gaza on an apparently straightforward school inspection. When a fellow teacher is arrested as a CIA spy by the sinister Palestinian security forces, Yussef ignores advice to leave.

He is quickly drawn into a deadly game where disputes are settled by gun battles and car bombs. Brutal, corrupt warlords torture and murder at will, while the *khamsin*, the hot, dusty desert wind, blows hard, turning the sky yellow and filling the air with choking sand. The Israelis barely feature in this dark, gripping and often moving book. Gaza, it seems, is a hell in large part of the Palestinians' own making.

In “A Vengeful Longing” the air in St Petersburg in the 1860s is also hard to breathe. Not because of sand, but because the lack of a proper sewage system means that human waste is stored in open barrels, even in the height of summer. The thickening stench hangs over the city, a metaphor for the wider decay in Russian society where aristocrats dance the night away and the poor starve in mouldy rooms.

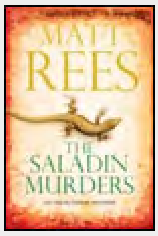
Porfiry Petrovich, who first appeared in Feodor Dostoevsky's “Crime and Punishment”, and his assistant Pavel Virginsky are dispatched to find out why a doctor's wife and handicapped son are murdered by poisoned chocolates, and a womanising army officer is shot dead in his rooms while his French paramour slumbers peacefully in his bed. Investigator Petrovich is a very engaging hero, eagle-eyed, with a sharp laconic wit, endless patience for his geeky sidekick and a soothing manner, especially when faced with beautiful, flirtatious women. Full marks to the author for bringing Petrovich back to life in this ambitious work that is a real pleasure to read.

The air is fresher in “A Death in Vienna”, although the dark, claustrophobic corridors of St Florian's military school, set in the Vienna woods, harbour their own bloody secrets. When a young cadet is found dead the authorities are keen to close the case quickly. But Inspector Oskar Rheinhardt has a strong feeling that something is badly awry in St Florian's closed, conservative hierarchical society. His hunch proves right when a strange pattern of razor cuts is found on the boy's body.

“A Death in Vienna”, which first came out in America in 2006 and is now being published in Britain, takes place in 1903. The Habsburg capital is on the cusp of modernity, its cosmopolitan mix of nationalities, and the dangerous new notions propagated by Sigmund Freud are evocatively pictured.

There are hints too of the terrible darkness yet to come. Like Investigator Petrovich, Inspector Rheinhardt has a sidekick, a Jewish psychoanalyst, Dr Max Liebermann. The author, who is a clinical psychologist, deftly weaves in a primer on the brain's inner workings into the hunt for the cadet's killer. Meanwhile, a

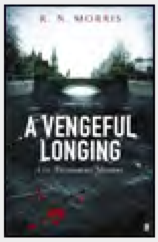
The Saladin Murders
By Matt Rees



Atlantic Books; 352 pages; £11.99

Buy it at
Amazon.com
Amazon.co.uk

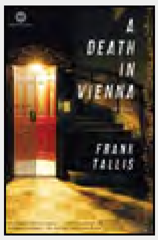
A Vengeful Longing
By R.N. Morris



Penguin; 336 pages; $24.95. Faber and Faber; £12.99

Buy it at
Amazon.com
Amazon.co.uk

A Death in Vienna
By Frank Tallis



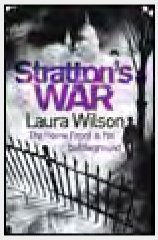
Random House; 480 pages; $12.95. Published in Britain as

Buy it at
Amazon.com
Amazon.co.uk

Stratton's War

raven-haired Magyar concert violinist adds an exotic love interest to an already enthralling narrative.

By Laura Wilson



Orion Books; 464 pages; £18.99

Buy it at
Amazon.co.uk

“Stratton's War”, set in London during the Blitz, also has two protagonists: Diana Calthrop, a society beauty and MI5 agent, and Detective Inspector Ted Stratton. The spook and the policeman are brought together by the gruesome death of former film star, Mabel Morgan, who is found impaled on the railings outside the block of flats where she lives. Wartime London is sharply drawn: the darkness of the black-out, the aftermath of a bomber raid, the glamour of West-End nightlife, the seedy world of aristocrats' rent boys and the Londoners' irrepressible Blitz spirit.

But the German bombers are not the only danger Britain is facing. Stratton and Calthrop are soon fighting the enemy within: the Right Club, whose aristocratic members demand that Britain fight with, not against, Hitler.

Laura Wilson is good on the distinctions of class, accent and vocabulary that divide Calthrop and Stratton. But even in stiff-upper-lip Britain humanity breaks through. The happily married policeman is puzzled to find himself increasingly attracted to the society beauty. She is fighting unsuccessfully against her hunger for her fellow agent, the sinister Claude Ventriss.

This enjoyable, intelligent book is based in part on fact. The Right Club existed; so did the spymasters and agents that inspired some of Ms Wilson's characters.

Two books set in cities at war, two in cities yet to be consumed by fire. However grim the backdrop and dangerous the journey, all of these fine works show that the human spirit remains indomitable.

The Saladin Murders.
By Matt Rees.
Atlantic Books; 352 pages; £11.99

A Vengeful Longing.
By R.N. Morris.
Penguin; 336 pages; $24.95. Faber and Faber; £12.99

A Death in Vienna.
By Frank Tallis.
Random House; 480 pages; $12.95. Published inBritain as “Fatal Lies”; Century; £12.99

Stratton's War.
By Laura Wilson.
Orion Books; 464 pages; £18.99

Neil Aspinall

Apr 3rd 2008
From The Economist print edition

Getty Images

Neil Aspinall, keeper of the Beatles' secrets, died on March 24th, aged 66

HE WAS brighter than they were. He had eight O-levels, where they mustered hardly any between them. He was richer: in 1961 he earned £2.50 a week as a trainee accountant in Liverpool, enough to have saved up for a second-hand van, while they had to scrape the fare for the 81 bus across town, lugging their guitars up to the top deck. In certain lights, with enough Brylcreem on his hair and enough tight black leather on his limbs, he was as handsome as they were too, like a young Tom Courtenay. Handsome enough to get Mona, his vivacious landlady and the mother of his friend Pete Best, who played drums for them, into bed and into the club, while the others still behaved like virgins.

Yet there seemed to be not one jealous bone in Neil Aspinall's body; which was why, for almost half a century, he was factotum, doorkeeper and man-of-all-work for four friends who became, in the words of Philip Norman, their biographer, “the greatest engine for human happiness the modern world has known”. From driving the battered old Commer, with hard benches back and front and his charges sleeping among the amps, he progressed to a tour bus and then to a chauffeured limousine with blacked-out windows, forcing its way through crowds of weeping teenage girls. From fetching everyone's fish and chips, slathered with vinegar not ketchup, he moved up to more particular orders: a one-egg omelette for Ringo, cheese-and-cucumber sandwiches for George, and for John caviar and chocolate cake. In time, as chief executive of the Beatles' company, Apple Corps, he acquired a chef and a dining room at his office in Savile Row. But he kept the lean look of a man who still worried about tickets and guitar strings, and who did not have time for lunch.

He could have told stories, if he had wanted to. Of getting lost at night in the snow near Wolverhampton as he drove the band to their first big audition at Decca, which they failed. Of picking girls for them from the giggling, screaming candidates who milled at the stage doors, and forging hundreds of signatures on record sleeves and photos. Of playing host to John and Yoko Ono on their first date, considerately opening out the sofa bed, only to find that Yoko thought this “crude” and went off to sleep on the divan; or of what John said down the phone to him as his flat was raided by the police in October 1968, before he had managed to finish flushing the marijuana down the loo.

In the vans, buses and hotel rooms bits of paper piled up like confetti, carrying scraps of songs, and more scraps were stuffed in the pockets of the trousers Mr Aspinall carried to the cleaner's. He did not keep them. When needed, he could thrum a tamboura for “Within You Without You” or plump out the chorus for “Yellow Submarine”, but he never dined out on it. No tell-all book was planned. His interest was not exploitation, but service. He was a handy man with a portable iron, and his job was ceaselessly to smooth out the creases in the story.

Luminous purple paint

Paul and George he knew from school: Paul in his art and English classes, George as a furtive fellow Woodbine-puffer behind the air-raid shelters. In a sense they were always members of the “Mad Lad gang”, larking together, or hurtling together down a back street as the Teds came after them. And for all the dazzle of the London Palladium or the Ed Sullivan Show, there was perhaps no more evocative venue for Mr Aspinall than the Casbah Club in the basement of his lover-landlady's house, where behind the rhododendron hedges the Silver Beetles, as they then were, would play on Saturday nights. He had bought the benches and the luminous purple paint that glowed on the walls, and after the show he would guard the equipment. When Pete Best was ditched by the group in favour of Ringo, the most painful test of Mr Aspinall's loyalty, he ended his affair with Pete's mother and moved out.

As boss of Apple, a job he took in 1968 because the Beatles asked him, his loyalty was also tested. Having sorted out the bank accounts and established where the original contracts were, out of the mess left behind by their manager, Brian Epstein, he spent his years defending the brand from Apple Computer and winkling royalties out of EMI, while keeping an eye on media generally. Management was still chaotic and freeloaders legion; but the firm was so profitable, neck-high in gold and platinum discs, that no one seemed to care.

Most of all Mr Aspinall protected the songs, moving snail-like and suspiciously towards the modern age. He resisted first CDs, then compilations, then digital remastering, until he was at last convinced they would do the Beatles no harm. His erstwhile charges fell out, fell apart, skidded in and out of marriages, were shot down. Yet “Nell” remained at Apple until only a year before lung cancer silenced him, trusted by all of them, making sure the money and the name were safe.

In a rare moment of self-revelation, he once told Mr Norman that he had had a dream. He was running from an unseen pursuer, carrying a precious load of silver fish in his arms. No matter how fast he ran, his pursuer was running faster, and no matter how tightly he tried to guard the fish, they slithered away. In life, though always running, he did better than that.

Overview

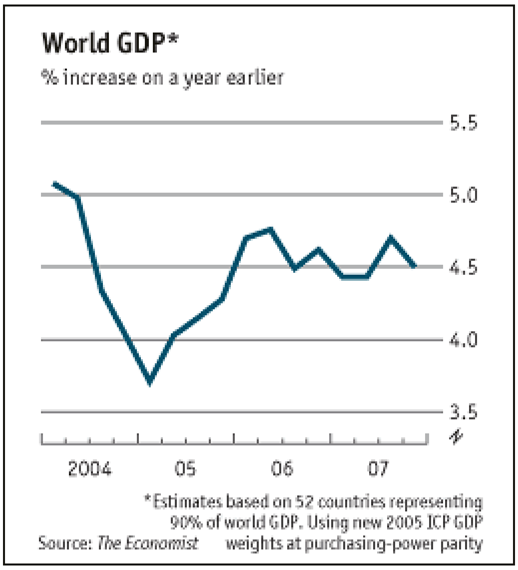
Apr 3rd 2008
From The Economist print edition

Consumer-price inflation in the **euro area** rose from 3.3% in February to 3.5% in March, according to a preliminary estimate.

Manufacturers in **Japan** are less cheery than they were at the end of last year, according to the central bank's quarterly Tankan survey. The percentage balance of large firms reporting “favourable” over “unfavourable” business conditions fell to 11 in March from 19 in December.

In **America** the Institute for Supply Management's manufacturing index edged up from 48.3 to 48.6 in March. A reading below 50 indicates falling business activity.

Hungary's central bank raised its benchmark interest rate from 7.5% to 8%, to help bring inflation back down to the 3% target.



Output, prices and jobs

Apr 3rd 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	+1.2	+1.7	+1.0 Feb	+4.0 Feb	+2.4	+3.3	4.8 Feb
Japan	+2.0 Q4	+3.5	+1.3	+1.5	+4.2 Feb	+1.0 Feb	-0.2	+0.7	3.9 Feb
China	+11.2 Q4	na	+9.8	+9.0	+15.4 Feb	+8.7 Feb	+2.7	+4.5	9.5 2007
Britain	+2.8 Q4	+2.5	+1.8	+1.8	+0.4 Jan	+2.5 Feb§	+2.8	+2.6	5.2 Jan††
Canada	+2.9 Q4	+0.8	+1.5	+2.1	-1.3 Dec	+1.8 Feb	+2.0	+1.7	5.8 Feb
Euro area	+2.2 Q4	+1.6	+1.6	+1.6	+3.8 Jan	+3.5 Mar	+1.9	+2.7	7.1 Feb
Austria	+3.0 Q4	+2.3	+2.6	+2.3	+7.9 Jan	+3.2 Feb	+1.6	+2.2	4.1 Feb
Belgium	+2.4 Q4	+2.0	+1.8	+1.8	-1.9 Dec	+4.4 Mar	+1.8	+2.6	10.7 Feb‡‡
France	+2.1 Q4	+1.5	+1.6	+1.6	+2.7 Jan	+2.8 Feb	+1.0	+2.4	7.5 Q4§§
Germany	+1.8 Q4	+1.1	+1.7	+1.7	+7.0 Jan	+3.1 Mar	+2.0	+2.3	7.8 Mar
Greece	+3.6 Q4	+2.8	+2.8	+3.3	+1.6 Jan	+4.4 Feb	+2.7	+3.9	8.9 Dec
Italy	+1.9 Q3	+1.7	+0.8	+1.1	+0.5 Jan	+3.3 Mar	+1.7	+2.6	6.0 Q4
Netherlands	+4.5 Q4	+4.8	+2.5	+1.9	+2.0 Jan	+2.2 Mar	+1.8	+2.0	4.1 Feb††
Spain	+3.5 Q4	+3.2	+2.4	+2.1	-0.2 Jan	+4.4 Feb	+2.4	+3.6	9.0 Feb
Czech Republic	+6.6 Q4	+7.0	+4.7	+5.4	+9.3 Jan	+7.5 Feb	+1.5	+6.5	5.9 Feb
Denmark	+2.0 Q4	+1.8	+1.5	+1.6	-1.8 Jan	+3.1 Feb	+1.9	+2.4	2.0 Feb
Hungary	+0.7 Q4	+0.8	+2.5	+3.6	+6.6 Jan	+6.9 Feb	+8.8	+5.7	8.1 Jan††
Norway	+4.7 Q4	+5.2	+2.9	+2.6	-1.4 Jan	+3.7 Feb	+0.8	+3.1	2.3 Jan††
Poland	+6.1 Q4	na	+5.1	+4.3	+14.9 Feb	+4.2 Feb	+1.9	+4.0	11.5 Feb‡‡
Russia	+7.7 Q3	na	+7.0	+6.0	+7.5 Feb	+12.7 Feb	+7.6	+12.5	5.8 Jan‡‡
Sweden	+2.8 Q4	+3.1	+2.4	+2.3	+3.8 Jan	+3.1 Feb	+2.0	+2.8	6.1 Feb‡‡
Switzerland	+3.6 Q4	+4.2	+2.1	+1.7	+9.1 Q4	+2.4 Feb	nil	+1.8	2.5 Feb
Turkey	+3.4 Q4	na	+3.7	+5.4	-0.4 Jan	+9.1 Feb	+10.2	+8.4	10.1 Q4‡‡
Australia	+3.9 Q4	+2.4	+3.0	+3.0	+1.6 Q3	+3.0 Q4	+3.3	+3.3	4.0 Feb
Hong Kong	+6.7 Q4	+6.6	+4.0	+4.6	-0.3 Q4	+6.3 Feb	+0.8	+4.0	3.3 Feb††
India	+8.4 Q4	na	+7.8	+7.2	+5.3 Jan	+5.5 Feb	+7.6	+5.8	7.2 2007
Indonesia	+6.3 Q4	na	+5.9	+6.3	+5.0 Jan	+8.2 Mar	+6.5	+6.8	9.8
01/02/2007									
Malaysia	+7.3 Q4	na	+5.8	+5.9	+7.0 Jan	+2.7 Feb	+3.1	+2.8	3.1 Q3
Pakistan	+7.0 2007**	na	+5.0	+5.3	-4.1 Dec	+11.3 Feb	+7.4	+9.3	6.2 2006
Singapore	+5.4 Q4	-4.8	+4.4	+4.7	+10.0 Feb	+6.5 Feb	+0.6	+3.3	1.6 Q4
South Korea	+5.5 Q4	+6.3	+4.5	+4.4	+10.1 Feb	+3.9 Mar	+2.2	+2.9	3.0 Feb
Taiwan	+6.4 Q4	na	+4.3	+4.4	+15.2 Feb	+3.9 Feb	-2.2	+2.4	4.0 Feb
Thailand	+5.7 Q4	+7.3	+4.8	+4.3	+14.7 Feb	+5.3 Mar	+2.0	+3.9	0.8 Dec
Argentina	+9.1 Q4	+8.0	+5.7	+4.5	+9.3 Feb	+8.4 Feb	+9.6	+10.9	7.5 Q4‡‡
Brazil	+6.2 Q4	+6.4	+4.3	+4.1	+9.7 Feb	+4.6 Feb	+3.0	+4.7	8.7 Feb‡‡
Chile	+4.0 Q4	+3.7	+4.0	+4.6	+5.7 Feb	+8.1 Feb	+2.7	+5.9	7.3 Feb††‡‡
Colombia	+6.6 Q3	+6.9	+5.0	+4.3	+5.7 Jan	+5.9 Mar	+5.8	+5.7	13.1 Jan‡‡
Mexico	+3.8 Q4	+3.0	+1.9	+2.8	+3.1 Jan	+3.7 Feb	+4.1	+3.9	3.8 Feb‡‡
Venezuela	+8.5 Q4	na	+5.5	+4.6	-2.5 Dec	+25.2 Feb	+20.4	+27.8	6.7 Q4‡‡
Egypt	+8.1 Q4	na	+7.1	+6.8	+7.5 2007**	+12.1 Feb	+12.6	+10.6	9.0 Q4‡‡
Israel	+6.8 Q4	+6.4	+3.5	+4.1	+5.3 Jan	+3.6 Feb	-0.8	+2.9	6.8 Q4
Saudi Arabia	+3.5 2007	na	+6.0	+5.6	na	+8.7 Feb	+3.0	+8.5	na
South Africa	+4.6 Q4	+5.3	+4.1	+4.8	+1.4 Jan	+9.8 Feb	+5.7	+7.0	25.5 Mar
2007‡‡									
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*									
Estonia	+4.8 Q4	+3.2	+4.0	+4.3	+2.6 Feb	+11.3 Feb	+4.7	+9.0	5.6 Jan
Finland	+3.7 Q4	+3.8	+3.0	+3.0	+4.4 Feb	+3.7 Feb	+2.2	+3.0	6.2 Feb
Iceland	+4.6 Q4	+1.2	+1.8	+2.5	+0.4 2007	+8.7 Mar	+5.9	+6.5	1.0 Feb‡‡
Ireland	+3.5 Q4	-3.3	+2.4	+2.6	+1.8 Jan	+4.8 Feb	+4.8	+3.0	5.2 Feb
Latvia	+8.0 Q4	na	+5.8	+6.0	-0.1 Jan	+16.7 Feb	+7.2	+10.5	5.0 Feb
Lithuania	+7.9 Q4	-4.3	+7.2	+6.4	na	+10.8 Feb	+4.3	+7.8	4.7 Feb‡‡
Luxembourg	+5.6 Q3	+2.8	+4.9	+4.8	+5.2 Jan	+3.1 Feb	+2.0	+3.1	4.6 Feb‡‡
New Zealand	+2.8 Q4	+3.1	+1.8	+2.6	+1.3 Q3	+3.2 Q4	+2.6	+2.9	3.4 Q4
Peru	+10.1 Jan	na	+6.3	+6.7	+10.0 Jan	+5.5 Mar	+0.2	+3.7	9.4 Jan‡‡
Philippines	+7.3 Q4	+7.4	+5.4	+5.5	-1.8 Dec	+5.4 Feb	+2.6	+4.0	7.4 Q1‡‡
Portugal	+2.0 Q4	+3.0	+1.7	+1.9	+1.0 Feb	+2.9 Feb	+2.4	+2.4	7.8 Q4‡‡
Slovakia	+14.3 Q4	na	+7.5	+5.7	+8.4 Jan	+4.0 Feb	+2.7	+3.0	7.8 Feb‡‡
Slovenia	+4.7 Q4	na	+4.6	+4.0	+1.2 Jan	+6.9 Mar	+2.3	+4.4	7.4 Jan‡‡

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

The Economist commodity-price index

Apr 3rd 2008
From The Economist print edition

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

	Mar 25th	Apr 1st*	% change on one month	% change on one year
Dollar index				
All items	254.7	247.9	-8.8	+32.2
Food	253.2	242.4	-9.5	+54.3
Industrials				
All	256.6	255.0	-7.9	+12.3
Nfa†	189.8	186.5	-7.9	+22.2
Metals	293.2	292.5	-7.9	+9.3
Sterling index				
All items	193.2	190.3	-8.3	+28.8
Euro index				
All items	151.0	147.0	-10.9	+11.1
Gold				
$ per oz	923.15	879.55	-8.9	+37.0
West Texas Intermediate				
$ per barrel	101.55	101.06	+1.1	+66.4

*Provisional †Non-food agriculturals.

The Economist poll of forecasters, April averages

Apr 3rd 2008
From The Economist print edition

***The Economist* poll of forecasters, April averages** (previous month's, if changed)

	Real GDP, % change Low/high range		Real GDP, % change average		Consumer prices % increase		Current account % of GDP	
	2008	2009	2008	2009	2008	2009	2008	2009
Australia	2.5/3.6	2.5/3.8	3.0 (3.3)	3.0 (3.2)	3.3 (3.1)	2.7	-6.1 (-5.6)	-5.7 (-5.4)
Belgium	1.2/2.7	1.1/2.4	1.8 (1.9)	1.8 (1.9)	2.6 (2.4)	1.8 (1.9)	1.8 (2.0)	2.0 (2.2)
Britain	1.2/3.1	1.0/2.3	1.8 (1.9)	1.8 (2.0)	2.6 (2.4)	2.1 (2.0)	-4.2 (-3.8)	-3.7 (-3.4)
Canada	1.1/2.5	1.4/2.5	1.5 (1.7)	2.1 (2.2)	1.7 (1.9)	2.0	nil (0.4)	-0.4 nil
France	1.2/1.9	0.9/2.2	1.6	1.6 (1.7)	2.4 (2.2)	1.8 (1.7)	-1.6 (-1.3)	-1.6 (-1.4)
Germany	1.2/2.5	1.0/2.2	1.7	1.7 (1.9)	2.3 (2.1)	1.8 (1.7)	6.2 (5.2)	5.8 (5.2)
Italy	0.1/1.7	0.4/1.8	0.8 (1.0)	1.1 (1.4)	2.6 (2.4)	1.9	-2.5 (-2.3)	-2.4 (-2.3)
Japan	0.9/2.1	1.0/2.2	1.3 (1.4)	1.5 (1.6)	0.7 (0.6)	0.6 (0.5)	4.7	4.7 (4.8)
Netherlands	1.4/3.5	1.4/2.4	2.5 (2.3)	1.9 (2.1)	2.0	2.1	7.2 (6.8)	6.9 (6.6)
Spain	1.8/3.8	1.0/3.0	2.4	2.1	3.6 (3.5)	2.7 (2.6)	-9.2 (-9.1)	-8.5 (-8.3)
Sweden	2.1/3.3	1.4/3.1	2.4 (2.6)	2.3 (2.5)	2.8 (2.6)	2.2	6.9 (6.1)	6.9 (6.1)
Switzerland	1.5/2.8	1.0/2.4	2.1 (2.0)	1.7 (1.9)	1.8 (1.6)	1.2	15.1 (14.6)	14.9
United States	0.8/2.2	0.9/2.6	1.2 (1.5)	1.7 (2.2)	3.3 (3.2)	2.3	-4.7	-4.2 (-4.3)
Euro area	1.1/2.6	1.1/2.2	1.6 (1.7)	1.6 (1.8)	2.7 (2.5)	2.0	0.1 (-0.1)	nil (-0.1)

Sources: ABN AMRO, BNP Paribas, Citigroup, Decision Economics, Deutsche Bank, Economist Intelligence Unit, Goldman Sachs, HSBC Securities, KBC Bank, JPMorgan Chase, Morgan Stanley, Scotiabank, UBS

Trade, exchange rates, budget balances and interest rates

Apr 3rd 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 $ Apr 2nd	Currency units, per $ year ago	Budget balance % of GDP 2008†	Interest rates, % 3-month latest	Interest rates, % 10-year gov't bonds, latest
United States	−819.2 Jan	−738.6 Q4	−4.7	–	–	−2.4	2.08	3.58
Japan	+105.4 Jan	+214.7 Jan	+4.7	103	116	−2.7	0.75	1.37
China	+250.0 Feb	+249.9 2006	+10.4	7.02	7.73	0.2	4.50	4.09
Britain	−177.2 Jan	−115.4 Q4	−4.2	0.50	0.51	−3.2	6.01	4.43
Canada	+44.8 Jan	+12.5 Q4	nil	1.02	1.16	0.3	1.98	3.71
Euro area	+25.5 Jan	−1.2 Jan	+0.1	0.64	0.75	−1.0	4.74	3.99
Austria	+0.4 Dec	+10.9 Q3	+2.7	0.64	0.75	−0.4	4.74	4.15
Belgium	+15.4 Jan	+2.7 Dec	+1.8	0.64	0.75	−0.5	4.80	4.31
France	−56.3 Jan	−36.9 Jan	−1.6	0.64	0.75	−2.8	4.74	4.17
Germany	+263.5 Jan	+256.7 Jan	+6.2	0.64	0.75	0.8	4.74	3.99
Greece	−57.1 Dec	−48.3 Dec	−12.5	0.64	0.75	−2.7	4.74	4.48
Italy	−14.1 Jan	−51.1 Jan	−2.5	0.64	0.75	−2.8	4.74	4.44
Netherlands	+57.2 Jan	+50.7 Q4	+7.2	0.64	0.75	0.5	4.74	4.20
Spain	−139.6 Jan	−146.0 Dec	−9.2	0.64	0.75	nil	4.74	4.27
Czech Republic	+4.4 Jan	−4.3 Jan	−3.2	16.1	21.0	−2.6	4.10	4.77
Denmark	+3.4 Jan	+3.3 Jan	+1.2	4.78	5.57	3.6	5.25	4.22
Hungary	−0.2 Jan	−6.9 Q4	−5.9	165	187	−4.1	8.43	8.50
Norway	+63.1 Feb	+64.1 Q4	+15.8	5.15	6.07	17.9	6.12	4.41
Poland	−12.2 Jan	−16.2 Jan	−4.0	2.24	2.91	−1.8	6.20	6.00
Russia	+140.6 Jan	+76.6 Q4	+4.0	23.6	26.0	1.2	10.25	6.43
Sweden	+19.1 Feb	+38.1 Q4	+6.9	6.00	6.99	1.5	3.92	4.01
Switzerland	+11.9 Feb	+69.6 Q3	+15.1	1.01	1.21	0.7	2.85	2.99
Turkey	−65.7 Feb	−38.9 Jan	−7.7	1.29	1.40	−2.9	16.73	6.51‡
Australia	−19.7 Jan	−56.4 Q4	−6.1	1.10	1.24	1.5	7.79	6.17
Hong Kong	−23.9 Jan	+27.4 Q4	+8.8	7.79	7.81	3.1	1.88	2.51
India	−75.0 Feb	−12.8 Q4	−2.0	40.0	43.0	−3.1	7.21	8.28
Indonesia	+40.0 Jan	+11.0 Q4	+2.1	9,215	9,150	−1.8	8.13	6.66‡
Malaysia	+31.0 Feb	+28.9 Q4	+13.8	3.19	3.46	−3.1	3.62	3.67‡
Pakistan	−16.9 Feb	−8.4 Q4	−7.0	62.8	60.6	−5.3	10.23	8.93‡
Singapore	+34.8 Feb	+39.1 Q4	+23.5	1.38	1.52	1.0	1.31	2.28
South Korea	+6.5 Mar	+0.9 Feb	+0.5	974	939	0.2	5.36	5.16
Taiwan	+15.7 Feb	+31.7 Q4	+5.1	30.4	33.1	−1.6	2.70	2.25
Thailand	+10.5 Feb	+14.3 Feb	+2.6	31.5	35.0	−2.8	3.25	3.96
Argentina	+12.1 Feb	+7.3 Q4	+2.5	3.17	3.11	0.9	11.00	na
Brazil	+34.1 Mar	−4.9 Feb	−0.4	1.73	2.08	−1.8	11.18	6.16‡
Chile	+23.0 Feb	+7.2 Q4	+3.8	436	541	5.4	6.48	3.96‡
Colombia	−0.8 Dec	−5.2 Q3	−4.0	1,826	2,173	−1.6	9.82	5.63‡
Mexico	−13.3 Feb	−7.4 Q4	−1.4	10.6	11.1	nil	7.44	7.49
Venezuela	+23.7 Q4	+20.0 Q4	+4.7	3.85	4.23§	−2.6	14.36	6.55‡
Egypt	−20.5 Q4	+0.5 Q4	+0.4	5.45	5.70	−7.0	5.73	4.90‡
Israel	−11.0 Feb	+5.0 Q4	+2.2	3.57	4.18	−1.4	3.04	5.19
Saudi Arabia	+146.6 2006	+98.9 2006	+30.8	3.75	3.75	12.8	2.26	na
South Africa	−10.3 Feb	−20.6 Q4	−8.0	7.82	7.38	0.6	11.45	9.02
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*								
Estonia	−4.4 Jan	−3.3 Jan	−13.1	10.0	11.7	0.6	6.35	na
Finland	+12.0 Jan	+11.6 Jan	+3.8	0.64	0.75	4.6	4.63	4.13
Iceland	−1.6 Feb	−3.2 Q4	−12.3	75.0	66.2	3.1	15.24	na
Ireland	+36.3 Jan	−12.7 Q4	−3.8	0.64	0.75	−0.5	4.74	4.37
Latvia	−7.2 Jan	−6.4 Jan	−18.2	0.45	0.53	1.0	5.63	na
Lithuania	−7.3 Jan	−5.6 Jan	−12.0	2.21	2.58	−0.6	5.06	na
Luxembourg	−6.1 Dec	+4.7 Q3	na	0.64	0.75	0.9	4.74	na
New Zealand	−3.6 Jan	−10.2 Q4	−7.5	1.27	1.41	3.0	7.30	6.50
Peru	+8.3 Jan	+1.5 Q4	−0.2	2.72	3.18	1.0	5.25	na
Philippines	−6.1 Jan	+6.4 Dec	+4.6	41.5	48.2	−0.2	6.25	na
Portugal	−26.6 Dec	−21.0 Dec	−8.8	0.64	0.75	−2.6	4.74	4.32
Slovakia	−0.9 Jan	−0.5 Nov	−2.8	20.8	25.1	−2.3	3.95	4.49
Slovenia	−3.1 Jan	−2.2 Dec	−2.5	0.64	0.75	−0.8	na	na

*Merchandise trade only. †*The Economist* poll or Economist Intelligence Unit forecast. ‡Dollar-denominated bonds. §Unofficial exchange rate.
Sources: National statistics offices and central banks; Thomson Datastream; Reuters; JPMorgan; Bank Leumi le-Israel; Centre for Monitoring Indian Economy; Danske Bank; Hong Kong Monetary Authority; Standard Bank Group; UBS; Westpac.

Markets

Apr 3rd 2008
From The Economist print edition

Markets

	Index Apr 2nd	% change on one week	% change on Dec 31st 2007 in local currency	% change on Dec 31st 2007 in $ terms
United States (DJIA)	12,605.8	+1.5	-5.0	-5.0
United States (S&P 500)	1,367.5	+2.0	-6.9	-6.9
United States (NAScomp)	2,361.4	+1.6	-11.0	-11.0
Japan (Nikkei 225)	13,189.4	+3.8	-13.8	-6.3
Japan (Topix)	1,282.1	+3.6	-13.1	-5.5
China (SSEA)	3,513.0	-7.2	-36.4	-33.8
China (SSEB, $ terms)	237.0	-9.3	-37.8	-35.2
Britain (FTSE 100)	5,915.9	+4.5	-8.4	-8.8
Canada (S&P TSX)	13,514.1	+0.9	-2.3	-5.4
Euro area (FTSE Euro 100)	1,194.6	+4.8	-13.1	-7.3
Euro area (DJ STOXX 50)	3,797.9	+5.2	-13.7	-7.8
Austria (ATX)	3,933.1	+7.1	-12.9	-7.0
Belgium (Bel 20)	3,837.8	+4.1	-7.0	-0.7
France (CAC 40)	4,912.0	+5.0	-12.5	-6.6
Germany (DAX)*	6,777.4	+4.4	-16.0	-10.3
Greece (Athex Comp)	4,162.3	+9.3	-19.6	-14.2
Italy (S&P/MIB)	33,140.0	+5.9	-14.0	-8.2
Netherlands (AEX)	457.0	+4.3	-11.4	-5.4
Spain (Madrid SE)	1,496.5	+3.2	-8.9	-2.7
Czech Republic (PX)	1,575.3	+4.3	-13.2	-1.8
Denmark (OMXCB)	410.7	+3.7	-8.5	-2.3
Hungary (BUX)	22,046.1	+1.3	-16.0	-11.8
Norway (OSEAX)	488.9	+5.1	-14.2	-9.6
Poland (WIG)	48,548.1	+2.5	-12.8	-4.1
Russia (RTS, $ terms)	2,069.6	+3.7	-13.0	-9.6
Sweden (Aff.Gen)	315.5	+6.3	-7.3	-0.1
Switzerland (SMI)	7,596.7	+5.7	-10.5	-0.1
Turkey (ISE)	40,985.2	+0.8	-26.2	-32.7
Australia (All Ord.)	5,544.9	+2.3	-13.6	-9.8
Hong Kong (Hang Seng)	23,872.4	+5.6	-14.2	-14.1
India (BSE)	15,750.4	-2.1	-22.4	-23.4
Indonesia (JSX)	2,342.2	-4.0	-14.7	-13.1
Malaysia (KLSE)	1,239.7	-0.5	-14.2	-11.1
Pakistan (KSE)	15,332.9	+0.9	+8.9	+6.9
Singapore (STI)	3,124.6	+4.3	-9.8	-5.9
South Korea (KOSPI)	1,742.2	+3.7	-8.2	-11.8
Taiwan (TWI)	8,605.3	-1.9	+1.2	+8.0
Thailand (SET)	825.7	+1.0	-3.8	+2.9
Argentina (MERV)	2,136.1	+2.7	-0.7	-1.2
Brazil (BVSP)	63,364.0	+3.2	-0.8	+2.0
Chile (IGPA)	13,419.4	+1.0	-4.7	+8.8
Colombia (IGBC)	9,233.6	+2.6	-13.7	-4.6
Mexico (IPC)	31,467.9	+4.7	+6.5	+10.1
Venezuela (IBC)	36,819.0	+5.0	-2.9	-47.9
Egypt (Case 30)	11,505.1	+3.5	+9.9	+11.2
Israel (TA-100)	978.1	+2.5	-15.3	-8.6
Saudi Arabia (Tadawul)	9,367.5	-0.5	+18.1	+18.1
South Africa (JSE AS)	29,933.0	+0.8	+3.4	-9.6
Europe (FTSEurofirst 300)	1,317.8	+4.7	-12.5	-6.6
World, dev'd (MSCI)	1,481.2	+2.4	-6.8	-6.8
Emerging markets (MSCI)	1,137.7	+2.7	-8.7	-8.7
World, all (MSCI)	375.1	+2.4	-7.0	-7.0
World bonds (Citigroup)	784.9	-1.8	+7.5	+7.5
EMBI+ (JPMorgan)	436.7	+0.1	+0.7	+0.7
Hedge funds (HFRX)	1,295.0	nil	-2.6	-2.6
Volatility, US (VIX)	22.5	21.6	22.5	(levels)
CDSs, Eur (iTRAXX)†	110.9	nil	+213.5	+234.7
CDSs, N Am (CDX)†	162.4	-3.9	+104.7	+104.7
Carbon trading (EU ETS) €	23.4	+4.0	+5.1	+12.2

*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.

Foreign-exchange reserves

Apr 3rd 2008
From The Economist print edition

The IMF's foreign-exchange reserves (COFER) database breaks down official holdings by currency. In the two years to the end of 2007 the dollar's share of industrialised countries' reserves fell slightly, whereas the share held in euros rose. The picture is murkier for developing countries, which hold the bulk of the world's official reserves. As many as half do not report the currency breakdown of their holdings in any given quarter. The available data show only a small fall in the dollar's share of holdings. This looks odd, given that the dollar fell by 19% against the euro over the period. The stability of the greenback's share, despite its falling value, suggests that some countries are still rapidly amassing dollars.