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The rise of the Gulf

Managing massive wealth

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Politics this week

Apr 24th 2008
From The Economist print edition

Hillary Clinton won the Democratic primary election in Pennsylvania by more than nine percentage points, a wider margin of victory than had been expected. Although she hardly dented **Barack Obama's** overall lead in delegates, Mrs Clinton will hope that the result boosts her argument that she is the more electable candidate in November's general election. The next big contests for the Democrats are Indiana and North Carolina on May 6th.

Mrs Clinton said that America could “totally obliterate” **Iran** if it launched a nuclear attack on Israel. See article

John McCain appeared to be rewriting the campaign playbook when he asked Republicans in North Carolina not to run adverts attacking Barack Obama's association with a politically incorrect pastor, Jeremiah Wright. Mr McCain said such attack ads only served to increase divisions. Pundits were sceptical that such a noble sentiment could endure the general election.

China's Olympic ideal

AFP

The **torch relay** for the Beijing Olympics proceeded, under tight security, through Delhi, Bangkok, Kuala Lumpur, Jakarta and Canberra. Meanwhile, several Chinese cities saw protests against Carrefour, a French retail chain; protesters were angered by the rough reception the torch relay received in Paris, as well as other perceived slights from France. The Chinese press urged the demonstrators to keep their patriotism within “rational” bounds. See article

In one of the most serious clashes in recent years in the north of **Sri Lanka**, the army said that 43 soldiers and 100 Tamil Tiger rebels had been killed in fighting in the Jaffna peninsula. The Tigers claimed they had killed 100 soldiers and lost 16 of their fighters.

A court in **Indonesia** sentenced two members of Jemaah Islamiah, the extremist group responsible for the 2002 Bali bombing, to 15 years in jail. See article

Khieu Samphan, head of state in **Cambodia** under the Khmers Rouges, made his first appearance at a genocide tribunal in Phnom Penh. His lawyers argued that he had no real power, and so was not responsible for any of the estimated 2m deaths the Khmers Rouges caused.

Itching for a fight

Georgia called an emergency meeting of the United Nations Security Council, claiming that **Russia** had shot down one of its spy drones over Abkhazia. The incident followed a Russian decision to step up links with the breakaway region in order to put more pressure on the Georgians.

The **Italian government** offered a *euro*300m ($500m) emergency loan to Alitalia, Italy's troubled national airline, after Air France-KLM pulled out of takeover talks. Silvio Berlusconi, who will take over as Italy's prime minister in May, promised that a group of Italian companies and banks would put together a new rescue plan for Alitalia. See article

Teachers in **Britain** staged their first national strike in 21 years. It came amid a bad week for Gordon Brown, the prime minister, who faced an open revolt from Labour members of Parliament over a tax plan that increases the burden on the working poor. See article

The **Danish** and **Dutch** governments evacuated their embassies in Kabul after threats from extremists over Danish cartoons of Muhammad and a Dutch film vilifying the Koran. The Danes and the Dutch have also moved staff out of their respective missions in Algeria and Pakistan.

Iraqi resurgents

AFP

In a reversal of fortune, **Iraqi** government troops took control of districts of Basra that had been held by militias loyal to Muqtada al-Sadr, which had given Iraqi forces a bloody nose only a few weeks ago. Iraq's prime minister, Nuri al-Maliki, a Shia, seemed to gain popularity among Sunni Arabs and Kurds. See article

Robert Gates, America's defence secretary, announced that **General David Petraeus** would become the overall commander of American forces in the Middle East in the autumn. Lieutenant-General Raymond Odierno will replace General Petraeus as America's top soldier in Iraq.

Osama bin Laden's deputy, Ayman al-Zawahiri, accused Iran of trying to “discredit” al-Qaeda by spreading a conspiracy theory, widely held in the Middle East, that Israel—and not al-Qaeda—was behind the attacks on America in September 2001. Mr Zawahiri had previously accused Shia Iran of seeking to spread its influence in the Middle East at the expense of the Sunnis.

Sudan began to conduct a national census as part of the peace deal signed between the government in Khartoum and rebels in the south in 2005. The census is supposed to make possible national elections next year. Meanwhile, the UN increased its estimate of the number of people who may have died in the conflict in Darfur to 300,000.

Despite growing pressure from African and foreign governments, the results of **Zimbabwe's** presidential election had still not been released nearly a month after the event. Reports mounted of violence by government security forces and party thugs against the opposition. See article

The Colorado flows no more

Fernando Lugo, a former Catholic bishop and liberation theologian standing for a centre-left coalition, was elected as **Paraguay's** president, ending the six- decade grip on power of the Colorado Party, the longest-ruling in the world. Mr Lugo campaigned for land reform and against corruption. In victory he signalled his distance from Venezuela's president, Hugo Chávez.

Mario Uribe, a former senator and a cousin of **Colombia's** president, Álvaro Uribe, was arrested on charges that he had colluded with right-wing paramilitaries. Around a third of the country's Congress is under investigation for paramilitary links.

AFP

In **Cuba**, ten women whose husbands were jailed in a crackdown on political opposition in 2003 were arrested, and then released, after staging a sit-in next to Havana's Plaza de la Revolución, the headquarters of the Communist government.

After meeting in New Orleans, Canada's prime minister, Stephen Harper, and Mexico's president, Felipe Calderón, joined George Bush in backing the **North American Free-Trade Agreement** and in calling on the United States Congress to ratify a trade deal with Colombia.

Business this week

Apr 24th 2008
From The Economist print edition

UBS made public a summary of an internal investigation into the mistakes that led it to write down a total of $38 billion, the most by any European bank hit by the subprime crisis. The company laid most of the blame on positions taken by its investment-banking arm. To rebuild its fortunes, the Swiss bank is reducing the size of its investment-banking business to refocus on its private-client base. See article

Other banks added to the list of woes stemming from the mortgage markets. **Credit Suisse**, UBS's rival, swung to a loss in the first quarter largely because it took SFr5.3 billion ($5.0 billion) in writedowns. **Bank of America** said its first-quarter profit had fallen by 77% compared with a year ago, and that it would increase its provision for credit losses by $5 billion. **Citigroup** booked another $13 billion in writedowns and made a quarterly loss of $5.1 billion. And **Royal Bank of Scotland** said it needed to raise £12 billion ($24 billion), about a third of its market value, in a rights issue to help protect its core capital. See article

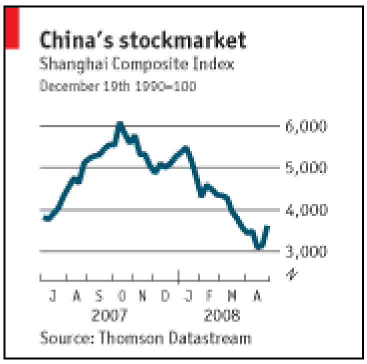
Use it wisely

The **Bank of England** unveiled an initiative that will allow British banks over the next six months to swap high-quality mortgage-backed and other securities for Treasury bills for up to three years. The central bank estimated that around £50 billion ($100 billion) of such assets would be swapped at first. It emphasised that the plan was not intended to finance new mortgage lending, a view which seemed to be contradicted by the chancellor, Alistair Darling, in his statement to Parliament on the scheme. See article

Meanwhile, a survey from the British Bankers' Association found that the number of **approvals for house purchases** fell by 46% in the 12 months to March and was at its lowest since the series began in 1997.

Analysts renewed speculation about whether **Société Générale** would be subject to a takeover bid after the French bank said that Daniel Bouton would step down as chief executive (he remains chairman). Mr Bouton, who was roundly criticised for the rogue-trading scandal that embroiled SocGen in January, would like the bank to remain independent.

What goes up can come down



In an effort to revive investor confidence, **China** reduced its stamp duty on **share trading** to 0.1% from 0.3%. The tax was increased in May 2007 to cool feverish stockmarkets. Since then the government has made fighting inflation its top priority, causing some to worry that economic growth will slow. However, investors responded positively to the cut in stamp duty, at least at first. The Shanghai Composite Index had fallen by half since last October; the day after the tax cut was announced, it leapt by 9.3%.

South Korea's corporate world was rocked by the announcement that Lee Kun-hee would resign as chairman of **Samsung Group** after his indictment for tax evasion. Mr Lee, whose father founded Samsung in 1938, has run South Korea's biggest *chaebol* since 1987. His is the biggest scalp in a nascent anti-corruption drive, which has frustrated campaigners because so few culprits have resigned. See article

Liberty Mutual, an insurer based in Boston, agreed to buy **Safeco**, a rival from Seattle, for $6.2 billion.

Amyris, an American biotechnology company, announced a plan to make **biodiesel from sugar cane** in collaboration with Crystalsev, a Brazilian firm. Amyris has created a micro-organism that contains genes from several different biological species, and can convert sugar into molecules similar to those in mineral-based diesel fuel—an example of a so-called second-generation biofuel. The new fuel should be on the market in 2010.

A game of monopoly

The Competition Commission published its interim report on **BAA**, operator of Heathrow, Gatwick and Stansted airports. The British antitrust watchdog said BAA's control of the three airports, which all serve London, might not be in the interests of consumers and airlines. It will give its provisional opinion in August. BAA, which is owned by Spain's Ferrovial, a construction company, has attracted criticism recently for poor service at some of its terminals. See article

Delta Air Lines reported a net loss of $6.4 billion in the first quarter. **Northwest Airlines**, with which Delta is pursuing a merger, lost $4.1 billion. Both companies have suffered from rising fuel prices.

The Indian Premier League, a new venture in **cricket**, got under way. Privately owned teams based in eight cities, with a mixture of foreign and Indian stars allocated by auction, are playing Twenty20, a short form of the game lasting a mere three hours. The tournament will run for seven weeks.

KAL's cartoon

Apr 24th 2008
From The Economist print edition

Illustration by Kevin Kallaugher

Gulf economies

The rise of the Gulf

Apr 24th 2008
From The Economist print edition

The Gulf is managing its wealth better during this boom than it did during the last one

Justin Pumfrey

MOST countries earn their keep through effort and ingenuity. Those of the Gulf owe their living to geological serendipity. The harder China works, the faster India grows, the higher oil prices climb.

The Gulf swells with confidence or despair depending on the price of “Arabian light” or “Oman blend”. Five years ago, though up from its $9 low in the 1990s, the oil price stood at a mere $26 a barrel. Many of the Gulf's governments were indebted and insecure. Saudi Arabia was facing an al-Qaeda insurgency. Expatriates, used to a secure if sequestered life, tried not to think about the tanks parked outside their compounds. Now the same oil fetches over $100 a barrel and confidence has returned. The insurgency in Saudi Arabia has been quashed. The Gulf is once again a source of envy more than concern (see article).

Surely only good can come from so much cash? Hardly. In the 1970s the Gulf's money was a disaster for Latin America, for, recycled through Western banks, it caused a decade-long debt crisis. The Gulf itself suffered by inflicting stagflation on the West, thus causing a 20-year-long slump in oil prices. They built white elephants such as the King Khalid airport in Riyadh, one of whose terminals has been mothballed since the airport opened in 1983. They allowed a greedy few, many of them arms dealers, to pocket huge fortunes. They distorted their economies in the name of diversification, for example by growing wheat in the desert.

A better Xanadu

Are the Gulf countries handling their windfall any better this time? The sheer quantity of cash is hard to manage. It is too plentiful for small economies to spend, and has therefore added to the glut of global saving that is in part responsible for the financial excesses of recent years. Indeed, some economists see an analogy with the 1970s. Gulf petrodollars have been recycled not to improvident governments in Latin America but instead to improvident homebuyers in the uncreditworthy fringes of America.

The Gulf is doing its best to spend its windfall. Stately pleasure domes are springing up all along the coast. Saudi Arabia announces six, no seven!, new economic cities, which it hopes will create millions of jobs for its restive, youthful population. There are worrying echoes of the wasteful 1970s. But this time round, more of the spending is being done by private companies, with an eye to consumer demand, rather than by states.

Awash with capital, the Gulf countries need labour. Thanks to a liberal attitude to guest workers, in the

UAE, for instance, over 90% of the private labour force is made up of foreigners. Some of the follies these Indians, Bangladeshis, Chinese and Filipinos build will not earn much return, but at least they help spread the wealth around. And now that American spending is faltering, a splurge is welcome. As Adam Smith said, outlays on "trinkets of frivolous utility" are what "keeps in continual motion the industry of mankind."

Still, the Gulf's splurge might be better spent if governments were doing even less of the splurging. Despite tentative reforms, too much money remains in state hands. The Saudis have become friendlier to business, taking steps to liberalise the financial system, airlines and telecommunications. But the government is still too fond of its grandiose projects and too slow to get unglamorous things right. It takes an age, for example, to enforce a contract in the country's courts.

By the same token, it would help if local currencies were allowed to strengthen. Currency reform is not just a way to constrain inflation, but also a means of redistributing spending. At present, the petrodollars are converted into local money at a fixed rate and doled out as governments see fit. With stronger local currencies the state would get fewer dirhams, dinars or riyals for every petrodollar. But Gulf residents would be able to buy more with their money, and guest workers could send more rupees home to families in Kerala.

There is another way to transfer economic initiative from governments to people. At present the Gulf states buy social peace by doling out generous benefits and subsidies, such as cheap housing and medical care, expanding the public payroll and forcing private companies to hire locals in the name of Omanisation or Saudi-isation. Too many Gulf nationals receive a government pay cheque for a meaningless job, or owe their jobs in private firms to a hiring quota. They pretend to work and have neither the time nor the incentive to start businesses or acquire skills.

Could there be a better way? Last winter, 604,000 Alaskans each pocketed a $1,654 cheque from the state's Permanent Fund, which invests Alaska's oil revenues on their behalf. Each year, the fund distributes a fraction of its profits, averaged over five years, to every resident. They do not have to work for it, and are free to spend it as they wish. This notion is as foreign to the Gulf as a glacier to the desert. But in a region that likes to impress people with outlandish projects, paying a simple dividend cheque to every Gulf national would be a more audacious venture than the tallest new tower.

Buy some insurance, while you're at it

Given the impressive levels of spending on education in the Gulf, it is hard to imagine that its middle classes will put up with so little control over their countries' wealth—or, indeed, their governments—for long. There are some signs of change, but they are small. By Saudi standards, King Abdullah is a reformer; by any other standards, he moves exceedingly slowly. There is external danger, too. When Saddam Hussein sent his tanks streaming into Kuwait, he was cheered on by many Arabs whose own countries never won a geological lottery and who continue to resent the undeserving fat cats with oil.

Today's dangers are different. Saddam is gone. But the Gulf states are threatened by the chaotic politics in Iraq and by the rivalry between America and Iran for influence in the region. In their volatile part of the planet, the sheikhs cannot buy perfect security. But they might consider investing a bit more of their windfall in stabilising Iraq and the broader Middle East, not just in their fabulous pleasure domes.

Vietnam

Asia's other miracle

Apr 24th 2008
From The Economist print edition

Vietnam has developed at stunning speed by letting market forces do their work. It should free up its politics, too

NOT so long ago the word “Vietnamese” was almost inevitably accompanied in press reports by the phrase “boat people”. For two decades after the fall of Saigon in 1975, the defining image of Vietnam was the waves of bedraggled refugees washing up on its neighbours' shores, fleeing oppression and penury back home. How things have changed. Today, many former refugees are returning to seek new careers and start businesses in a transformed Vietnam. It is now one of Asia's fastest-developing countries, with annual growth averaging 7.5% over the past decade. Although this is less stellar than China's growth, our special report this week finds that Vietnam has made more impressive progress in cutting poverty than its vast northern neighbour. The government's initial hopes for 9% growth this year may be dashed, as the country struggles with double-digit inflation and a yawning trade gap. But the long-term outlook remains promising.

Shooting out of poverty

Vietnam's cities are bright and bustling and the countryside, where most of its 85m people still live, seems hardly less developed than that of officially much richer Thailand. A country once on the brink of famine has turned itself into one of the biggest exporters of farm produce. In a stark reversal of fortunes, the Philippines—once Asia's second-richest country—recently had to beg Vietnam to sell it rice for its hungry millions. Vietnam's social and economic progress has made it the poster-child of multilateral institutions such as the World Bank. It has become one of the fastest-growing destinations for multinational firms and holidaymakers. It is a rising diplomatic power: in July it will chair the UN Security Council, on which it holds a temporary seat.

There are many useful things Vietnam could do with its new-found prestige, through both example and active diplomacy. Other countries in transition could benefit from its advice on how to set aside old enmities, open up to the world and reform defunct economies. As a rare friend of North Korea and Myanmar, Vietnam could help coax those benighted places out of self-imposed isolation. As a country that has escaped deep poverty by embracing free trade, Vietnam could encourage developing countries to take a more constructive stance in the Doha round of world trade talks (and shame richer ones into doing the same).

Remarkable as its achievements are, Vietnam is still not satisfied. It wants to go all the way to become a rich, high-tech country and has set a target date of 2020 for getting there. As several foes have learnt over the past century, the intelligence and determination of the Vietnamese should not be underestimated. But if it wants to realise its dream, Vietnam must learn the right lessons from its own story so far, and from those neighbours who have got to where it wants to be.

Vietnam began to be a success only after its ruling Communists accepted that capitalism, free markets and free trade were the surest route to riches. They began in 1986 with a liberalisation programme called *doi moi* (renewal), though real reform came in fits and starts over the following 20 years. Collectivisation was scrapped, farmers were given their own land to till and agricultural prices were freed. In 2000, private business—until then strictly curbed—was legalised and a stockmarket created. Trade barriers were lowered, exports and imports soared, and Vietnam is now among the world's most open economies. There can probably be no going back: any attempt to reapply the dead hand of government will ensure that Vietnam's dream of riches by 2020 remains just a dream.

Like South Korea, Taiwan and now China, Vietnam has shown it is possible to escape poverty under an authoritarian system. But it is surely no coincidence that most of the world's richest countries by income per head are liberal democracies. Political freedom is a right in itself and it does not need to be justified by arguing that it has economic advantages. But it does have them. Vietnam's leaders are already discovering that it is hard to run a thriving market economy with the methods that suited a planned economy. Managing all the strains of a fast-developing society is easier if there is a free market in opinions as well as in goods and services. In particular, tough but necessary economic decisions are easier to sell if citizens feel they have had some say in them.

Now become a star

So far, the Communist Party seems determined to retain its monopoly on power. It calls pro-democracy campaigners “terrorists” and puts them in jail. But it should take special note of the experience of South Korea and Taiwan. Until the late 1980s they too were dictatorships. Their regimes, facing rising dissent, saw the writing on the wall and democratised. Now, though their politics are a bit rough, they have the sort of prosperous, technology-based economies that Vietnam aspires to. The Vietnamese Communist Party seems instead to have been taking more interest in the example offered by Singapore, another prosperous, high-tech neighbour. Singapore's tiny size makes it a bit of an exception but even its constrained democracy—with rivals to the ever-ruling People's Action Party allowed to compete within tight constraints—would be a good start for Vietnam.

It is true that Vietnam also has neighbours, such as the Philippines and Thailand, where democracy has been a bumpy ride. But what this demonstrates is that democracy is a necessary rather than sufficient condition for reaching the premier league. The present generation of Vietnamese leaders, children of the independence struggle who want the best for their people, should think about who might come after them. If the next generation is less principled and more corrupt but cannot be dislodged from power, the country will slide backwards.

So far there are few signs of revolt against one-party rule. But as the Vietnamese get used to their broad economic and social freedoms, they are bound to appear eventually. Why wait? How much better for Ho Chi Minh's heirs to go down in history as having led the way in bringing stability, prosperity and, at last, real freedom to the people of Vietnam.

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Chinese nationalism

Flame on

Apr 24th 2008
From The Economist print edition

Rather than shout themselves hoarse, maybe foreign and Chinese protesters could try talking

Reuters

WHATEVER hopes there were that this August's Beijing Olympics would be a festival of fun and friendship with a bit of sport thrown in are fading fast. The event was intended to mark China's reintegration into the world, and re-emergence as a great power. Instead, preparations for the games have degenerated into some of the ugliest verbal confrontations for years between China and its critics. Passions and tempers are running high on both sides. On China's, even those suggesting something as innocuous as a dialogue are being pilloried as “traitors”. Foreign journalists have received death threats. Far from being a celebration of China's new openness, the Olympics risk vindicating those abroad who argued it was not a fit host and those at home who think a fearful, envious world will never give a resurgent China its due.

As in 1999, after NATO's bombing of China's embassy in Belgrade, or in 2005, when anti-Japanese protests in China threatened to get out of hand, China's government finds itself in an awkward fix. It wants to rein in the popular anger before it descends into violence, or turns on the government itself. Yet its own policies and its control of information have stoked the anger in the first place.

That is not to deny that the angry Chinese nationalists who have deluged the internet with their splenetic outpourings and staged protests in China (see article) have a point. Coverage in the Western press of unrest in Tibet has been rather one-sided. It has stressed the harsh Chinese crackdown on peaceful protests and tended to overlook the violence by Tibetans. For most Chinese observers, what happened was an outburst of vicious racist thuggery directed at ethnic Han Chinese in Lhasa, the Tibetan capital. And the authorities, incomprehensibly, tolerated it until 19 people had been killed.

Similarly, views of the protests attracted by the round-the-world tour on which China is taking the Olympic flame differ sharply. In the West most attention has been paid to the exploits of pro-Tibetan protesters, such as hanging banners high above the Golden Gate bridge in San Francisco, and the menacing behaviour of the Chinese torch guards. In China, the defining moment was when a protester in France tried to grab the flame from a female torchbearer in a wheelchair. How dare the outside world, runs the refrain of a legion of Chinese bloggers, lecture China about uncivilised behaviour?

Of course, the antics of unruly demonstrators in Paris cannot be used to condone or justify Chinese repression in Tibet. Although it remains unclear exactly what happened in Lhasa, it is certain that Chinese police shot protesters in neighbouring Sichuan; that thousands of Tibetans have been detained; and that others are forced to undergo hated “patriotic re-education”, which many see as aimed at obliterating their own culture. Tibetans have real grievances, after decades of cultural discrimination and economic marginalisation.

All over bar the shouting

China's government cannot admit that. Nor, having blamed the Dalai Lama, Tibet's exiled spiritual leader, for the unrest, is it easy to open talks with him. So it has closed the obvious path to reconciliation with its Tibetan minority. Having lied to its people about Tibet for so long, how could it explain to them a new, less hostile policy? It seems also to have convinced many of its people of the truth of two other egregious lies: that criticism of China's government is an attack on the Chinese people, and that dialogue is a sign of weakness. In fact, both foreign and Chinese protesters might learn something from each other. But it is hard to learn with one hand holding a megaphone and the other clenched into a fist.

The Democrats

Swinging in the wind

Apr 24th 2008
From The Economist print edition

How much more of this can the Democrats take?

AFP

ALL democratic systems have their quirks, and America's is the electoral college, an 18th-century oddity whose principal effect is to ensure that the president is chosen not by the overall popular vote, but by the outcome in a handful of big “swing states”. These swing states now mean that Barack Obama, who has recently seemed to be cruising towards the Democratic nomination, may have a problem.

Hillary Clinton's nine-point win on April 22nd (see article) means she has bested Mr Obama in Florida, Ohio and now Pennsylvania—the three most important swing states. Electoral-college votes are awarded on a winner-take-all basis, and America's politics are so finely balanced that whoever wins two of these three is more or less guaranteed the presidency. If the Democrats cannot hold Pennsylvania and move Ohio from the Republican column into their own, they can kiss the election goodbye. And the polls suggest that success in both these states would be more likely if Mrs Clinton were the nominee than if Mr Obama were. Her more solid appeal to the working-class vote is the main reason. Blue-collar workers are the crucial swing voters in the swing states, and Mr Obama, with his ranting anti-American preacher and his snooty attitude towards their guns and their God, has not yet won them over. John McCain, war hero and scourge of Washington waste, might please them more. Mrs Clinton is a polarising candidate; but Mr Obama is polarising too, in different ways.

That, at any rate, is the case that Mrs Clinton is now making to the “superdelegates”. This group of 800 senior party members must decide the nomination, since the primaries have so far given Mr Obama an inconclusive edge of only around 150 among the 3,250 elected delegates. But Mr Obama has a strong case of his own to make. For a start, he can claim victory on most metrics: he has won more delegates, more states and (just barely) more of the popular vote than Mrs Clinton, and none of these is likely to change as the primaries wind down. He is much better at raising money (her campaign is nearly broke, but he has oodles of cash on hand) and much better at appealing to independents than she is. His electioneering talents are truly exceptional, and he has not yet started to apply them against Mr McCain. Once he does so, he may well be able to shrink the Republican's ratings as surely as he shrank Mrs Clinton's, over and over again.

Take a deep breath

What all this means is that the contest will not end soon. And that is a prospect that is terrifying many senior Democrats. The longer the rivals spend explaining why the other is unelectable, the greater the chance that neither will be elected. History recounts that bitterly contested nominations usually produce losing nominees.

But it doesn't have to be that way. Yes, the candidates are being rude about each other, and some of the mud will stick. And yes, the party will need to swallow hard if it is to unite around its eventual nominee. But the prolonged race does have some compensations. It has forced the rivals to build up machinery for raising cash and mobilising voters that will stand the Democrats in good stead in November. It has given them a chance to get their messages, which are actually pretty similar, across. But by turning viciously negative (she more than he) about each other, they are now in great danger of abusing all that free publicity. Delaying a decision until the Democratic convention at the end of August therefore carries great risks. The Democrats should wait until the last primaries are held on June 3rd; then the superdelegates should declare themselves, and the matter should be settled.

Mr McCain, for his part, is starved of money and has failed to use his period of grace to put forward much in the way of convincing economic policy, his area of greatest weakness. But he has been doing a good job of persuading the Republicans—ideologically far more divided than the Democrats are—to rally behind him. If the Democrats are unable or unwilling to do the same once their long battle is over, they don't deserve the White House.

Bank capital

Joseph and the amazing technicalities

Apr 24th 2008
From The Economist print edition

Adjusting banking regulation for the economic cycle

Illustration by David Simonds

BANKERS have a bad habit of making economic cycles worse. They are notorious for lending people umbrellas when the sun is shining and asking for them back when rain starts to fall. When the economy is strong and asset prices are rising, banks are only too eager to lend to those wanting to buy assets, helping to push prices higher. In bad times, when prices are falling, banks ask for their loans back, forcing the borrowers to sell assets and driving prices down further.

Right now, banks are desperately plastering over the cracks in their balance sheets created by the credit crunch. This week Royal Bank of Scotland launched a £12 billion ($24 billion) rights issue (see article). Other banks have tapped the bulging wallets of sovereign wealth funds. But there may be a limit to investors' largesse: those who have bailed out banks so far have lost money.

If the well of investors' patience does run dry and banks are forced to shrink their lending, the economic situation may get a lot worse. Already the riskiest borrowers in America and Britain are being shut out of mortgage markets, with predictable consequences for house prices.

Regulators are partly to blame. When the credit boom was roaring in 2005 and 2006, central banks did make pointed comments about the “underpricing of risk”—in plain English, that banks were not charging borrowers enough. But they did nothing about it; indeed, by keeping nominal interest rates low, they encouraged the credit excesses.

International regulations on the capital adequacy of banks do exist, but they tend to be procyclical too, requiring lenders to raise more capital only when the problems have already occurred. And the regulators tend to be one step behind the practitioners. Banks were able to exploit the first lot of so-called Basel rules, because they could hide risky loans off their balance sheets. The new rules, Basel 2, may be more sophisticated in their treatment of risk but they rely heavily on models developed by banks themselves. As the past year's events have demonstrated, those models can be seriously flawed.

Cycling backwards

Could there be a better way to regulate the industry? The regulations could be countercyclical, requiring banks to be like the biblical Joseph and raise more money in the fat years to see them through the lean ones. Defining the cycle may sound prohibitively difficult but Charles Goodhart, a professor at the London School of Economics (and a former monetary policymaker at the Bank of England), suggests a way around it: monitoring whether the pace of loan growth or the rate of increase of asset prices was moving sharply above trend, and requiring banks to find more capital if the alarm sounds. Had such a rule been in place, the subprime-mortgage boom might not have been so explosive.

Of course, the devil would be in the detail. Regulators would need a breakdown of how bank lending was being directed to different geographical areas and asset classes. In good times, greedy bankers would have the incentive to cheat; for example, by making loans to offshore holding companies that would then pass on the money to Florida condo-buyers. Such rules would need to be international, to stop foreign banks from stealing market share from banks in countries that observed the regulations.

The regulators would also need to be careful about being too lax during the downturns. After all, it is at such times that banks are most likely to need capital to keep them afloat. Bank customers might be resentful if they felt regulators had been complicit in letting a bank go under (although deposit insurance should soothe them). But if banks are forced to raise more capital during the booms, their finances should be stronger during the busts.

Despite this, countercyclical regulations would not be popular with the bankers. Over a full cycle, such rules would probably require banks to have more capital than under the existing system (and given the rescue of Bear Stearns, the rules would need to apply to investment as well as commercial banks). Because money tied up in capital earns lower returns, that would mean lower profits.

But it is hard to feel much sympathy for bankers who rake in fortunes during the boom and require taxpayers to help them out in the bust (or make central banks jump through hoops for them, as the Bank of England has done this week—see article). An efficient financial sector is vital for a modern economy but trading securities has arguably achieved too much importance in the Anglo-Saxon world. Winston Churchill once said that he would rather see finance less proud and industry more content. That is not a bad motto for those devising a new set of banking regulations.

Economist.com OPINION LEADERS

Recovery at Fiat

The miracle of Turin

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From The Economist print edition

The lessons that other carmakers can learn from the fixing of Fiat

Rex

SOME corporate turnarounds are the result of a big change in strategy. Nokia, for instance, was a messy conglomerate in a backwoods Baltic country until it abandoned the rubber boots and loo paper and concentrated on mobile phones. Some are the consequence of a brilliant new invention. Apple was just a bit player in the personal-computer market until it invented the iPod. And some are brought about by the realisation that the company has lost its way and needs to focus once more on what it's good at. Fiat belongs to the last category; and the remarkable story of the recovery of a company long written off as one of the sickest firms in Europe's sickest economy (see article) holds lessons for other carmakers.

Fiat had long been synonymous with Italian industry: celebrated, at its best, for making beautiful products yet derided for inflexibility in the workplace and bureaucratic management. By the time Sergio Marchionne came along in 2004, most of the beauty had gone and the stiffness had become sclerotic. Born in Italy but educated in Canada and schooled in business outside the car industry, Mr Marchionne combined an insider's sense of how the system worked with an outsider's vision of how badly it needed to change. He managed to get his homeland's politicians, unions and bankers behind him by making clear early on that he could restore Fiat by rebuilding rather than just slashing and burning.

Mr Marchionne first focused on making Fiat more supple. He tackled the company's massive debt, partly by persuading General Motors to cough up $2 billion to be rid of the obligation it had entered into in happier days to take over Fiat. With the help of a rights issue, he was able to pay off the banks to whom Fiat had owed €3 billion. Within 60 days he had slimmed Fiat's corpulent administration to a size more suited to its modest output. He took control of the car division, installing a new breed of young manager and introducing a culture of transparency and honesty. He gave his new team both clear targets and the support needed to hit them. Engineers were told to cut out duplication in car parts that could easily be shared across the whole range.

Then he focused on making cars that people would want to be seen driving. Fiat's three car brands were told to think hard about what defined them and to deliver products that would engage buyers' emotions. All the designers were put under one roof with orders to give up the wilful eccentricity that had led to some notably ugly cars. Development was speeded up by going further with “virtual engineering” than any other carmaker. This allowed a dowdy range to be refreshed within three years and gave product planners a vital speed advantage over competitors. Freed from the stifling embrace that had put clunky American engines in Alfa Romeos (to the dismay of Alfistas all over Europe), Mr Marchionne has sought out new partners with pragmatic promiscuity, while refusing to sell Fiat's best technology to rivals.

Look and learn

What can Detroit's troubled Big Three learn from the miracle of Turin? First, that they should not have been seduced into neglecting their primary business, carmaking, by the easy profits earned from concentrating too much on pick-up trucks and thus surrendering market share to Japanese and European firms when fashion and high gas prices turned against them.

Second, that they could and should have addressed their own operational and product-line problems sooner. General Motors has been grinding away along similar lines to Fiat, but it has taken a decade to improve quality and deal with its burden of health-care and pension costs. True, it was lumbered with powerful unions, but so was Mr Marchionne, and he won them round by communicating the seriousness of Fiat's crisis. Ford may at last be slowly sorting itself out—under Alan Mulally, formerly of Boeing, another car-industry outsider—but took too long to ditch peripheral brands and leverage the engineering skills of its successful European arm. Chrysler may have found the owners it needs in private equity, but it is too soon to tell. Detroit may get back on the road, but had its bosses been as bold and as honest as Mr Marchionne, they too might already be motoring merrily.

On Israel, Bertelsmann, Tibet, bitter politics

Apr 24th 2008
From The Economist print edition

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Israel at 60

SIR – Your special report on Israel (April 5th) quoted me explaining how the deterrence theory of the cold war would not apply to the polynuclear Middle East that could emerge in the wake of an Iranian bomb. You dismissed this talk as coming from "hawks" in Israel who "tend to have more sway" in "a country obsessed with security" and insinuated that Israeli concerns about Iran's nuclear ambitions are blown out of proportion by "squadrons of ex-spooks and retired generals". This does not do justice to the serious debate of this crucial issue.

The cold war was a stable period because of its bipolar nature, its relatively rational strategic decision-making processes, clear lines of command over nuclear arsenals and the absence of public pressure to launch a nuclear war. Nevertheless we now know that the world came much closer to nuclear confrontation than was previously thought. It is only right that we begin to prepare for the possibility of a Middle East with a number of nascent nuclear powers in which those restraining cultural and political elements are absent.

Israel has little choice but to view the Iranian threat through the prism of the past 60 years in the region and take into account the record of brinkmanship by regional leaders seeking to enhance their public support, popular enthusiasm for nuclear weapons, and the strong influence of religious beliefs that sanctify risk propensity and martyrdom. These do not augur well for a stable Middle East.

Shmuel Bar
Institute for Policy and Strategy
Interdisciplinary Centre (IDC)
Herzliya, Israel

SIR – Regarding the "separation barrier", it is not a wall that Israel is building around Palestine; it is a cage. This is the first example in history of a group of people building a barrier around another group not to keep them out, but to keep them confined. Israel is treating the Palestinian people as though they are cattle or dogs. Not only is the rest of the world watching, they are supporting the keepers.

Matthew Pflaum
Atlanta

SIR – Is Israel the sole cause of Palestinian suffering? Which neighbouring countries have extended assistance? Not Lebanon, which confined Palestinians to refugee camps, depriving them of the right to work, the ability to educate their children and the right to become citizens. Certainly not Jordan, which quarantines exports from the West Bank until they are proven to be free of Israeli content, further burdening Palestinian businessmen.

Ted Levy
Weston, Connecticut

SIR – You detailed the problems inhibiting economic growth in Israel. Most of these problems derive from a single source: Israel's socialist past. The economy has morphed into the worst kind of statist system, in which bureaucratic and oligarchic elites exert excessive control and curb competition. One exception is the bold reform in financial markets instituted by Binyamin Netanyahu when he was finance minister.

The reform reversed two decades of little growth and deep recessions into five years of spectacular growth. It broke the power of a bank oligopoly that had wasted Israel's savings on reckless loans to cronies in big business while starving small- and medium-sized enterprises of credit.

If the partial freeing of financial markets could have such spectacular results, imagine what other such vital reforms could achieve. Israel is like a coiled spring of enterprise waiting for its corrupting political system to stop suppressing it. It could then replicate its high-tech miracles in other sectors as well.

Daniel Doron
Director
Israel Centre for Social and Economic Progress
Mevasseret Zion, Israel

Bertelsmann's performance

SIR – I do not agree with the statements in your recent article (Face value, March 22nd) concerning my term as chief executive of Bertelsmann. The development of the company between 1998 and 2002—ie, the creation of the RTL Group, the acquisition of Random House, etc—have not “strained” Bertelsm€ann's finances in any way. At the time of my retirement its debt amounted to €334m (with revenues of €20 billion). RTL Group today contributes more than 50% towards Bertelsmann's profit.

I also do not agree that my “internet ventures” were costly in general. Selling the company's AOL shares and its 50% stake in AOL Europe and the sale of mediaWays, an internet-service provider, generated a profit of €10 billion.

In the three-and-a-half-years of my leadership Bertelsmann doubled its revenue, tripled its operative profit and quintupled its net equity. Not a bad result compared with the company's present situation, almost six years after my resignation.

Thomas Middelhoff
Chief executive
Arcandor
Essen, Germany

Chinese Tibet

SIR – You seem to support various accusations made by exiled Tibetans (“Torch song trilogy”, April 12th). You could also explore opinions that are more in line with the majority of the Chinese people. Tibet has been a protectorate of China (and later under formal Chinese jurisdiction) since the Qing Dynasty 300 years ago. It will always remain a formal part of China. The Chinese people should migrate to Tibet in massive numbers. Then maybe 20 years from now we can hold a formal free referendum in Tibet to decide its fate and satisfy the international standard for democracy.

Lawrence Ren
Guangzhou, China

A bitter era

SIR – Ronald Holdaway (Letters, April 12th) commends Dick Cheney for trying “to shape public opinion rather than be shaped by it.” Surely a politician who, when told that two-thirds of Americans oppose his views replies “So?”, is not trying to shape public opinion but merely expressing his contempt for it.

A.M. Ungar
Baltimore

SIR – What do you mean, “Pittsburgh feels decayed, like Cleveland” (“Welcome to the Super Bowl”, April 12th)? I moved to the Cleveland area after living in shiny and new Seattle for 15 years, and I have news for you. Cleveland is a pretty nice place. Sure, it has been hurt by the outsourcing of manufacturing jobs to China and the flight of people to the sunbelt, but we have plenty of water, limited traffic problems, reasonable housing prices, world-class cultural activities and great health care.

Andre Lukez
Chagrin Falls, Ohio

SIR – The sight of Hillary Clinton and Barack Obama vying in Pennsylvania for the Abraham Lincoln Award for the candidate with the humblest beginnings (Lexington, April 19th) reminded me of the Monty Python sketch about the four Yorkshiremen. Each man argues that his family had the hardest upbringing: “There were 150 of us living in t' shoebox in t' middle o' road”; “You were lucky. We lived for three months in a paper bag in a septic tank”, and so on. Maybe the Python team could write a new version in time for the parties' conventions this summer.

Margaret McGirr
Greenwich, Connecticut

Gulf economies

How to spend it

Apr 24th 2008 | DUBAI AND JEDDAH
From The Economist print edition

Corbis

A region awash with oil money has one or two clouds on the horizon

THE Gulf is full of loud architectural statements—towers that reach over 600 metres into the sky, hotels that will be suspended under the sea. It is easy, then, to miss the quiet resonance of Imperial College London's gleaming diabetes centre in Abu Dhabi, the capital of the United Arab Emirates (UAE). The building is decorated with tessellated plates of aluminium, a pattern inspired by the geometry of an insulin crystal and the *musharabiya* latticework of the region's past.

Opened in 2006, the hospital now cares for 6,000 patients, who pass through its chain of tests and treatments in a single visit. Almost a fifth of the UAE's native population suffers from diabetes, a rate second only to Nauru's. Next come three fellow members of the Gulf Co-operation Council (GCC)—Saudi Arabia (16.7%), Bahrain (15.2%) and Kuwait (14.4%).

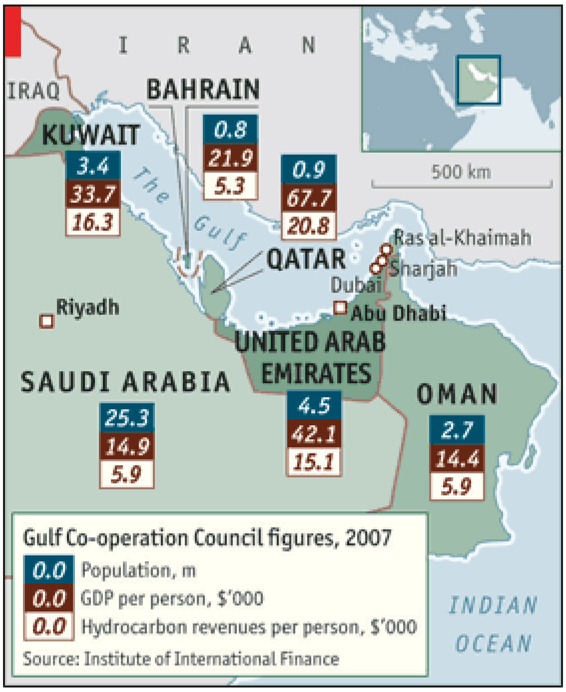
The ailment is one unhappy consequence of the region's economic transformation. Before 1961, Abu Dhabi lacked even a paved road. Since then, it has enjoyed a startling transition from pearling to petroleum, from souk to mall and from sand to glass. This prosperity has bought a sedentary lifestyle and a sugary diet, which may have triggered a genetic predisposition to diabetes among Arabs. In the neighbouring emirate of Dubai shoppers are invited to enrol in “Mall Walkers”, a power-walking club that promises to give more than your credit card a workout.

Diabetes is a useful metaphor for the Gulf's present problems. The region's economies are struggling to absorb petrodollars, accumulating like glucose in the bloodstream. The risk they face is the economic equivalent of renal failure: inflation, a hollowing-out of the non-oil sector, and a young, growing workforce in chronic need of outside labour to supplement it.

The six nations of the GCC, which also includes Qatar and Oman, earned $381 billion from their exports of oil in 2007 and another $26 billion from gas, according to the Institute of International Finance (IIF). If the oil price remains at about $100 a barrel, they will reap a cumulative windfall of almost $9 trillion by 2020, reckons the McKinsey Global Institute: a vast number relative to the size of the GCC economies, which had a combined GDP of $800 billion in 2007.

Not all these riches are ingested, of course. The Gulf added $215 billion to its stock of foreign assets in 2007, the IIF calculates. This hoard is divided between the region's central banks, its sovereign-wealth funds and its wealthy sovereigns. It added up to $1.8 trillion by the end of last year, by the IIF's estimates, and more like $2.4 trillion, according to Brad Setser of the Council on Foreign Relations and

Rachel Ziemba of RGE Monitor.



This financial clout has aroused anxiety, especially as some of the smaller funds have ventured beyond bank deposits, government bonds and minority stakes into less anonymous investments. In March the government of Abu Dhabi wrote letters to finance ministers around the world, explaining the motives guiding its investments. Its funds are only in it for the money, the letters said.

It is a plausible claim. If the Gulf is now a financial superpower, as Mr Setser and Ms Ziemba put it, then it has had its greatness thrust upon it. Its dollar surpluses were accumulated more by accident than design. The region's governments, scarred by the cheap oil of the 1990s, were slow to believe high prices would last. Their revenues then outpaced their ability to spend.

Slowly, however, the Gulf states' domestic ambitions have begun to catch up with their greater means. The six members of the GCC have announced or begun projects worth $1.9 trillion, according to *Middle Eastern Economic Digest*, 43% more than a year ago. The magnitude and mystique of the Gulf's foreign investments may arouse curiosity and concern. But what is more remarkable is how much the Gulf is now trying to spend on itself.

An avenue in the desert

No one could accuse Dubai of hoarding rather than flaunting wealth. For those not content with five-star luxury it offers the sail-shaped Burj al-Arab, the world's only seven-star hotel. Guests arrive by helicopter or Rolls-Royce, watch 42-inch plasma TV-screens in their rooms and choose from 13 pillows on which to lay their heads.

Dubai makes an exhibition of its prosperity because its economy now depends on people with money. With only a tiny percentage of the UAE's oil reserves, it has become adept at conjuring up ventures for others to finance. Now that its more conservative neighbours, such as Saudi Arabia and Abu Dhabi, are keen to invest more at home, they are learning from Dubai the arts of immodesty and audacity.

There are few better tutors than Emaar, one of Dubai's big-three developers, best known for building the Burj Dubai, the world's tallest tower. In 2006 its Saudi offshoot raised 2.55 billion riyals ($680m) to build a metropolis on the Red Sea coast, 100km north of Jeddah. The King Abdullah Economic City (KAEC), due for completion in 2016, will have over 2,000 factories and 2m people. Its resorts will offer 22,500 rooms and its port will dwarf the Islamic Seaport in Jeddah, handling the equivalent of 20m 20-foot containers a year and 300,000 pilgrims bound for Mecca.

In the last oil boom, new industrial cities such as Yanbu and Jubail arose at the government's behest. But Emaar raised its money from local investors in an oversubscribed public offering. Such “stockmarket hullabaloo" was new to Saudi Arabia, one critic says. Indeed, the private sector has never before taken on a city of this size.

Over the entrance to the site hangs a portrait of King Abdullah, looking down benignly. The archway marks the beginning of a 17km road lined with palm trees, which cannot disguise the dusty emptiness that extends for miles on either side. The wind-blown sand forms natural speed bumps along the route. Where the road meets the sea, construction has begun. A rig pounds an inlet out of the coast, sending rubble rattling down a pipe to the sea. Workers take a moment to pray, bending like the palm trees in the wind.

Emaar makes its money selling dream properties "off-plan" (ie, before they are built), using the proceeds to turn the rendering into a reality. In Dubai the model works well, thanks to the strength of Emaar's brand and the speed of Dubai's administration. In Saudi Arabia, buyers are more wary and the ministries less brisk. Emaar has recently agreed to lease industrial space to a Saudi-French lubricants company and an aluminium joint-venture from Abu Dhabi and Dubai. But the Saudi king, visiting last August, seemed unimpressed with progress. The deadline was tightened from 2026 to 2016. In February an even bigger "industrial zone" was announced, Sudair City, which will be financed mostly by the government.

Emaar faces another speed bump common to the entire region: the mounting cost of men and materials. Cement, steel, even sand are becoming pricier, and engineers are in short supply. Inflation, which reached 8.7% in February, is a shock to the Saudis, whose central bankers are as conservative as their clerics. In Oman the rate is 11.1%, an 18-year record. In the UAE and Qatar it is also well into double digits.

Behind these disturbing numbers lie three economic forces. First is the rise in the world price of commodities, especially food, thanks to strong demand and strained supply. Second is the fall of the dollar, to which all Gulf currencies are pegged except the Kuwaiti dinar. The third force is less familiar. It is the rise in the price of non-traded goods, principally housing and office space, which is arguably a natural result of the oil boom, and may even help the Gulf absorb its new riches.

The high price of food can tax even the hardiest consumer. The cost of good camel fodder has more than doubled in eight months, says Sameh Musabha, who watches four of his 80-strong herd trot around the race track in the UAE's tiny emirate, Ras al-Khaimah. "Everything is expensive now," he says. At the Two-Dirham Plaza nearby, many items now sell for five.

The fall of the greenback, meanwhile, has raised the price of those imports not invoiced in dollars. Foreign workers complain bitterly that the money they earn in the Gulf stretches less far when sent to their families in India, Pakistan or Britain. The peg has forced the Gulf's central banks to shadow America's Federal Reserve, even as their economies have parted ways.

Might they re-peg their currencies at a stronger rate, or abandon the peg altogether? A meeting of the GCC in December dismissed the idea, saying that a rejigging of rates might jeopardise their ambition of monetary union in 2010. A stronger reason, suggests John Sfakianakis, chief economist of Saudi British Bank (SABB) in Riyadh, was Saudi Arabia's reluctance to undermine the dollar, the currency of its closest ally. But Qatar's prime minister thinks his currency is 30% undervalued, and he may still break ranks.

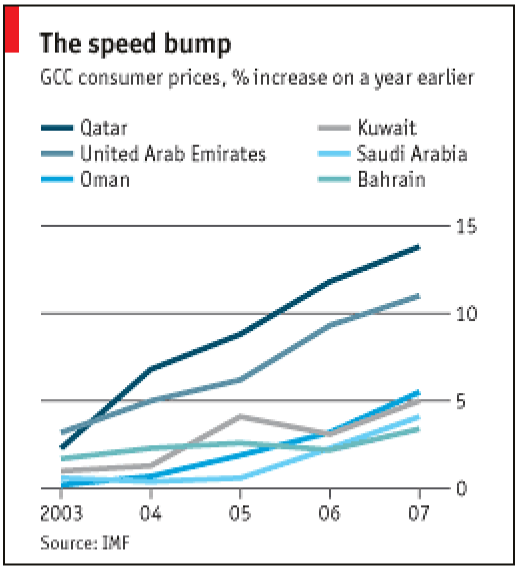
Disappearing dhows

Even if the dollar were steady, the region's prices would be unstable. This is because if the Gulf is to absorb its petrodollars, the price mechanism has work to do.

When an energy exporter converts its petrodollars at the central bank, domestic spending rises. But unless the local economy has a lot of slack, it cannot magically produce more goods and services to meet this fresh demand. Their price instead rises, relative to the price of things that can come in from overseas. According to a study by three IMF economists, a doubling of the oil price results eventually in a 50% rise in the price of non-tradable goods (such as housing), relative to tradables.

This shows up as inflation. But the price rises should peter out once they have served two useful functions: diverting demand to goods from abroad, and increasing the supply of those goods and services that must be produced at home.

You can see this macroeconomics at work all over the UAE. By Dubai's old creek, wide-bottomed dhows, moored four abreast, are hidden by the cargo piled on the wharf. Car parts from Germany, seedless tamarind from Myanmar and basmati rice from Pakistan are offloaded by small cranes from China. Meanwhile the price of housing, a service that must be consumed where it is produced, is soaring. In Dubai, rents rose by 30% in 2006 and another 17% in 2007. The government has tried to cap increases at 5% this year, but landlords turf tenants out on any pretext and charge 30-40% more when they re-let. Office space in Dubai now costs almost as much as in midtown Manhattan.



A camel-boy from Bangladesh

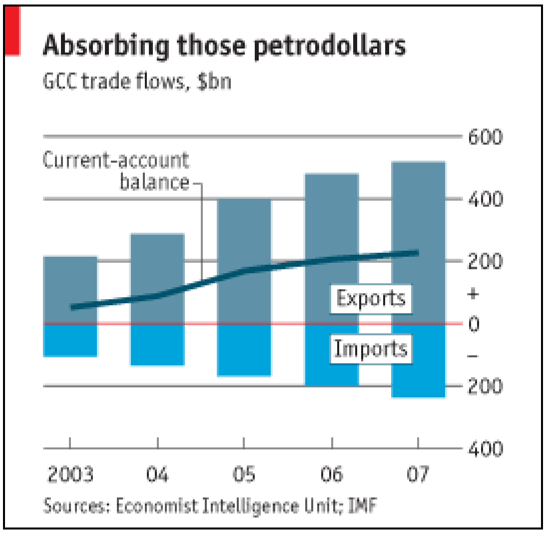
Some goods and services cannot be imported, but the labour required to produce them can be. In the Gulf, immigration serves almost as a tool of macroeconomic stabilisation, keeping wages contained. Illiterate young men from rural Pakistan fly into Riyadh, Saudi Arabia's capital, their passports signed with a thumbprint. At the luggage carousel, they pick up bundles of oranges they will sell before taking up jobs driving trucks or twisting steel across the kingdom. In Dubai, workers from South Asia are shuttled in from desert labour camps in the same yellow buses that ferry American children to school. They file on to construction sites, an arm draped over the man in front.

The Gulf has long assumed this queue of workers was endless. But some construction companies now struggle to find ready manpower. Labourers have dared to demand better wages. On March 18th hundreds of workers in the emirate of Sharjah torched cars and buildings in a labour camp in a protest over pay. In February 45 Indian builders were condemned to jail and deportation for violent protests.

The migrants have some backing in their home countries. In Bahrain, the Indian government has requested that their nationals be paid a minimum wage, much to the resentment of the Bahraini government. But Bahrain is itself pioneering a sweeping reform of its labour market, designed to make foreign labour more expensive. From July 1st it will charge companies a monthly levy of 10 dinars ($26) for each foreign employee on their books, in addition to a visa fee of 200 dinars.

This ambivalence towards foreign labour is shared across the Gulf. The native-born want to enjoy the profits and products that immigrant labour makes possible. But they do not want to face the competition immigrants bring. Foreigners do 60% of private-sector jobs in the GCC region; in the UAE, they do over 90%. Even Mr Musabha, the camel-owner, employs a young apprentice from Bangladesh.

Many nationals find work instead on swollen government payrolls, underwritten by petrodollars. But Bahrain's oil-fields are running dry and Saudi Arabia's deep reserves are spread thinly over a large population (25m) that is growing faster than oil output. The country is no stranger to poverty. In old Jeddah, beautiful coral houses sink into dilapidation. Elderly women watched by stray cats search for the best picks from the city's rubbish skips.



The Saudi and Bahraini states cannot afford to employ every citizen who wants a job. But the “petrodollar wage” still casts a long shadow, setting expectations and raising living costs. Elsewhere in the world the private sector would compete with the government for labour, offering comparable pay. But in the Gulf private employers hire immigrants instead. This leaves many Saudis and Bahrainis in limbo. They cannot count on a government job; nor will they settle for a low private-sector wage.

Licensed layabouts

According to McKinsey, the Gulf economies need to create 280,000 jobs a year to employ the young citizens graduating from schools and universities. But despite some of the lowest student-teacher ratios in the world, many emerge with few marketable skills. One response is to force companies to hire locals, imposing quotas in the name of Omanisation or Saudi-isation. But this measure undermines the work ethic of locals and the morale of immigrants. McKinsey reckons a quarter of native employees in Bahrain, Saudi Arabia and the UAE fail to show up for work.

Another response is to foster new industries other than oil, which employs too few, and construction, which pays too little. Saudi Arabia has made progress privatising telecoms, liberalising airlines and opening up financial services. It is also pinning great hopes on its economic cities, of which KAEC is but one of six. The others include a Knowledge City near the holy city of Medina; a city based on steel, copper, aluminium and other heavy industries in Jizan; and a fourth that will nurture agri-business in Hail, which produces 90% of the country's corn and a third of its potatoes. All told, the cities are supposed to create 1.3m jobs by 2020.

Unfortunately, the region's diversification plans lack much diversity. For example, no fewer than 11 aluminium smelters are in the works, on top of two already in operation in Dubai and Bahrain. Mr Sfakianakis suspects the Gulf's governments have heard the same advice from the same cadres of consultants. The GCC is guilty of a “me-too” approach to industrial development, says a report by the National Bank of Kuwait, which raises the risk of over-capacity not just in aluminium, but also in petrochemicals and property.

In the small Gulf countries, such as Kuwait and Qatar, the economic task is rather different. Their governments' hydrocarbon revenues last year amounted to about $60,000 and over $90,000 per citizen respectively. These resources will not last for ever, of course. But that does not mean they need to diversify their production. By investing the proceeds of their energy sales in a broad range of assets, they can diversify their income instead. Over the long run, a diversified portfolio of stocks, bonds and property is likely to outperform oil anyway.

Their economic fate is the one imagined by John Maynard Keynes in his 1930 work, “Economic Possibilities for our Grandchildren”. In an age of easy prosperity, the struggle to ensure the citizenry is employed gives way to the challenge of keeping them occupied. How to avoid becoming a nation of coupon-clippers?

Abu Dhabi is experimenting with a more interesting future. In February ground was broken on the Masdar Institute of Science and Technology, the first step in an initiative to foster renewable-energy technologies, from conception to manufacture. The initiative will be based in a small eco-city, which will invite its citizens to economise on energy and escape from their cars.

The ground-breaking ceremony was powered by 24 solar panels of various designs, each competing for the bid to serve the city. In the site office the electricity meter turns backwards, an early example of Masdar's ambition to contribute electricity to the national grid beyond the power it needs to run itself. In a country dedicated to driving and drilling, Masdar is bold, perhaps quixotic. It is an attempt not so much to diversify the economy as to invert it. Is it a folly? The beauty of Abu Dhabi is that it has the money to make it work, and the money not to worry too much if it fails.

The Democrats in Pennsylvania

No surrender

Apr 24th 2008 | PHILADELPHIA AND WASHINGTON, DC
From The Economist print edition

AP

The Democratic primary is set to continue for a few more bruising weeks

THERE is no spinning away the importance of Hillary Clinton's nine-point victory over Barack Obama in the Pennsylvania primary on April 22nd. The victory has not only put fire in her belly. It is also reinforcing growing doubts in the minds of the superdelegates about Mr Obama's electability in November. Mrs Clinton has now won the primaries in seven of America's eight biggest states, and its three most important swing states. Mr Obama's lead comes, in part, courtesy of a string of victories in low-turnout caucuses.

The most important of the many statistics to emerge from the Pennsylvania exit polls was Mrs Clinton's 40-point margin among white voters who did not go to college. These people are the heart and soul of the old Democratic Party. They hold the balance of power in a swathe of big industrial states that the Democrats simply have to win in November to take the White House. But both polling and anecdotal evidence suggests that they are singularly averse to Mr Obama's charms, even when those charms are boosted by a two-to-one spending advantage and the support of Bob Casey, a senator who is beloved by blue-collar Pennsylvania.

Of those who responded to the exit polls, only 60% of Catholics said they would vote for Mr Obama in the general election, and a further 21% said they would vote for John McCain. Sixteen per cent of white voters said that race had an influence on their decision—and almost half of those 16% suggested that they would not support Mr Obama in the general election. Some blue-collar voters joked that they were “too bitter” to vote for Mr Obama. Others brought up Mr Obama's remark about “clinging” to religion and worried that the religious figure that he “clings to” goes in for bashing America.

What Mrs Clinton called her “double digit” victory (the final figure turned out to be 9.2%) gave her a huge boost after her relentless drubbing from members of the Democratic establishment, who have been urging her to step aside, and Democratic fund-raisers, who have been turning off the cash spigots. Her victory speech saw her at her feisty best. Michael Nutter, the mayor of Philadelphia, urged the primary-night crowd to “take about a five-hour break. Then let's get ready for Indiana.” The Clinton campaign says that the money is pouring in again. Mrs Clinton's regained status as the “comeback kid” will also guarantee lots of free media.

But will all this be enough to turn the race upside down? Mrs Clinton has won the most precious commodity available to her at the moment—time. Time to sow further doubts in the minds of the superdelegates. And time for Mr Obama to make another game-changing mistake. But the odds are nevertheless against her: the punch of her victory speech, for example, was diminished by the fact that she had to include an appeal for money.

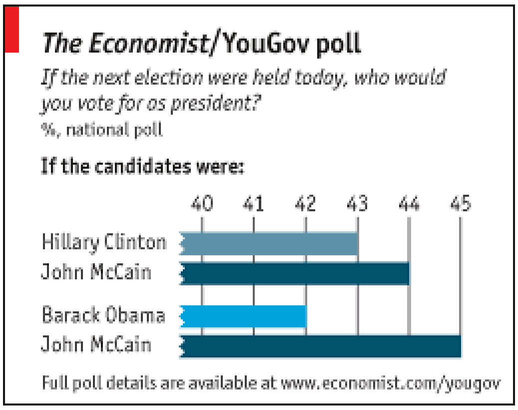
The Democratic Party's odd rules mean that she will add only a net 10-15 delegates to her count. That means that Mr Obama's lead will fall from 161 elected delegates to around 150. The coming Democratic primaries will prove a mixed bag. Mr Obama is likely to win big in North Carolina—and go some way to making up the 200,000 gain in the popular vote she got from Pennsylvania. The remaining states are likely to split fairly evenly, with Mrs Clinton taking Kentucky, West Virginia and Puerto Rico and Mr Obama taking Oregon, Montana, South Dakota and Guam. It will take a blow-out victory on May 6th in Indiana—the primaries' next Super Bowl—to break the pattern. But Indiana is not such fertile ground for Mrs Clinton as Pennsylvania: it has a younger population and allows independents and even Republicans to vote in its primary.

Mrs Clinton has showed much less ability to expand the party than Mr Obama has. Over the past year the Pennsylvania Democratic Party has gained 300,000 new voters while the Republican Party has lost 70,000. Mr Obama won those new voters by about 20 points. Mrs Clinton has also fought more clumsily than her opponent. It is worth recalling that she started off this election campaign with the most powerful brand name in Democratic politics, the support of the party establishment and an air of inevitability. That is quite an inheritance to have squandered.

Same old Democrats

The Clinton campaign argues that the Pennsylvania race has created “a new landscape”. But the truth is that it has simply exposed the same old landscape—a party deeply divided along demographic and cultural lines. Mr Obama won six in ten voters under the age of 29. Mrs Clinton won a similar proportion of voters over 60 (who made up 32% of the electorate) and a majority of people over 40. Some 35,000 people showed up on Independence Mall in Philadelphia's Centre City on April 18th to cheer Mr Obama. But around blue-collar towns such as Reading and Scranton Obama supporters were as rare as vegetarian restaurants.

This division is becoming increasingly bitter. The Clintons believe that Mr Obama will lead the party to disaster in November. Mr Obama's supporters accuse Mrs Clinton of raiding Karl Rove's playbook. A Clinton television ad aired on the eve of the election threw in the 1929 stock market crash, Pearl Harbour, the Cuban missile crisis, the cold war and September 11th, 2001, complete with video of Osama bin Laden. “If you can't stand the heat, get out of the kitchen”, the narrator intoned. Seventeen per cent of Pennsylvania voters said they either will not vote if Mrs Clinton gets the nomination or will vote for Mr McCain; 25% said that they will do likewise if Mr Obama wins the nomination. Those decisions may well not hold. But the Democrats have lost one of their most important advantages from a few months ago: the idea that all the ills of modern politics can be traced to George Bush and Mr Rove.



All this suggests that Mrs Clinton may be half-successful in her pursuit of the presidency. She has demonstrated Mr Obama's weakness with a vital Democratic constituency, the blue-collar worker. She has raised doubts about his toughness in times of crisis. But it still looks as though she has done all this too late to seize his crown. The only person who has clearly benefited is John McCain.

On the campaign trail

Primary colour

Apr 24th 2008
From The Economist print edition

Speaking for us all
"How many debates did you have to have? None? That sounds good."
Barack Obama discusses elections with a ten-year-old boy who had just become class president. NPR, April 19th

LOVE ME
"Well, I think, just knock on the door and say 'She's really nice', or you could say it another way, 'She's not as bad as you think'."
Hillary Clinton gives advice to her campaigners in Philadelphia. NPR, April 19th

Decision time
"I need [superdelegates] to say who they're for starting now. We cannot give up two or three months of active campaigning and healing time. We've got to know who our nominee is."
Democratic Party chairman Howard Dean is getting impatient. CNN, April 17th

Faint praise
"Either Democrat would be better than John McCain. And all three of us would be better than George Bush."
Mr Obama, campaigning in Reading, Pennsylvania. AP, April 20th

Setting the bar high
"That would be the biggest upset of the century."
Ace Smith, North Carolina director for the Clinton campaign, admits that a win in the state by his candidate is extremely unlikely. CNN.com, April 18th

Hard liquor
"Let's say I didn't mind it.... But I don't make it a regular habit."
Mrs Clinton discusses drinking whisky shots. ABCNews.com, April 21st

Sugar high
"I'm going to give the press some pies and see if it makes them sweeter."
Mr Obama, yearning for the days of good press coverage, bought $50-worth of pastries for campaign staff and media. Patriot News, *April 21st*

New frontiers
"Ninety years old and I never thought I'd see this. Republicans don't come to this bend."
Nettie Young, one of the quiltmakers of Gee's Bend, Alabama, on a campaign visit by John McCain. He bought three quilts. Los Angeles Times, *April 22nd*

Campaign finance

Mammon, McCain and Obama

Apr 24th 2008 | WASHINGTON, DC
From The Economist print edition

John McCain looks set to accept public funds and the accompanying shackles

LAST year, jokes John McCain, his presidential campaign was in such a pickle that he could only count on the support of his wife and his mother—“and Mom was starting to keep her options open.” This year, things have been looking up. In the Republican primaries the Arizona senator easily trounced rivals who were richer, younger, more articulate and better-looking. Still, he will now have to do it all over again against a Democrat in the run-up to November, and he is finding it horribly hard to raise money.

This week the McCain campaign admitted that it will probably have to accept public funds for the November election. That would guarantee Mr McCain $84m to spend between the Republican convention in September and the election. The catch is that if he accepts cash from taxpayers, he cannot spend more than a token amount from any other source. (The Republican Party can spend another $19m or so supporting him; and supposedly independent groups can easily find loopholes in the complex campaign-finance laws that allow them to run blatantly electioneering attack ads.)

Previous presidential nominees have all accepted public funds in general elections. But this year was supposed to be different. Both parties' candidates were expected to raise such huge sums that they would find it advantageous to forgo the subsidy. But Mr McCain has not.

He has raised some $72m so far, but spent most of it winning his party's nomination. At the end of March his campaign had about $11.5m in the bank. Such sums are pocket change to Barack Obama, who has raised an incredible $235m. The junior senator from Illinois boasts $51m in cash, insignificant debts and a web-based fundraising operation that parts donors from their dollars at least three times faster than Mr McCain's operation can. And that is before Mr Obama has even clinched the Democratic nomination. If and when he wins it, there will be no one else for Democrats to donate to, so he may raise cash even faster. Hillary Clinton, for her part, has less cash, more debt and more difficulty raising fresh funds than Mr Obama. But she still far out-raises Mr McCain.

If he is the Democratic nominee, it would be hugely to Mr Obama's advantage to shun public funds. Granted, back in the days when he did not realise what a cash-magnet he is, Mr Obama piously vowed to accept public funds if his opponent did. Now, having seen how useful it is to be able to saturate the airwaves with ads praising himself and damning his opponent, he has slithered away from that vow. The current system of public financing for elections is “creaky”, he says. The Obama method of raising lots of small donations over the internet is like a “parallel public financing system,” he told donors earlier this month. Sure it is.

Mr McCain, meanwhile, is making the most of his underdog status. Addressing voters in a depressed part of Ohio this week, he noted that they, like he, must know what it feels like to be counted out and written off. “What matters most of all”, he said, “is that you didn't give up.”

Death penalty

A pointless extinction

Apr 24th 2008
From The Economist print edition

The Supreme Court's ruling upholding lethal injections has resolved nothing

AP

It's not unusual

ACROSS America, those states that still impose the death penalty have been rushing to resume executions following the Supreme Court's ruling on April 16th upholding the use of lethal injections. More than 40 executions had been put on hold until the court decided. But the end of the seven-month *de facto* nationwide moratorium is unlikely to produce a bloodbath. Rather, as Justice Clarence Thomas grumbled, the seven-to-two ruling "is sure to engender more litigation...[because] we have left the states with nothing resembling a bright-line rule."

This is because the court's decision was based on lethal injections as administered in just one state, Kentucky. Of the 36 states that retain the death penalty, 35—together with the federal government—have adopted lethal injections in the belief that this is the most humane method of execution. (Nebraska used to use the electric chair until its Supreme Court ruled in February that this was unconstitutional.)

Although at least 30 states use the same three-drug procedure as Kentucky, the standards, protocols and therefore the risk of a botched execution differ. This leaves the door open to further objections that lethal injections in other states violate the eighth amendment's ban on "cruel and unusual" punishment. So rather than a mad rush to the death chambers, there is likely to be a gradual resumption in executions, accompanied by many more legal challenges. This week the Supreme Court rejected lethal-injection appeals from Alabama, Mississippi and Texas, clearing the way for them to set new execution dates for inmates who had earlier been granted last-minute reprieves by the court.

Last year 42 executions were carried out in America, down from 53 the previous year and a peak (since the Supreme Court allowed executions to be resumed, in 1976) of 98 in 1999. Last year's total was kept artificially low by the court's decision in September to hear the Kentucky case, bringing all executions to a screeching halt. But the downward trend in capital punishment is clear. Death sentences have been falling steadily, down from a peak of 326 in 1995 to an estimated 110 last year.

Announcing the Supreme Court's judgment, John Roberts, the chief justice, said that to constitute a cruel and unusual punishment, the execution method had to present a "substantial" or "objectively intolerable" risk of serious harm; avoidance of all pain was not required. Justices Thomas and Antonin Scalia set the bar higher, arguing that the method would have to be "deliberately designed to inflict pain" to be unconstitutional. Justice Stephen Breyer felt it was sufficient to show "a significant risk of unnecessary suffering". But whatever their interpretation of the eighth amendment, seven justices agreed that Kentucky's method was lawful.

While concurring, Justice John Paul Stevens declared that he no longer believed the death penalty itself to be constitutional. Having voted in 1976 to uphold capital punishment, he now agreed with the late Justice Byron White (in *Furman v Georgia,* 1972) that its imposition represents "the pointless and needless extinction of life with only marginal contributions to any discernible social or public purposes". Justices Stephen Breyer, David Souter and Ruth Bader Ginsburg are believed to think the same.

Thirty years ago, only 16 countries had abolished the death penalty; now more than 90 have. In the developed world, only America and, occasionally, Japan still use it. (Taiwan and South Korea have it on their books, but no longer impose it.) In December, the UN passed a resolution, backed by 104 states, calling for the first time for a worldwide moratorium on capital punishment. Even China, the world's most avid executioner, is seeking to limit the death penalty and make it more humane—by using more lethal injections.

Immigration

Not very nICE

Apr 24th 2008 | AUSTIN
From The Economist print edition

More and more raids, but still no solutions

ON APRIL 22nd Felipe Calderón, the president of Mexico, paid his first visit to Dallas, Texas. In any other year it might have been a mundane appearance. Mexico is an important trading partner for the city. But America's relationship with Mexico is a bit strained at the moment, and that is clear from a look at Dallas county.

Over the past year several Dallas suburbs have acquired a reputation for being hostile to Mexican immigrants. In May 2007 voters in the town of Farmers Branch backed plans to ban landlords from renting flats to illegal immigrants. Shortly thereafter the suburb of Irving gave its police the right to check the immigration status of anyone pulled over for a traffic violation. The consul advised Mexican nationals to avoid Irving altogether. Tom Leppert, the mayor of Dallas, says that the city is less gung-ho than the county, but that anyhow much of America is polarised over immigration. “I don't think we're any different than any place else,” he says.

There is some truth to that. Frustration over federal inaction has been widespread and mounting since Congress's effort to develop a comprehensive approach to immigration failed last year. So many towns, states and individuals have taken matters into their own hands that it is hard to keep track. In 2007, according to the Migration Policy Institute, state legislatures considered more than 1,000 measures addressing immigration.

In response, the Immigration and Customs Enforcement agency (ICE) has been stepping up its workplace raids. In 2005 the ICE arrested fewer than 200 people at work; last year the number was around 860. The Department of Homeland Security, of which ICE is a part, has said there will be more this year. In April alone there have been raids at nightclubs in Dallas, a resort in Virginia, and a wood-products plant in Idaho. The biggest operation came on April 16th, when agents around the country swept into five chicken-processing plants, a doughnut company and seven Mexican restaurants. That night alone yielded 300 arrests.

Critics of the raids say they are expensive and futile: there are 12m illegal immigrants in America, and only a tiny proportion can be rounded up in this way. Antonio Villaraigosa, the mayor of Los Angeles, has called for Homeland Security to focus its efforts elsewhere. Raiding employers, he says, will hurt the city's economy. But part of the point of them, presumably, is to deter employers from hiring illegals in the first place.

From a humanitarian perspective the raids are traumatic for the workers, most of whom have done nothing wrong. They can lead to horrible problems when American-born children of illegal immigrants are separated from their parents. In tiny Cactus, Texas, a union representative recently observed that workers at a beef-processing plant are still so edgy after a 2006 raid that they shake and cry at the thought of another. Douglas Rivlin of the National Immigration Forum called last week's raids “a black eye” for the country, considering that Pope Benedict XVI on his recent visit was calling for immigrants to be treated with dignity.

In Dallas, Mr Calderón joined the chorus of those defending illegal immigrants. He acknowledged that Mexico must work to provide opportunities at home for its sons and daughters, but noted that “the American economy cannot run without Mexican labour.” He joked that he himself has relatives working illegally in the United States. But, he said, until the United States achieves immigration reform, he would not say where.

History in California

Fighting for a piece of Clio

Apr 24th 2008 | LOS ANGELES
From The Economist print edition

What a struggle over the school curriculum reveals about California

THREE years ago Bob Huff, a newly-elected Republican assemblyman, voted for a bill that would have pressed schools to teach pupils more about Filipinos' role in the second world war. “What could be wrong with that?” he remembers thinking. More knowledge is no bad thing—and, besides, California contains more than 1m Filipinos. But then Mr Huff, who sits on the state's education committee, realised that almost every group was pushing its own history.

Indeed they are, now more than ever. No fewer than seven bills that would alter how history is taught are currently before California's legislature. One is another measure about Filipinos. The others would encourage or force more lessons about African and Latin American cultures, American Indians, the “secret war” in Laos, the deportation of Hispanics in the 1930s, the desegregation of Mexican pupils and the Italian contribution to California. All of which would be added to a curriculum that is already a brisk 5,000-year trot from ancient Egypt to contemporary America.

The bills' chances are dim. Although the Democrats who control both houses of the state legislature almost invariably support such measures, Arnold Schwarzenegger, the governor, has tended to veto them. Yet the real target of this historical barrage may not be the statute book. Next month a group of academics and bureaucrats will begin holding public hearings on an overhaul of the curriculum framework—the first full one since 2001. The coalitions that have been formed to push for legislation will no doubt make their feelings known.

Nor is legislation the only source of pressure. The state board of education follows “social content guidelines” which, among other things, ban negative depictions of religious groups and foreign cultures. Many have duly complained of slights and inaccuracies; among the most zealous are Hindus, who have succeeded in toning down descriptions of the caste system. Such groups are particularly keen to edit California's textbooks because the state is America's biggest education market. Changes made there tend to find their way into classrooms across the country.

Diane Ravitch, who helped write California's curriculum in the 1980s, complains that every group supports every other group's plea for inclusion, resulting in a consensus for including a huge amount of new material. Yet the curriculum battles also reveal how the balance of power is shifting. It is not surprising that Asians and Hispanics dominate the current crop of bills: they are California's two fastest-growing groups. These days American Indians have great economic and political clout thanks to their virtual monopoly on gambling. History, after all, is written by the winners.

And as for the Italians, they are just trying to keep up with what Bill Cerutti of the Italian American Task Force calls the “approved groups”. He complains that because Asians, blacks, Hispanics and American Indians have all successfully won more space in the curriculum, there is less classroom time to recognise the contributions of others. “We want to be in there, too,” he says. It all sounds like bad news for poor old Rameses II.

Health

Eat, smoke and die early

Apr 24th 2008 | WASHINGTON, DC
From The Economist print edition

Worrying news about poor American women's lifespans

FEW numbers tell a happier story than those that measure life expectancy. An American born in 1900 could expect to live 47 years. Thanks to colossal improvements in sanitation and medicine, that figure is now 75 for men and 80 for women. And the poorest Americans have gained the most: blacks, for example, live more than twice as long now as they did a century ago.

So it is both alarming and surprising when life expectancy falls, even for a small part of the population. Yet that is what some researchers at Harvard have found. They looked at death rates by county, having corrected for migration and merged sparsely populated ones so that America's 3,141 counties became 2,068 “county units”.

For most Americans, life expectancy continues merrily to rise. But between 1983 and 1999, it fell significantly (by about a year) for women in 180 county units, and stagnated in another 783. Men fared less poorly: their life expectancy fell significantly in only 11 county units, and stagnated in another 48.

Put differently, life expectancy appears to have either stagnated or fallen slightly for some 4% of American men and 19% of women. The main culprits are diseases linked to smoking or obesity, such as lung cancer and diabetes. The crucial question is whether this represents a blip or the start of a trend.

Majid Ezzati, one of the study's authors, says it is too soon to say. An optimist would point out that women took up smoking later than men. It was not until after the second world war that they started puffing at anything like the male rate. The bulge of poor women now dying of lung cancer may be a hangover from the end of the taboo on female smoking. But both sexes have quit in droves since the 1970s, so the death toll may fall in the future.

A pessimist would reply that the other big killer, obesity, keeps spreading, especially among the poor. “We've been saying for ages that it must have peaked, but it keeps going up,” says Dr Ezzati. Two decades ago, no state had an obesity rate above 15%. Now, 22 have passed the 25% mark. The counties where life expectancy has fallen are nearly all in the South or Appalachia, where huge deep-fried portions are the norm and waistlines are among America's widest. Neither are getting any smaller.

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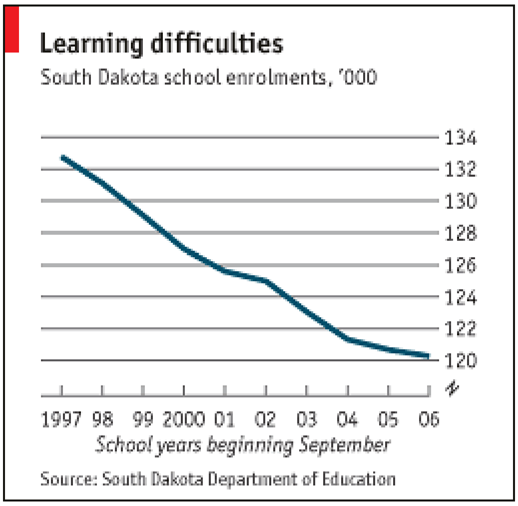
WORLD
UNITED STATES

Rural schools

Shrinking pains

Apr 24th 2008 | RUTLAND
From The Economist print edition

South Dakota's rural schools grapple with change



NESTLED in wide fields somewhere west of Interstate 29 lies Rutland, South Dakota, population an estimated 200. Rutland's post office closed decades ago. But at the end of Main Street is a school. For Rutland, and many other small towns like it, a local school is a community's heart and a main employer. The future of schools like this one, however, is uncertain.

Last year South Dakota passed a law to force school districts with fewer than 100 students to merge, though the most remote districts are exempt. The state had 168 districts for just 120,277 students in the 2006-07 school year, and enrolment had declined 9.4% over the previous ten years (see chart). Many of those districts have just one school.

Legislators, particularly urban ones, reckon that merging districts will create economies of scale and allow schools to offer a broader curriculum. But in many cases, a merger will lead a good school to close, forcing its pupils to take long bus journeys to the next town. Ten districts have already been slated for reorganisation. Rutland, with 124 students, is one of many near the brink.

The push for school consolidation has been long and contentious. In 1939, the first year for which data are available, America had some 117,000 school districts. By 2005 it had just over 14,000. The issue is especially fraught in states with many rural schools. In North Dakota, talk of forced mergers in the late 1990s sparked such outrage that politicians dropped the subject entirely. Maine's new consolidation law is creating political havoc.

Carl Fahrenwald, Rutland's superintendent, says the state should not interfere. Small rural schools, he argues, perform well and nurture competition. The Rural School and Community Trust, a pressure group, points to small schools' low drop-out rates and strong parental involvement. An analysis of South Dakota's test scores, however, shows mixed results. Younger students in small districts do score higher than those in big ones. For teenagers, big districts score higher.

Even the most defiant schools superintendent will admit that rural districts face challenges. South Dakota allots about $4,500 for each student. Though small districts receive a little extra cash, districts that lose students lose money. Many districts, including Rutland, have to raise money locally to cover their costs.

The biggest difficulty, however, is finding teachers. Mr Fahrenwald is Rutland's superintendent, physics teacher and bus driver. There are fewer teachers to hire: the number of state students graduating with a teaching degree dropped by 30% between 2000 and 2007. It doesn't help that South Dakota's salaries for rural teachers are the second-lowest in America.

Consolidation, legislators hope, may begin to offset these trends. A merged school means recruiting one algebra teacher, not two. Don Kirkegaard, the head of a consolidated district in the north-eastern part of the state, says he now has more money for pension accounts, special education and capital expenses. Critics say that the savings are often lost because of greater bureaucracy.

But the debate over rural schools hides a sad irony. The better a small town educates its pupils, the more likely they are to seek jobs elsewhere. According to a study by Pennsylvania State University, returns to investment in human capital are much lower in rural areas than in urban ones.

Lexington

Only in America

Apr 24th 2008
From The Economist print edition

Illustration by Kevin Kallaugher

America's particularities will survive George Bush

IT IS exceptionalism week in the world of American think-tanks. No fewer than three of them—the American Enterprise Institute and the Brookings Institution in Washington, DC, and the Manhattan Institute in New York City—have arranged discussions of a fat new book on the subject, “Understanding America: The Anatomy of an Exceptional Nation”, edited by Peter Schuck and James Q. Wilson. But, as Hegel feared, do the thinkers understand a concept just as it stops being relevant? Does the owl of Minerva really fly only at dusk?

All countries are exceptional. But America likes to think of itself as exceptionally exceptional, different from other advanced industrial countries not just in its social arrangements but also in its underlying values. America has a smaller state than other comparable countries and a more unequal distribution of wealth. It is also more strongly committed to what Margaret Thatcher once called “Victorian values”—individualism, voluntarism, patriotism.

American exceptionalism has been increasing ever since the rise of the modern conservative movement from the late 1960s onwards. The current Bush administration, with its commitment to conservative values at home and assertiveness abroad, is the most exceptional administration in recent years. But the book raises a new question: is a new cycle, dominated by a rejection of conservatism and a convergence with West European norms, about to dawn?

There is plenty of compelling evidence. The Bush administration has whipped up a mighty opposition. The Democrats are poised to increase their majorities on Capitol Hill and have a better-than-even chance of taking the White House. George Bush has the highest disapproval rating of any president in the 70-year history of the Gallup poll. Nearly three-quarters of Americans think the country is heading in the wrong direction. The conservative movement is suffering a collective mental breakdown.

Americans strongly favour the introduction of universal health care. They are also desperate to improve their global image. Both Hillary Clinton and Barack Obama have promised to introduce the former. All three candidates have promised to improve the latter. The next administration will undoubtedly see significant moves, such as the closing of Guantánamo Bay or the adoption of stronger environmental regulations, that will be intended to make America less of an outlier.

But look at the 2008 election—the one that is supposed to be changing the direction of the country—and American exceptionalism seems to be as strong as ever. Where else do primary elections go on for well over a year? Where else do candidates raise tens of millions of dollars a month from their supporters? And where else do the party rank-and-file (as well as some non-party people) get a chance to choose the candidate for the top job? Gordon Brown became Britain's prime minister without a single ordinary Briton casting a vote. John McCain won his party's nomination despite the opposition of a large chunk of his party. Mr Obama is leading an uprising against his party's old establishment.

The various campaigns have often invoked American exceptionalism, especially the strength of its religious feeling. Mrs Clinton has stressed her credentials as a cradle Methodist who once thought of becoming a minister. Even before the Jeremiah Wright affair, Mr Obama spoke at length about how he found purpose in life when he discovered God. The only odd thing about this election is the fact that the Democratic candidates both seem more comfortable with God-talk than Mr McCain.

All three candidates preach a peculiarly American style of patriotism. Mr McCain invokes his military service in Vietnam, when he learnt to depend on something greater than himself. Mr Obama argues that there is not a red America or a blue America but one America united by common values. All three candidates wax lyrical about the American dream. And by European standards all three candidates are strikingly willing to sanction the use of force. Mr McCain sings “Bomb, bomb Iran” to the tune of “Barbara Ann”. Mr Obama talks about sanctioning a search-and-destroy mission in Pakistan without the permission of that country's government. Mrs Clinton said this week that, as president, she would have no qualms about “totally obliterating” Iran if it used nuclear weapons against Israel.

More liberal is not less American

A Democratic hat-trick in November would certainly produce a more liberal America, with more government involvement in providing health care and protecting the environment. But it will be a liberal America of an exceptionally American kind, not a facsimile of Europe. Both candidates have rejected the “single-payer” health-care model popular in Canada and Europe. Instead they advocate a very American solution—allowing people who are happy with their private health coverage to keep what they have but then using a mixture of mandates and subsidies to extend coverage. And even modest changes will be endlessly diluted. The world may be transfixed by the presidential campaign. But the president's powers, as the book stresses, are remarkably limited, qualified not just by Congress and the courts but also by the states and the localities.

The big change coming is not the end of American exceptionalism but the end of American triumphalism. Winning the cold war left many Americans intoxicated with power. Even Bill Clinton boasted about America as the “indispensable nation”—a country that stood taller and saw farther than its rivals. The mood is very different today. The main challenge facing the next president will not be to blunt American exceptionalism, but to make sure that American triumphalism is not replaced by a grumpy and irresponsible isolationism.

A tale of two Mexicos

North and south

Apr 24th 2008 | CUETZALÁN AND OAXACA
From The Economist print edition

Why can't its stagnant southern states catch up with the rest of Mexico?

IT IS not a place where misery reveals itself immediately. Fields climb over mountains, green as Ireland. A smattering of attractive hotels cater to tourists visiting the local waterfalls. Bells ring out from the two churches that dominate opposite ends of Cuetzalán, a small town in the northern mountains of the state of Puebla. But the appearance of a pastoral idyll conceals a poverty trap.

Mexico's southern states are more mountainous and rural than the north, with a bigger proportion of Indians. And on almost any socio-economic indicator, these areas lag behind the rest of the country. At the bottom are Chiapas, Oaxaca and Guerrero, but parts of Puebla and Veracruz are little better off. In a human-development index comparing Mexican municipalities, drawn up for the United Nations, 95% of the places in the bottom decile are in the south. In the north, 12% of people in rural areas are extremely poor, against 47% in the south, according to the Woodrow Wilson Centre, a think-tank in Washington, DC.

Although politicians have long been aware of this gap, government efforts to tackle it have accomplished little. A grandiose Plan Puebla-Panama, launched by President Vicente Fox in 2001 to develop the south, stayed largely on paper. The “March towards the South”, a scheme of the same year to attract investment, paid businessmen to create jobs that in some cases never materialised, says Gerardo Esquivel, an economist at Colegio de México, a university in Mexico City.

Felipe Calderón, Mr Fox's successor, also has plans. Reasonably enough, these focus on infrastructure: one of the south's obvious handicaps is that getting products to ports and airports, let alone to the United States, is slow and expensive. The government hopes to mobilise from public and private sources investment in roads totalling $28.7 billion over his six-year term, including $6 billion this year. Some of these will be in the south, including a new highway along the Gulf coast and feeder roads to both coasts. Some critics, such as Mr Esquivel, say this is not enough.

Others question whether roads alone can help. José Antonio Aguilar, an official in Puebla, says that the past four years have seen “a total transformation” of his state's infrastructure “but we haven't been able to turn this into growth in income.”

Perhaps the crux of the problem is that there is little incentive for private investment in the south because the population is too poor and dispersed, says Roberto Newell of the Mexican Institute of Competitiveness, a private think-tank. The paradox, says Eduardo León of the Boston Consulting Group, a management consultancy, is that “we must depend on the government to create non-governmental sources of investment.”

The roots of stagnation are complex. As well as difficult geography, they include ethnic discrimination and poor education. In addition, it is both a cause and consequence of economic torpor that politics in the south remains the province of strongmen. Incompetence, corruption and even violence are common. In Puebla, the governor has been accused of helping to cover up a paedophile ring (he denies it, and the federal Congress dropped an investigation). The city of Oaxaca, once a tourist magnet, is only slowly recovering from seven months of protests in 2006 calling for the ouster of the state governor, in which a score of people were killed. Adalberto Castillo, head of a local chamber of commerce, estimates that the state's economy would be some 20% bigger today had the protests never happened.

A self-styled Zapatista revolutionary army took over parts of Chiapas in 1994. It has not formally called off its rebellion, which involves some 20,000 people. But the federal government now quietly supplies electricity and water to the villages the Zapatistas still control, according to Xavier Abreu, an official at the federal government's agency for indigenous people.

The Zapatista rebellion raised Mexicans' awareness of race discrimination. But this remains a problem. The majority of the population in every one of Mexico's 100 poorest municipalities is of indigenous descent, says Mr Abreu. One policy designed to help the poor Indians is bilingual education. But the flaws of the public education system are magnified in the south. In practice, the teachers' union rather than the government controls teaching appointments; the union sometimes appoints a teacher who speaks a different indigenous language to his pupils, according to Mr Abreu. A typical adult in the south has only six years of schooling; the corresponding figure in northern Mexico is 8.1 and 9.7 in Mexico City. And those years of schooling are not full years: local education officials report that in urban areas in the south an average teacher spends only 110 of the notional 200 days of the academic year actually in the classroom. The record is even worse in rural areas.

Mexicans of indigenous descent face cultural barriers too, some of them self-imposed. Mr Newell argues that Mexican society has not negotiated its way around the difficult question of how to retain respect for Indian traditions while integrating the countryside economically. “It is a cruel choice,” he says, “but you have to give up some differentiation.” Amerindian culture dictates maize as the staple crop; a smallholder farming a few acres with a hoe cannot compete with Iowa combines. Better infrastructure and education in the more urbanised north mean that the benefits of Mexico's membership of the North American Free-Trade Agreement have accrued there, while income in the south stagnates because of low productivity.

Yet not all is gloom in the south. In some places there are signs that local government is becoming more efficient. By updating its property registry, Guerrero's state government has raised its annual revenue from property tax by 38%, which officials hope will result in higher public investment. In Puebla, officials are encouraging farmers to switch from maize and coffee to higher-value crops, such as bamboo and fruit. Such schemes are not helped by the fact that government agricultural subsidies go disproportionately to the richer north. And they are exceptions.

The big wealth gap polarises politics, too. In the north, Mr Calderón won 43% of the vote in the 2006 presidential election, while only 24% went to Andrés Manuel López Obrador, his populist rival. But in the south Mr López Obrador won 40%, and Mr Calderón 27%. This regional divide contributes to political gridlock. The right plays to its electoral strength in the north, and the left to its constituents in the south, squeezing out opportunities for compromise and progress. The latest example concerns a desperately needed reform to liberalise Mexico's declining state-owned oil industry, opposed by Mr López Obrador. The south instinctively favours big government and mistrusts private initiative.

With each passing year, the socio-economic gap widens. Monterrey, Mexico's northern industrial capital, is starting to resemble south Texas. Many parts of the south still look like a northern extension of Guatemala. But unless the government shows a greater ability and willingness to tackle its problems, the south will not just remain stuck in its poverty trap but risks handicapping the country as a whole.

Cuba

Fins ain't wot they used to be

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From The Economist print edition

Camera Press

Sunset for those 1950s cars?

THE stately American sedans from a bygone era, finned and chrome-bedecked, may be central to the tourist image of Cuba as a romantic timewarp. But their survival has little to do with any Cuban predilection for collectors' cars. “I'd swap it for a Volkswagen any day,” grumbles Miguel, as he fires up his powder-blue 1956 Chevrolet in a Havana backstreet. For decades Cubans have not been allowed to buy freely any car made since 1959, the year of Fidel Castro's revolution. But it is just possible that this ban might soon be lifted.

Since formally taking over the presidency from his ailing brother on February 24th, Raúl Castro has swiftly discarded several “excessive” restrictions. Cubans can now stay in the fancy hotels previously reserved for foreign tourists, and rent their own mobile phones. Bans have been lifted on the sale of microwaves, DVDs and computers. There have been strong hints that the government will scrap the requirement that Cubans obtain exit permits to leave the country.

Could the right to buy cars come next? At present, vehicles are divided into two categories: those registered before 1959, and those after it. The former (mainly 1940s and 1950s American imports) are viewed by the government as relics from the island's capitalist past and can still be legally bought and sold. Cars imported after that date are deemed state property (initially handed out to loyal workers and Communist Party officials), whose ownership can be passed only within families. Cubans, famed for their ingenuity in circumventing rules, have been known to get married simply to gain legal possession of a car, and then divorce.

Even if Raúl Castro, who is driven around in a BMW, does decide to ease the rules on car ownership, few Cubans will benefit—at least in the short term. With average wages at just $17 a month, a mobile phone, let alone a car or a stay at a tourist hotel, is out of the reach of all but a tiny minority (mainly those with generous relatives abroad). A change in the rules might nevertheless be welcomed by one group the government is keen to keep loyal.

The first batch of doctors who have served in Venezuela as part of a swap for oil is now returning to Cuba. Each has been given the right to buy a car. To do so, they can draw on the $4,000 annual salary paid during their five-year assignments abroad and kept frozen in a bank account. Under current rules, they can withdraw only $5,000 or so for a car. But all post-1959 cars must be bought through the state, which imposes a 100% mark-up. A second-hand Lada will be all that most returning doctors can afford.

On the black market, where cars are bought and sold without the original title of ownership, prices are no lower. A 1940s Jeep goes for $7,000, while a 1980s Mercedes 190, which would be considered as scrap in the United States, may fetch as much as $35,000.

Whatever their immediate practical impact, these nods to the consumer society send a message. “Fidel set up all these rules to prevent the Cuban 'haves' from displaying their wealth to the 'have-nots',” says a European diplomat in Havana. “Raúl seems much more relaxed on that front.”

Colombia

Cousin Mario

Apr 24th 2008 | BOGOTÁ
From The Economist print edition

“Parapolitics” touches the first family

FOR ten hours on April 22nd Mario Uribe, a former senator and a cousin of Colombia's president, Álvaro Uribe, holed up in the Costa Rican embassy in Bogotá seeking political asylum. The request was turned down. As he left the embassy, Mr Uribe was arrested on charges that he sought support from right-wing paramilitary gunmen in an election in 2002 and bought land obtained illegally by them.

With his arrest the steadily escalating scandal known in Colombia as “parapolitics” moved a step closer to President Uribe. This began in 2006 when prosecutors acted on evidence uncovered by researchers of links between several legislators in the north of the country and the paramilitaries (most of whom were also involved in drug trafficking). It gathered momentum with testimony from paramilitary leaders who demobilised under a peace deal negotiated by President Uribe's government. Now 31 lawmakers are in jail—though only four have so far been convicted—and another 31 are under investigation. That adds up to more than a fifth of the Congress.

President Uribe said that he was “pained” by his cousin's arrest but that it would not affect his efforts to protect the country's institutions. These have notably included a tough security policy that has greatly weakened Colombia's left-wing guerrillas. He argues that it is these policies that enabled him to persuade the paramilitaries to demobilise, and that have created a climate in which the institutions of justice can operate freely. There is no evidence that the president himself had links to the paramilitaries, who imposed a reign of terror on parts of the countryside in the name of fighting the guerrillas.

Nevertheless, the spreading parapolitics scandal is an embarrassment to President Uribe. There are some “wonderful people” in the president's coalition but at least a third of its members are “linked to criminals”, says Claudia López, a political consultant who has investigated parapolitics. The president's political ties to his cousin were close. They cut their political teeth together in the 1980s in the same faction of the Liberal Party in Antioquia, their home region.

The parapolitics scandal has called into question the legitimacy of Congress, and almost paralysed lawmaking. A senior paramilitary leader boasted after the 2006 election that a third of Congress's members were elected with his movement's backing. In parts of northern Colombia, voters and candidates were dragooned into doing the paramilitaries' bidding.

Under the current rules, those under investigation are replaced by another member of their party. Both the opposition and the government agree that a political reform is needed to punish parties, and not just individuals, that have links to either the paramilitaries or the guerrillas, though they disagree about the details.

Opinion polls show that Mr Uribe is the most popular president in Latin America. Most Colombians reckon he has saved their violence-plagued country. Mario Uribe's arrest and the breadth of the parapolitics investigations are a sign to some of the health of Colombian democracy. “I never imagined that this would go so far and that the justice system would prosecute so many politicians linked to the paramilitaries,” says Ms López.

But that is not the way it will be seen by the Democrats who control the United States Congress and who are stalling a free-trade agreement with Colombia for a mixture of protectionist and human-rights motives. On Capitol Hill “things were already difficult for Colombia, and this will make it more difficult,” concludes Michael Shifter of Inter-American Dialogue, a Washington think-tank.

Bolivia

Once more to the brink

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From The Economist print edition

Much voting and little trust

AT LEAST so far the chosen weapon is merely the ballot box. But Evo Morales, Bolivia's socialist president, and his opponents in the more capitalist-minded and prosperous eastern regions are once again heading for battle. On May 4th Santa Cruz, the biggest and richest of those regions, plans to hold a referendum on regional autonomy. The government says that the vote is illegal, and is encouraging its supporters elsewhere to go to Santa Cruz to demonstrate. There is tension, but so far no serious bloodshed.

On the face of things, the gulf between the two sides looks unbridgeable. The opposition fears that Mr Morales wants to impose Venezuelan-style socialist autocracy on Bolivia. It particularly resents the way in which he is trying to ram through a new constitution: the text of this was approved in December at an improvised session of a Constituent Assembly, held in a technical college, which a hostile mob prevented the opposition representatives from attending. Similar tactics were used when Congress voted to declare the autonomy referendum illegal.

For his part, Mr Morales, who is of Aymara Indian descent, charges that his opponents form a racist elite who are blocking reforms that threaten their privileges. The government had proposed to hold a referendum to approve the new constitution on May 4th, but postponed it when the electoral authority said it needed more time to organise the vote.

Local leaders in Santa Cruz see the referendum as a way of standing up to Mr Morales. They hope for a turnout of 80% and to win a similar share of the vote. Three other regions—Beni, Pando and Tarija—have scheduled similar referendums, while Cochabamba and Chuquisaca are considering following suit.

This defiance has exposed divisions among Mr Morales's aides. Some favour arresting regional leaders, or deploying the army to prevent the referendum. Instead, the president has ordered the police not to patrol polling stations. The Santa Cruz authorities have signed up thousands of volunteers to do the job. The government seems certain to claim that the vote cannot be trusted.

The president remains popular, but less so than he was. Inflation is heading for 20% this year. The government's coffers are bursting after it nationalised the oil and gas industry, but it has proved inept at spending its treasure trove.

Strip away the mistrust, and the issues separating the two sides look negotiable. Both accept that the constitution should limit the maximum size of farms; they just disagree about the limit. And Mr Morales is surely right when he says that the crux of the argument is about money: the eastern regions, home to Bolivia's natural-gas fields, want to keep more of the royalties rather than yield them to the centre.

But an attempt by the Catholic Church to mediate was rebuffed by the opposition, which accuses the government of bad faith during talks last year. Assuming it is fortified by the referendum, the opposition might be prepared to return to the table. Mr Morales will then face what might be the decisive choice of his presidency.

India

Shovelling for their supper

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From The Economist print edition

The world's biggest public-works project just got bigger. In some places it is working better than many feared; but by no means everywhere

OUTSIDE Ajit Pura village, in India's ari d state of Rajasthan, 42 women and a man scrape earth into panniers, hoist the panniers to their heads, and walk the contents up to a low embankment rising on the edge of the work-site. It is designed to slow the passage of monsoon flood-water, encouraging more of the precious liquid to infiltrate Ajit Pura's dusty soil. This should help irrigate just a few peasant plots for a year or two, before the embankment is washed away. And yet, modest as that sounds, to some development wonks this site is revolutionary.

Its creation was a policy cornerstone of the coalition government led by the Congress party: a guarantee of 100 days' employment on public works each year to any rural household that requests it. As an eye-catching promise—in a country where some 260m exist below the poverty line—it helped Congress win power in 2004. And with an eye to India's next general election, due by May 2009, the party's leaders are now making brave claims for its success. Last year, operating in 330 districts, the “National Rural Employment Guarantee Scheme” (NREGS) provided 30m families with an average of 43 days' work. This month, to much fanfare, NREGSwent India-wide (see map).

India has a history of rotten public-works schemes. At best, these have produced nothing of much value: Rajasthan, a drought-prone region, is littered with their residue: ditches and dykes as mysterious in function as crop circles. Worse, public-works budgets have made easy plunder for corrupt officials. By Congress's own rule of thumb—attributed to Rajiv Gandhi, the party's murdered leader, in the 1980s and since parroted by activist and politician alike—85% of welfare spending fails to reach its intended recipients.

To devotees of the scheme, including several fiery campaigners who helped design it, NREGS is different: above all, because its provisions are enshrined in the law. Wherever it applies, Indians may demand employment as their right. If it is not provided within 15 days, they are entitled to receive unemployment benefit. What is more, many safeguards have been written into the scheme, in an effort to make it more transparent and less misused than its predecessors. To exorcise ghost workers, NREGS muster rolls are read aloud at work-sites each morning. Many of these lists are available online. To chase away dodgy contractors—a main beneficiary of some works projects—at least 60% of the funds devoted to NREGS must be spent on wages for manual labourers.

Another beauty of the scheme, for its supporters, is that these poor folk are self-selecting: only a genuinely needy man would be likely to labour under an Indian sun for 60 rupees ($1.50) a day, the national minimum wage stipulated under NREGS. In tandem with one or two other recent efforts to hold the underperforming Indian state to account—for example, a right to information law, passed in 2005—NREGS represents for some starry-eyed acolytes the basis for a social-security system in a country that has more poor people than any other.

In Rajasthan, at least, it is working well. With its history of public works, and with fairly well-established local governments to run the scheme, the state last year came closer to honouring its prescriptions than any other. In the fiscal year that ended this March, Rajasthan provided an average of 85 days' work to some 2m households, a threefold increase in public-works employment offered by the state.

Better still, in Rajasthan NREGS employees came mostly from India's poorest groups: including 19% from *dalit* (formerly “untouchable”) castes, and 46% from tribal groups. Nearly 70% were women. Earning 73 rupees for a day's labour—the minimum wage set by the state—they did better than their sisters working in agriculture. In 2005 the average agricultural wage for women in Rajasthan was 48 rupees a day.

In Ajit Pura, in Rajasthan's southern district of Jalor, these benefits are manifest. According to the muster roll displayed at its work-site, 19 of the 43 workers belong to marginalised groups. They include the only man, Rajesh Harijan, from the Hindu sweeper caste, who shares street-sweeping duties in the village with his brother, rotating annually. The brothers are paid for this with sporadic gifts of bread.

Victory for digging

Another shoveller, Hiri Bawari, presents an even starker vindication of the scheme. As a temporary crutch for agricultural labourers, NREGS was designed to tide them over the lean season between sowing and reaping, and thus stanch temporary migrations to India's cities. Thereby, it is hoped, NREGS should ensure that the education of rural children is not disrupted—and in the case of Ms Bawari's children, that is so. A resident of Ajit Pura, she used to migrate to Punjab and Haryana, making and hawking plaster statues of Hindu gods. Together, Ms Bawari, her husband and their ten-year-old son used to earn 50 rupees a day for this work. Now she earns 73 rupees. Her husband earns 100 rupees as a farm labourer (happily, local wage-rates have risen, allegedly because of competition from NREGS). And the couple's three sons are in school.

It is a hopeful tale, but not typical. In a state that has embraced NREGS, Jalor is an especially well-run district. Its top official, or district magistrate, has made several improvements to the scheme—defying local mores, for example, by insisting that at least one-third of work-site foremen are women. Elsewhere, alas, NREGS frequently offers little obvious improvement on the rotten works schemes of the past.

Enthusiasm for NREGS among state governments has been patchy, with some of India's poorest and most populous states, such as Bihar and Jharkhand, slow to adopt it. Others have politicised NREGS, viewing it through the prism of their relations with the central government: Uttar Pradesh's 180m people, for example, saw no benefit from the scheme until mid-2007, when they elected a state government less hostile to the one in Delhi.

Even where the scheme is working well, it has hiccups. Jalor, for example, is supposed to have 27 locally hired engineers, to provide technical advice to the local governments. But, in a poor district, only five engineers can be found—of whom four have in fact been dragooned from other government service.

Elsewhere, a surfeit of pointless earth embankments is the least of the trouble. A report on NREGS by an autonomous government auditor, released in January, pinpointed many examples of error and abuse. Another, by researchers at Allahabad University, estimated that 33% of NREGS wages in Jharkhand were being trousered by corrupt officials (the government disputes this). Hardly any unemployment benefit has been paid to millions of people who are currently being denied all or part of their 100-day entitlement. India's rural development minister, Raghuvansh Prasad Singh, admits some of these “shortcomings”, which arise, he says, “because so many dishonest people are there”. But he is confident that, because of the transparency and checks in the scheme, the failings will be put right in a year or two.

That the states' bad behaviour makes NREGS so far neither national nor guaranteed does at least ease one big concern: its cost. This was originally projected at $11 billion a year. According to Mr Singh, however, though NREGS may overshoot its provisional budget of $4 billion this year, it is unlikely to cost more than $6 billion annually. Its opportunity cost may be another matter. According to a recent World Bank simulation, more Indian peasants would be withdrawn from poverty if the government just handed them cash—without first making them shovel dirt.

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China

Manage that anger

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The nationalist genie is out of the bottle

NOT for the first time, and probably not for the last, large numbers of Chinese citizens are awash in a potentially dangerous flood of patriotic indignation. The cause this time is what they see as grossly unfair criticism of China by foreign activists and governments, and biased coverage of China by foreign news outlets. In mid-March riots in Tibet laid bare the vast differences in Chinese and foreign perceptions of China's human rights in general and its rule of Tibet in particular.

At first Chinese anger was largely confined to the internet, with fiery postings on blogs, message boards and purpose-built sites (eg, www.anti-cnn.com). But now the rage has begun to take to the streets. On April 19th crowds of protesters, estimated by the police at between 1,000 and 2,000, carried banners and chanted patriotic slogans in several Chinese cities. Small-scale protests took place even in Beijing, where hypersensitive security officials seldom tolerate such things. But whereas, on the internet, bullying, foul language and explicit threats of violence have been commonplace, the demonstrations have been peaceful and orderly.

Reuters

No French fries for him

The protesters have many targets. The CNN television channel stoked anger not only with its coverage of events in China, but also with some intemperate remarks made by a curmudgeonly in-house commentator, Jack Cafferty. He said that although America's relationship with China has changed a great deal, "they're basically the same bunch of goons and thugs they've been for the last 50 years." Few in China were mollified when he later made it clear that he had meant China's government, not its people. And few seem to see any parallel with a recent commentary by *Xinhua*—a state-run news agency that serves, it is worth noting, as the mouthpiece for China's government—calling Nancy Pelosi, speaker of the House of Representatives, "disgusting" and "detested".

France has also come under fire. A relay around the world of the Olympic torch, en route to Beijing for the games in August, has had troubles at several stages. But its reception in Paris was particularly unruly. One torchbearer, Jin Jing, a wheelchair-bound Chinese fencer, was accosted by protesters trying to snatch the flame. And France's president, Nicolas Sarkozy, has been among the most outspoken of foreign leaders about the possibility of boycotting the Olympics' opening ceremony. Moreover, Paris's city council is to award honorary citizenship to the Dalai Lama, Tibet's exiled spiritual leader. Mr Sarkozy opposed the decision, but Bertrand Delanoë, the mayor of Paris, called the Dalai Lama, reviled by China's government as a "splittist", a "champion of peace".

All this has made Carrefour, a French retail chain with more than 100 shops in China, a target for protests and boycott calls. Both Carrefour and the French government have tried to repair the damage. Carrefour has repeated its support for the Beijing Olympics and denied rumours that it has provided financial support to the Dalai Lama. The French government has offered Ms Jin a formal apology for the abuse she suffered in Paris, and invited her back for a more enjoyable visit.

The display of outraged patriotism serves the interests of China's government in ways both obvious and subtle, at least up to a point. It naturally prefers to see people united behind government policies and cross at foreigners than to have them complaining about corruption, inequality, environmental degradation and the many other problems at home. And the government will be pleased if its people turn against foreign forms of democracy and freedom of expression that they have sometimes been tempted to argue it might consider adopting.

But things could easily go too far. One danger is that anger could shift away from foreigners who offend the nation's dignity, and toward the Chinese government for failing to do enough about it. This has happened before, as in the violent 1999 protests that erupted after NATO aircraft bombed China's embassy in Belgrade. Another danger is that too much anti-foreign sentiment will scuttle China's effort to play the gracious host in August, when hundreds of thousands of visitors will descend on Beijing for the Olympics.

By April 20th authorities had begun the delicate work of trying to rein things in without offending the nation's more hot-blooded nationalists. Permits for further demonstrations were reportedly being denied and websites purged of their more rabid content. A front-page editorial that day in the Communist Party's *People's Daily* urged people to “cherish patriotism while expressing it in a rational way”. “The more complicated the international situation is,” argued the paper, “the more calm, wisdom, and unity need to be shown by the Chinese people.”

Mixed in with all the nationalist bluster have been a few voices of moderation. But a bit of calm and wisdom could go a long way, as could a more nuanced understanding among Chinese nationalists of the outside world that so frequently angers them. Chinese protesters who were so incensed by Mr Cafferty's comment might, for example, be surprised at some of the venom he's poured on America's own leaders. And they might be even more surprised at just how little anybody cares.

Indonesia

Bully pulpit

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Religious freedom is put at risk by political expediency

SEVERAL thousand hardline Muslims protested outside President Susilo Bambang Yudhoyono's palace in Jakarta on April 20th demanding that he ban Ahmadiyah, an unorthodox but moderate Muslim sect founded in 19th-century India that claims around 200,000 members across Indonesia. At an earlier meeting of one of the groups involved, a leader was filmed chanting “Kill Ahmadiyah! Kill! Kill! Kill!” Far from having these extremists arrested for inciting violence, Mr Yudhoyono was this week considering pandering to them by issuing a decree to restrict Ahmadiyah's freedom of worship. One group of advisers has urged him to do so, while others were counselling against a move that would violate constitutional guarantees of religious freedom.

Reuters

“X” marks the spot

The proposed ban has its roots in Mr Yudhoyono's tender treatment of the Indonesian Ulemas Council (MUI), a semi-official group of Muslim clerics that was created during the authoritarian regime of Suharto (1966-98). The president nodded his approval as the MUI issued *fatwas* against “deviant” sects. On April 23rd Abdul Salam, a self-proclaimed prophet who leads another unorthodox group, al-Qiyadah al-Islamiah, was jailed for four years for blasphemy. MUI's *fatwas* have also given vigilante groups an excuse to attack sects' members and their homes and mosques. In Ahmadiyah's case the *fatwas* have also prompted another Suharto-era creature, the Co-ordinating Board for Monitoring Mystical Beliefs in Society, to launch an inquisition.

In January the board said it had decided not to call for a ban because Ahmadiyah's leaders in Indonesia had issued a statement affirming that Muhammad was the last prophet, rather than Mirza Ghulam Ahmad, the Indian mystic who founded the group. But this month the board declared that since Ahmadiyah had gone back on this pledge to “correct” its beliefs, a ban was now in order. Government officials then said that a decree against Ahmadiyah, though not necessarily an outright ban, was being prepared. Last weekend, police forced Ahmadiyah to cut short its annual congress in Bali.

As elsewhere, there are differences among Indonesia's Ahmadis over the meaning of their founder's claims to prophethood. However, under Article 29 of Indonesia's constitution—“The state guarantees all persons the freedom of worship, each according to his own religion or belief”—their beliefs are their own affair.

Unfortunately, it is not that simple. The constitution's guarantee of religious freedom is immediately preceded by an apparently contradictory affirmation that “the state shall be based upon the belief in the one and only God.” Indonesian law requires citizens to belong to one of six officially approved religions even though three are not monotheistic: Buddhists and Confucianists have no god; Hindus have lots of them. Now that Indonesia is a democracy, the constitutional guarantee of freedom of worship might be thought to trump all other arguments. But the mess has yet to be cleared up by the courts.

Yet Mr Yudhoyono's government can do the right thing when pushed. After the Bali bombings in 2002 it rounded up most leaders of Jemaah Islamiah (JI), the jihadist group responsible. Three of the bombers were sentenced to death and face execution shortly. Two more JI leaders, arrested last year, were sentenced to jail terms this week. However, while it is contemplating banning peaceable Ahmadiyah, the government has been reluctant to prohibit JI despite its atrocious violence. It may do so now that the courts, in this week's sentences, have at last labelled JI a terrorist group. There have also been no moves to ban the local chapter of Hizb-ut-Tahrir, a radical group that, although it does not preach violence, does call for the downfall of the Indonesian state and its replacement with a caliphate.

Mr Yudhoyono may believe that he is avoiding conflict by appeasing the country's vociferous but unrepresentative radical Islamist fringe. His liberal critics retort that the state has a duty to protect minorities, rather than sacrifice them to some supposed public good. In any case, suppressing Ahmadiyah and al-Qiyadah al-Islamiah would be more likely to damage Indonesia's stability and unity than letting their members worship freely. The country's many Hindus, Christians and members of other faiths would surely be asking themselves: “Are we next?”

Some Ahmadiyah members have called for help from the United Nations' Human Rights Commission. The outside world—which has so far seen Mr Yudhoyono as a democrat, a reformist and a leader of moderate Islam—might indeed make it clear to him that giving in to the bullies and repressing a peaceable religion would have unfortunate consequences.

Australia

Green, no queen

Apr 24th 2008 | CANBERRA
From The Economist print edition

Kevin Rudd's reformist zeal

Get article background

FOR all the boundless energy he has shown since becoming Australia's prime minister five months ago, Kevin Rudd looked tired on April 20th, as he received a document listing ideas for the country's future. And little wonder. Mr Rudd has staked a claim to represent the “reforming centre” of Australian politics. Yet even someone with his self-assurance must have been daunted by the document's main big idea: wholesale reform of Australia's 107-year-old constitution.

Reuters

Teacher Rudd at his whiteboard

The document was the product of an “ideas summit” that Mr Rudd had assembled in Canberra. Its 1,000 participants, invited by his government or chosen by it from applicants, included business leaders, celebrities, politicians, sex workers, outback farmers and aboriginal Australians. They argued for two days over how they wanted Australia to change by 2020.

For all its novelty value, and despite a few dismissive sceptics, the gathering was perfectly timed by a prime minister who is riding a wave of public approval. Since he unseated the former conservative coalition of John Howard last November, leading Labor to power after almost 12 years in opposition, Mr Rudd has embarked on change at a relentless pace. First he ratified the Kyoto protocol on climate change; then he delivered a formal apology in Parliament to the “stolen generations” of aborigines for past injustices.

Within hours of returning from a 17-day trip to America, Europe and China on April 13th, he announced the appointment of Quentin Bryce, a human-rights lawyer, as Australia's first female governor-general (representing Queen Elizabeth, Australia's head of state). The main opposition Liberal Party is still stunned from its election rout. An opinion poll after the summit suggested Mr Rudd's honeymoon has a long way to run: 71% of voters preferred him as prime minister, compared with 10% for Brendan Nelson, the opposition leader.

Mr Nelson's party had banished grand gestures from Australia's political agenda. But Mr Rudd, in his embrace of change, admires them: witness the summit itself. He opened it in the great hall of Parliament House by declaring that the “old way of governing has long been creaking and groaning.” Participants then divided into ten groups to devise better ideas.

Some groups wanted Australia to become more green. Others wanted it more connected with Asia, and to take a stronger role in combating HIV and other epidemics in the Pacific. One issue, however, swept all others aside: reform of Australia's constitution, enacted in 1901 to divide power between the federal government and the six states.

David Morgan, a former boss of Westpac, one of Australia's biggest banks, says the original model is “poorly suited to the needs of the 21st century”. The most urgent task, he says, is the creation of a national economy unhampered by conflicting state-government regulations. George Williams, a constitutional lawyer, blames the “dysfunctional” constitution for some A$9 billion ($8.5 billion) a year lost in buck-passing, red tape and duplication. Heather Ridout, of the Australian Industry Group, a business lobby, argues the federal structure is the most glaring cause of policy failures in health and education.

After a standing ovation for Mr Rudd, the most rousing applause came for a call to end Australia's constitutional links with the monarchy and make it a republic. Mr Rudd responded: “This federation needs to be fixed.” He will reply to the summit's ideas later this year. But writing the states and the queen out of the constitutional picture is easier said than done. Of 44 referendum proposals over the years to change the constitution, only eight have passed. A referendum on becoming a republic in 1999 failed, largely out of popular cynicism about the motives of the politicians promoting the reform.

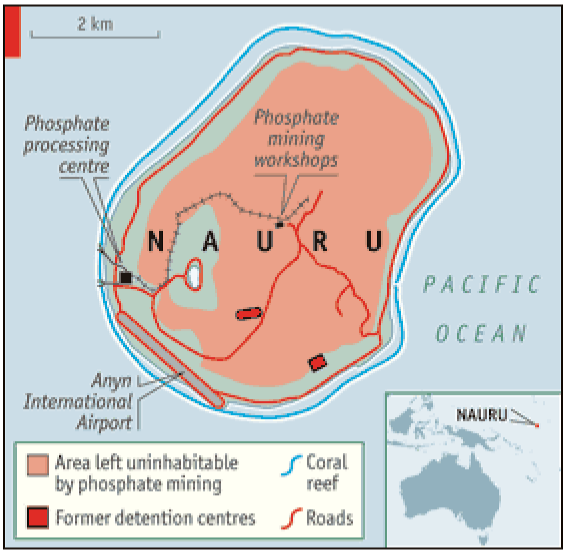
With his people's summit, Mr Rudd's bid for a fresh start has at least cleverly tapped a growing sense among Australians that politicians and civil servants do not have all the answers. Bill Bowtell of the Lowy Institute, a Sydney think-tank, argues that the summit was a “breathtaking” exercise in winning endorsement for reform. For now, Mr Rudd's government faces the more mundane task of delivering its first budget in May. After figures on April 23rd showed annual inflation at 4.2%, spending cuts are unavoidable. The budget, more than the summit, may decide if Mr Rudd's honeymoon continues.

Nauru

Dumped on again

Apr 24th 2008
From The Economist print edition

Amid political deadlock and economic ruin, will Nauru's luck ever turn?



IF COUNTRIES were traded like books, Nauru, one of the world's smallest, would long ago have ended up on the remaindered shelf. The tiny remote speck in the Pacific is an economic shipwreck. Since last August, when an election left parliament deadlocked, it has also suffered utter political paralysis. A snap election called for April 26th by the president, Marcus Stephen, may at least produce a government capable of making decisions. But it will not provide a solution to the country's biggest economic headache: the collapse of its most recent business venture—acting as an immigration holding-pen for Australia.

Among the many changes wrought by Kevin Rudd (see article) was the closure last month of the detention centres on Nauru for people seeking asylum in Australia. The centres dated from 2001, when John Howard, prime minister of the then ruling conservative coalition, offered the cash-strapped islanders financial grants, debt write-offs and free fuel in return for building them and keeping the asylum seekers far from Australian soil while their applications were processed. So delighted were the islanders with the windfall that the first would-be refugees were greeted with songs and flowers. The centres became a lifeline for the island's 13,000 people, employing about one-tenth of them directly.

Their closure follows a string of commercial mishaps for an island that was, improbably (and briefly), among the world's richest places in terms of income per head in the 1970s. Its bounty was the lucrative product of millennia of seagull-droppings on coral: phosphates, for fertiliser.

As the money rolled in many islanders chose to remain unemployed, cashing the royalty cheques while foreign workers dug out the deposits. Nauruans literally grew fat on their earnings; rates of obesity and diabetes soared. But strip mining has left the island a barren, jagged wasteland. The wealth it generated was squandered in a number of disastrous investments, as Nauru tried its hand as an early sovereign-wealth fund, and got its fingers burnt. It tried to reinvent itself as an offshore tax haven, and took to hosting all manner of shady banking nameplates. Its services were reputedly much in demand among the Russian mafia. And it made friends with Taiwan, a generous donor to its dwindling band of diplomatic partners.

The abrupt end to the detention-centre business may throw Nauru again on the mercy of international donors. It will help if the election produces a functioning government. The lack of a government majority in the 18-seat parliament has stalled investment projects and the passage of a budget. The election was prompted by a row between Mr Stephen and the parliament's speaker, David Adeang, who last month sought to bar from office two cabinet members who hold dual Australian and Nauruan citizenship. The Supreme Court ruled against the ban. But Mr Stephen decided enough was enough. Many Nauruans would agree. But they change their governments often, without ever seeming to change their luck.

The Philippines

Too many babies?

Apr 24th 2008 | BANGKOK
From The Economist print edition

The food crisis revives worries about population growth

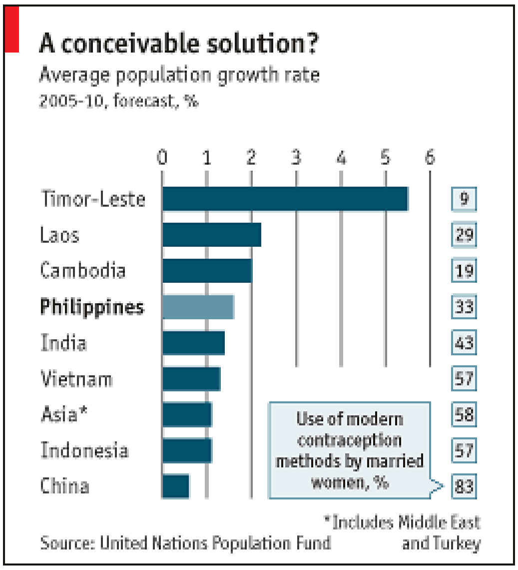
AMID panic over soaring rice prices and worries about whether the Philippines, the world's biggest rice importer, can secure enough supplies, the results of the latest census have diverted blame towards a perennial culprit: overpopulation. The figures put the population at almost 89m when the census was taken last August, up from 77m in 2000. That means it has been growing at just over 2% annually since then. That rate is below the 2.3% annual growth of the 1990s and the 3% of the 1960s. But it is still faster than expected. Some analysts think the census undercounted, especially among poorer Filipinos. The population may now be up to 93m.

Every hour, then, the country has an extra 200 little mouths to feed. And increasing numbers of them are being born into grinding poverty. Other new government figures show that the number of people scraping by on less than $1 a day has risen by 16% since 2003, to 28m. More people mean more houses, which means less land to grow crops. The government this month imposed a temporary ban on building on farmland, as it revives its attempt to achieve self-sufficiency in rice.

Some senior officials are pressing President Gloria Macapagal Arroyo to agree to a big expansion of state-provided contraception and other family-planning help. But Mrs Arroyo is a devout Catholic and wary of upsetting the influential bishops. She relies on their grudging support to resist pressure for her resignation or ouster, following a plethora of corruption scandals.

For years poor Filipinas relied on contraceptives supplied by USAID, America's aid agency. However, its programme has been wound down and the government has put only modest provision in its place. Despite a ban and the risk of up to six years in jail, 500,000 Filipinas have abortions each year.

The debate over whether population growth is the prime cause of poverty and underdevelopment has raged in the Philippines for years. The Catholic bishops do have a point, that corruption and misgovernment are in fact mostly to blame. The Philippines has more than enough land and other natural resources to support its population if it were not so incompetently run. But fast population growth only makes things worse. And figures from the United Nations Population Fund show that making contraceptives more widely available does seem to bring population growth down (see chart). Timor-Leste, another poor and Catholic Asian country, is an extreme case: hardly any contraceptives and an astonishing baby boom.



Correction: Myanmar

Apr 24th 2008
From The Economist print edition

Our briefing on Myanmar ("Spring Postponed", April 12th) was wrong about a provision of the draft constitution to be put to a referendum on May 10th. If passed, future amendment of the constitution would require both a 75% parliamentary majority and approval by 50% of eligible voters. Apologies for the error.

Iraq

Nuri al-Maliki, a dogged survivor

Apr 24th 2008 | BAGHDAD AND CAIRO
From The Economist print edition

Illustration by David Simonds

Recent military and political developments offer a gleam of hope that Iraq's government can start building a stronger consensus towards an eventual peace

NURI AL-MALIKI, Iraq's battered but durable prime minister, is starting to surprise his many critics, who have generally damned him as dull, indecisive, sectarian and unpopular even among his own Shia Arabs.

In the past month he has been ridiculed for the Iraqi armed forces' dismal failure to subdue the Shia militias loyal to a firebrand cleric, Muqtada al-Sadr, in Basra, the main port city. There was talk that he might at last be dumped. His own party, part of a broader Shia coalition, has little popular backing. The Sunni insurgency against his American-backed government rumbles bloodily on, with a rash of suicide bombings killing at least 100 civilians last week alone. And he has hitherto been cold-shouldered by the leaders of predominantly Sunni Arab countries in the region, such as Saudi Arabia, many of whom view him as a vengeful and sectarian Shia.

Yet he may have a knack of turning failure into success. In the past fortnight, there has been a surge of commentary, even in parts of the Arab press, suggesting that Mr Maliki could be slowly turning things round. By all accounts, his popularity across the country, especially among Sunni Arabs and Kurds, has risen. More secular-minded Shias have welcomed his efforts to whack the Sadrist militias. Optimists have begun to wonder whether he could, at last, begin to forge something akin to a non-sectarian consensus that could start containing the violence—no one thinks it will end soon—and gradually restore a modicum of peace.

Most strikingly, Mr Sadr and his men appear to have backed away from confronting Mr Maliki and the Iraqi forces in Basra, where, after the fiasco of its original assault against the militias, the Iraqi army has apparently now taken control of the Sadrists' former strongholds. So, despite the dire initial performance of the Iraqi forces and the gross mishandling of the campaign by Mr Maliki's government, the prime minister seems to have come out on top after all.

This week, at a pair of conferences, one in Bahrain that embraced America's closest Arab allies, the other in Kuwait that gathered all of Iraq's neighbours plus the world's eight rich countries, Mr Maliki lobbied for more support. He sought to dispel the feeling that persists among Iraq's neighbours that his country is doomed to permanent instability or fragmentation and to persuade them that his government is not in hock to Iran. Yet Mr Maliki also drew special comfort from a public endorsement by Iran's foreign minister, Manuchehr Mottaki, when he reiterated support for the Iraqi government's efforts to disarm the Shia militias, presumably including those of Mr Sadr, which have previously looked for sustenance to Iran.

Mr Maliki also used both meetings to chide his neighbours for not helping him enough. His officials noted that despite previous pledges, no Arab country has a resident ambassador in Baghdad, and none has followed the example of Europe, America and Russia by reducing demands for Iraq to repay debts incurred by Saddam Hussein's regime. The meetings ended with declarations of support for Mr Maliki's government, promises of stronger diplomatic ties, and a pledge to hold the next such conference in Baghdad.

Part of Mr Maliki's renewed confidence stems from Iraq's improvement in security. The western province of Anbar, still a hotbed of al-Qaeda a year ago, remains relatively quiet, as does most of the Euphrates valley. This is largely due to the Americans' success in striking deals with Sunni tribal leaders who have turned against al-Qaeda and in fostering a so-called *Sahwa* (Awakening) movement to oppose it.

In another notable development, political parties close to the *Sahwa* are emerging in Anbar in the run-up to provincial elections due in October (or at least by the end of the year). The largest party so far, headed by Sheikh Ahmed Abu Risha, a tribal leader from Ramadi, claims to have opened 230 offices across Iraq and signed up 400,000 members. The hope among some in Baghdad is that, by empowering Sunnis who previously eschewed the political system, they will turn against the wider insurgency. At a higher level, there is renewed talk that the biggest old-established Sunni Arab political group, the Iraqi Islamic party, led by a vice-president, Tariq al-Hashemi, may rejoin the government, further bolstering a peaceful Sunni Arab front against the insurgents.

On other political fronts, Mr Maliki seems at last to be making progress too. After two years of often bitter negotiation, hope is again rising that an all-encompassing package of laws to deal with oil—the sharing of revenue, the management and exploration of oilfields, and the status of a new national oil company, among other things—may soon be clinched.

The UN, too, has become more engaged in trying to nurture peaceful politics, with the October elections marked as a hoped-for breakthrough. The high price of oil should certainly enable Mr Maliki to distribute cash more widely, for instance allowing a Sunni-dominated provincial council in Anbar to help rebuild the local infrastructure and public services.

Still, don't count Mr Maliki's chickens

But there is plenty of scope for Mr Maliki to foul up. He still seems loth to welcome the new Sunni political groups. The tribal leaders want more of their men inducted into the defence and interior ministries now dominated by Shia parties. The government says that there are some 150,000 *Sahwa* people, many of them former insurgents, and that it can absorb only a fifth of them into the security forces, while offering jobs and training to the rest. In Anbar, 24,000 policemen from the *Sahwa* movement (also known as “Sons of Iraq”) are said to have been taken on. But the government has failed so far to keep its promise to increase that figure to 30,000. The Shia-led government still fears the Sunni *Sahwa* people may yet turn against it.

Especially in provinces where Sunnis and Shias are mixed up, such as Salaheddin, north of Baghdad, resentment may be rising among Sunnis who have recently stated their readiness to join the security forces but have been rejected. “The Iraqi government is bringing shame to my tribe,” says Sheikh Sabah al-Shammar, a *Sahwa* tribal leader in the province. “My fighters demand jobs and I am not able to give them any. This is dangerous.”

The *Sahwa* has been less successful in other provinces, especially Nineveh (which includes Mosul, where the insurgency remains fierce) and Diyala, which have mixed populations, both in sectarian and ethnic respects. In these areas, al-Qaeda remains a potent force, playing on Sunni fears of domination by Shias in Diyala and by Kurds in Nineveh. Though the Americans say that violence in Diyala has dropped sharply in the past year, in recent months it has stopped falling. Moreover, the Iraqi forces there seem unable to operate effectively without American backing.

And the Sadrists, still being hammered in their eastern Baghdad strongholds, certainly cannot be counted out, in Basra or elsewhere. Mr Sadr has previously withdrawn them from the field of battle, only to bring them back with a vengeance. They still comprise a huge constituency of the Shia poor. Indeed, they will probably have to be included in any final accommodation. Mr Maliki would be unwise to exclude them from the October elections.

Despite the honeyed words of Arab leaders at the two recent regional conferences, the governments of neighbouring Arab countries are still wary of embracing Mr Maliki. Kuwait and Saudi Arabia are both particularly twitchy about Iran's ever-closer ties with his Shia-dominated government. Arab countries remember, too, that Jordan's embassy was destroyed in August 2003, that Egypt's ambassador was murdered two years later, and that Bahrain's narrowly escaped being kidnapped. On the issue of Iraqi debt, the Arabs are still loth to write it off.

All the same, if Mr Maliki sustains his recent progress on the military, economic and political fronts, his detractors at home and abroad may start treating him with more respect. Iraq does, after all, sit on the world's third-largest reserves of oil. And he has so far confounded the many commentators who predicted he would long ago have fallen.

Economist.com WORLD MIDDLE EAST & AFRICA

Saudi Arabia

Our women must be protected

Apr 24th 2008 | CAIRO
From The Economist print edition

A report that publicises the plight of Saudi women

THE first and second time her husband shot her, the distressed woman in her 30s rejected advice to file a complaint. To do so, she explained, would require the presence of her obligatory male guardian, who happened to be...her husband. Without him, her testimony would not be legally valid. Besides, the all-male police might accuse her of “mixing” with the opposite sex, a crime in the eyes of most Saudi judges. The third time her husband shot her, she died.

This tale, told by a Saudi social worker in a new report on women's rights in the kingdom, is particularly harrowing. Yet it dramatises the more mundane plight of millions of Saudi women who are unable by law to study, work, travel, marry, testify in court, legalise a contract or undergo medical treatment without the assent of a close male relative, be he a father, husband or, less commonly, a grandfather, brother or son.

AFP

You can own it but you can't drive it

That Saudi women are banned from driving is well-known. But it is the imposition of male guardianship over adult women, affirms the detailed report by Human Rights Watch, a New York-based monitoring group, that is the biggest obstacle to female advancement. As the report points out, half the kingdom's citizens are treated in effect like children or the mentally ill for the duration of their lives. Worse, the guardianship policy creates a paradox: women may be held legally responsible for a crime, even though they are not deemed to have full legal capacity.

Oddly enough, there appear to be no written statutes mandating male guardianship for women. In the religiously conservative kingdom, where Muslim *sharia* law is held to override all other rules, the practice stems instead from extremist Wahhabi interpretations of Muslim scripture, particularly from a Koranic passage that describes men as the “protectors and keepers of women”. Sadly for Saudi women, the all-male Saudi judiciary is made up entirely of Wahhabi extremists.

Despite having signed various international charters for women's rights, the Saudi government has done little either to modify the system or to enforce the minor reforms it has sponsored. Theoretically, for instance, women above the age of 45 no longer need a male guardian's permission to travel, yet airport officials routinely demand it anyway. A judge may, in theory, release a woman from the guardianship of an abusive parent or spouse, but only 1-2% of such appeals succeed, says a lawyer in the report. More than half of university students are women, yet they make up a tiny fraction of the workforce. This year will see the first-ever crop of female law graduates, but the justice ministry is unlikely to license any to practise, and judges are even less likely to allow them in their courtrooms.

Liberal-minded Saudis have long criticised such foibles, comparing the kingdom unfavourably to Muslim and Arab neighbours where women are far less restricted. Even those Saudis who uphold their traditions as defending female “honour” may take note of another woman's testimony to Human Rights Watch. A mother tells her daughter why she remarried: “I sold my body so that my paperwork can get taken care of. It tarnished my reputation and dignity, but our affairs are getting resolved.”

Optimists say the mere fact that the Saudi authorities let Human Rights Watch compile its report in situ is progress; four years ago the idea would have been damned as foreign interference. Last month, senior representatives from eight ministries met people from the rights group in Saudi Arabia and politely discussed the report ahead of publication, insisting that they could all “work together”. The Saudis' officially sanctioned National Human Rights Commission, set up four years ago, privately agreed with many of the recommendations, predicting, among other things, that women would be allowed to drive cars “in the near future”—but such hopeful assurances have been given before. And, though one newspaper, the relatively liberal *al-Watan*, has aired parts of the report, the Saudi media have generally ignored it.

The Palestinian territories

Chickens and eggs

Apr 24th 2008 | RAMALLAH
From The Economist print edition

Reform of the Palestinian security forces can barely get off the ground

THIS month Israel agreed to let the Palestinian Authority (PA) open 20 police stations in the West Bank. For the first time since the Palestinians' violent second *intifada* (uprising) began eight years ago, they will be in rural areas, where Israel, not the PA, is in charge of security. Last month Israel also gave the PA permission to deploy 620 special-forces troops in the northern West Bank city of Jenin, home to some of the most diehard Palestinian militants.

It is all part of a $5.4 billion plan meant to speed the arrival of a Palestinian state. Israel is negotiating a “framework agreement” (no longer a fully-fledged peace deal, as planned last autumn) with the PA's president, Mahmoud Abbas. But it has always insisted that Mr Abbas must first show that his security forces can take the place of the Israeli army in fighting Palestinian gunmen.

AP

The march of progress, perhaps

That is asking a lot. The PA has never had full control of the West Bank, many security people are ex-militants, and the armed “resistance” to Israel is popular. Besides, reform of the PA's security forces has a long and tangled history.

The dozen-odd forces, each loyal to individual commanders and politicians, were the divide-and-rule method by which the late Yasser Arafat, Mr Abbas's predecessor, held on to power. Both men have used them as patronage and to soak up unemployment, letting them swell to around 85,000-strong, far beyond the 30,000 limit envisaged in the Oslo peace accords of the 1990s. Foreign donors tried in vain to make Arafat slim them down. During the *intifada*, Israel destroyed most of their buildings and facilities.

After Arafat's death in 2004, security reform returned to the agenda, but was dropped again after the Islamist Hamas movement defeated Mr Abbas's party, Fatah, in parliamentary elections in 2006. A Hamas-Fatah power struggle broke out. American-led attempts to undermine Hamas by equipping and training the PA forces, which remained mostly loyal to Fatah, exacerbated the conflict, until Hamas defeated Fatah in the Gaza Strip last June. After that, donors shifted their attention back to the West Bank and, in an attempt to entrench Mr Abbas's authority there, have revived the reform plans.

An American team led by Lieutenant-General Keith Dayton and an EU police mission have both expanded their training programmes, while various foreign special forces, one from as far away as Moscow, are providing anti-terrorist instruction. But the approach is beset with flaws.

A detailed plan presented last autumn by General Dayton sets sensible long-term goals: to unify, shrink and spruce up the security forces, and replace their political loyalties with obedience to whoever runs the PA. It includes establishing new chains of command, replacing equipment, rebuilding bases, creating bodies to monitor performance, and so on. But it is impossibly ambitious. Of the $5.4 billion price tag—for the first three years alone, not including salaries and pensions—just $230m was raised for security at a grand PA pledging conference in Paris in December, when donors were unexpectedly generous in their pledges overall. This will not go far; currently, one foreign official estimates, even the PA's prison space meets only around a tenth of its needs.

Moreover, there is a conflict among Mr Abbas's own cadres between technocratic reformists like his prime minister, Salam Fayyad, and Fatah stalwarts. Shy of confrontation at the best of times, Mr Abbas does not want to antagonise Fatah people by weakening their influence on the security forces, and Mr Fayyad cannot push reforms through without his backing. Apart from one initial round of firings, he has not been able to trim the bloated payroll.

Finally, Israel has stymied the PA's own efforts. As in Jenin this month, earlier this year it allowed the PA to station troops in the city of Nablus. They cleaned up criminal gangs and enforced an amnesty, agreed with Israel, in which militants loyal to Fatah surrendered their weapons. They got results; Israeli officials were quietly impressed. But they hold sway only during the day; the Israeli army continues to make deadly nightly incursions against other armed groups, such as Islamic Jihad. It is conducting similar raids in Jenin, occasionally even against amnestied men.

Meanwhile, Israel's raids on fighters in Gaza, which kill a lot of civilians too, add to the tension in the West Bank. This week there have been hints that Egyptian attempts to broker a ceasefire in Gaza may at last bear fruit. But when such truces have been reached in the past, Gazan groups have soon abandoned them, citing Israel's continuing raids in the West Bank.

All this “casts a lack of credibility on the PA,” says Shami Shami, a Fatah legislator from the Jenin refugee camp. Israeli officials say they cannot risk letting a potential suicide bomber get through, but some PA officials are convinced Israel is deliberately sabotaging the PA's efforts. It is certainly reluctant to surrender any responsibility to it. The green light for the new police stations and deployment in Jenin came only after a lot of American pressure on Israel to give Mr Abbas a chance to prove himself.

The security reform is a victim of the Israeli army's success. Israelis have got used to a life virtually free of suicide bombers. There is no way they can expect the same effectiveness from the PA forces. But those forces cannot build up to the same level unless Israel gives them leeway to do so. As so often in the Israeli-Palestinian puzzle, it is a case of chicken and egg.

Zimbabwe

The stalemate turns bloody

Apr 24th 2008 | JOHANNESBURG
From The Economist print edition

Could Africa turn against Robert Mugabe?

AMID reports of widespread and systematic violence along with persisting post-electoral shenanigans, Zimbabwe's president, Robert Mugabe, seems grimly bent on staying in power. The mood among Zimbabweans hoping for his demise has swung from euphoria in the immediate aftermath of the election to fear, despair and even horror. But hope still flickers that regional diplomacy may yet persuade Mr Mugabe to go.

Nearly a month after the election on March 29th, the presidential result had still to be announced, though independent observers reckon that the challenger, Morgan Tsvangirai, won far more votes, if not an outright majority. The first results of a recount in some 23 of the 210 parliamentary constituencies have, however, started to come in. If Mr Mugabe reversed the results in just nine of them, he would win back a majority in Parliament, which the electoral commission had previously declared to have been won by the opposition.

AP

Why you mustn't vote against the old man

A recount may also enable Mr Mugabe's ruling ZANU-PF to declare that the presidential contest must go to a second round (at a date not yet announced, though the electoral act says it should be within three weeks of the first round if no candidate wins an outright majority). The fear is that the 84-year-old Mr Mugabe would then order the security forces and party thugs to bully the voters, especially in the rural areas, into plumping for him second time round, with the aid of more thorough rigging. So far the opposition Movement for Democratic Change (MDC) has said it would boycott a second poll; plainly, it would then lose by default. But if it competed, it would risk defeat due to intimidation and more blatant rigging.

Instead, Mr Tsvangirai and Tendai Biti, the MDC secretary-general, toured Africa to beg its leaders to persuade Mr Mugabe to go. There were signs that they wanted him to, though none has publicly said so outright. After South African dockers sympathetic to Mr Tsvangirai, a former trade unionist, refused to offload a cargo of arms bound for Zimbabwe from a Chinese merchant ship at a South African port, an array of southern African governments eventually also refused to accept the ship.

Jacob Zuma, leader of South Africa's ruling African National Congress, has criticised the delay and the violence as “tantamount to sabotaging the democratic process”, in contrast to the continuing but increasingly derided “quiet diplomacy” of South Africa's president, Thabo Mbeki. “I imagine that the leaders in Africa should really move in to unlock this logjam,” said Mr Zuma, suggesting that a team of African leaders should go to Harare, Zimbabwe's capital. South Africa's main trade union group, which strongly backs Mr Zuma, has called on African leaders to refuse to recognise Mr Mugabe.

Other African figures have begun to express disquiet. Raila Odinga, Kenya's new prime minister, and Kofi Annan, a Ghanaian who was the UN's secretary-general, said southern Africa's leaders must do more to resolve the impasse. Yet the official response of the Southern African Development Community (SADC), a club of 14 countries that has led the diplomacy for the past few years and in the present crisis, has been muted. Their leaders say they still have faith in Mr Mbeki's mediation.

It was notable, however, that Levy Mwanawasa, the Zambian president who chairs SADC, asked member countries to refuse to offload or transport weapons from the Chinese ship. Mozambique and Angola also declined to accept it. Britain's prime minister, Gordon Brown, has proposed an arms embargo against

Zimbabwe. For the MDC these were small but encouraging signs that international anger may start to weaken Mr Mugabe.

There was also a wave of muttering, in Zimbabwe and elsewhere, about a “managed transition”. An article in Zimbabwe's *Herald* newspaper, usually a government mouthpiece, suggested a government of national unity, albeit with Mr Mugabe still as president, to be followed by fresh elections. This resembles what happened in Kenya, where Mwai Kibaki, who is generally thought to have lost an election in December, remains president in return for sharing power with the opposition. But Mr Mugabe's spokesman dismissed the idea.

Meanwhile, the violence is sharply worsening. Mr Biti compared it to war. Pro-government militias are roaming the countryside, terrorising and beating up suspected opposition supporters; the police usually remain idle or in some cases even take part in the violence. The Zimbabwe Association of Doctors for Human Rights says it has treated at least 323 cases of injury resulting from organised violence and torture since the election.

Human Rights Watch, a global watchdog, says that the ruling party has set up torture camps across the country as part of a systematic and orchestrated campaign. Victims are rounded up and taken to the camps at night and beaten for hours on end. Hundreds of huts and houses have been burnt down. In the poor suburbs of Harare militias and soldiers are enforcing an unofficial curfew and have abducted MDC campaigners. The MDC says that at least ten people have been killed since the election, 3,000 families have fled their homes, 500 people have been hospitalised and over 400 party activists arrested, making it hard for the MDC to function.

Outrage in southern Africa, perhaps even in government circles, seems to be growing. But in the face of a resurgent Mr Mugabe's determination to hang on, it is unclear what the MDC or governments in Africa and elsewhere will do. Zimbabwe's agony is far from over.

Cyprus

A glimmer of hope, with ice cream

Apr 24th 2008 | NICOSIA
From The Economist print edition

AFP

Two presidents may be talking, but there is still a long way to go to resolve one of the world's most intractable problems

MEHMET ALI TALAT, the unrecognised president of northern Cyprus, recently pulled off a publicity stunt, aimed at winning the hearts of ordinary folk. But it was not his Turkish-Cypriot voters he was wooing as he sampled the local ice cream (pictured above, centre). His walkabout was among Greek-Cypriots in the southern half of the divided capital, Nicosia.

For an hour or so, he padded around the heart of the city, chatting to locals and a mob of reporters. Admittedly, he was surrounded by bodyguards, whose pockets bulged with what looked awfully like guns (tactfully ignored by local Greek-Cypriot officials). Besides the ice cream, he also shopped for music: with rather clunky symbolism, he tried to buy a copy of Pink Floyd's “The Wall”, but it was out of stock.

It was a gesture to celebrate a change a few days earlier, when Ledra Street, a fortified flashpoint whose closure has long symbolised Cyprus's conflict, was reopened as a crossing-point between north and south. Prospects for a breakthrough in Cyprus are looking up. Not before time, say weary bureaucrats in Brussels (where the Cyprus issue snarls talks on Turkey's entry into the European Union and also obstructs defence links between the EU andNATO) and at the UN in New York, where the island's problems have occupied several generations of mediators.

The conflict in Cyprus goes back over 50 years. In its present shape it dates from 1974, when Turkish troops overran the northern third of the island after a short-lived coup, sponsored by the junta then ruling in Athens, who wanted to unite Cyprus with Greece. A stalemate and a UN buffer zone have persisted ever since.

If hopes of a settlement reuniting the island as a loose federation are rising, it is mainly thanks to the election defeat in February of the hardline Greek-Cypriot leader, Tassos Papadopoulos. His successor as president, Demetris Christofias, is not only more moderate, but also from the same leftist camp as Mr Talat (indeed, Mr Christofias is nominally a Communist). The two men even have old ties through the pan-Cypriot trade-union movement.

They now want to relaunch a peace process that has been stalled for four years. It was in April 2004, a week before Cyprus joined the EU, that a UN plan to reunite the island was endorsed by Turkish-Cypriots but massively rejected by Greek-Cypriots, at the urging of Mr Papadopoulos. Greek-Cypriot “no” voters felt that the plan failed to guarantee adequate restitution for 160,000 or more people forced south by the 1974 invasion, and let too many Turkish troops—6,000, as opposed to the present 30,000—remain on the island, under a withdrawal plan whose execution was not guaranteed. To many Turkish-Cypriots, it seemed as if their neighbours were selfishly digging in their heels, refusing to share power and money, when their bit of the island was on the brink of raking in all the benefits of EU entry.

Although some of the UN plan's defects, from the Greek viewpoint, may be fixable, the “no” vote also laid bare a core of voters who insist on a unitary state and reject the whole notion of a bizonal, bicommunal federation, on which all negotiations have been based since the late 1970s. That is one of many obstacles that Mr Christofias will have to surmount if he is to persuade a majority of his voters to take risks for peace. He and Mr Talat held initial talks in March. High-level negotiations are planned in late June, if 100 or so experts from the two sides can make enough progress on details.

Cypriots on both sides have seen all this before, of course. The peace process has been revived time and again, only to collapse amid rows over Turkish troops, and what to do about property taken from its original owners in 1974, or in previous rounds of violence. Greek-Cypriot officials say that when they began to prepare the new talks, they found the gap between the two sides shockingly wide—even wider than four years ago. Yet one diplomat says he has never witnessed such a change in mood in so short a time, to the extent that one problem now is managing expectations. Some Greek-Cypriots are determined to set aside the rejectionist tactics of Mr Papadopoulos, which have done their image in Europe little good.

Is the optimism justified? Visit the two leaders in their respective halves of the capital, and their words do not sound entirely helpful. Mr Talat dismisses the idea that the EU can help with a settlement, saying that, with both Cyprus and Greece in the EU as members with a power of veto, the union is “biased” and “cannot play an honest broker role”. Mr Christofias can appear pretty grumpy, too. He says the “so-called isolation” of Turkish-Cypriots in the north is not the fault of Greek-Cypriots, nor of his predecessor as president.

Among diplomats in Brussels, there was much exasperation over Mr Papadopoulos's blockage of attempts to allow the north of the island to trade more freely. That is unfair, says Mr Christofias. In keeping with the standard Greek-Cypriot line, he says the real problem is Turkey, whose refusal to fulfil its obligation to open its ports and airports to traffic from Cyprus led in 2006 to a partial suspension of talks on its own membership of the EU.

Asked about Mr Talat's walkabout, Mr Christofias sniffs that he does not care for showy public relations. “I have crossed the line, maybe 40 times,” he says. Yet perhaps his grumbling should not be taken too literally. Both men have to be careful to nurture multiple constituencies (in Mr Talat's case, he answers not just to his voters, but also to Turkey's politicians and generals). Even in Heraclis, the ice-cream shop that served Mr Talat, pleasure at his walkabout is tinged with cynicism about the prospects. Turkish generals hold the real power, asserts the owner, Costas Vrontas.

Perhaps the greatest cause for hope is that the Greek and Turkish sides do co-operate whenever they can do so in security and to mutual advantage. Politicians from both sides have backed an international effort to publicise and preserve the old city of Famagusta, whose French, Venetian and Ottoman overlords all left their mark on its architecture. Another flicker of hope is the bicommunal campaign on Facebook, a social-networking website, to protect the island's wild donkeys, ten of which were mysteriously shot dead recently. Donkeys “that belong to us are murdered by [people] who do not belong to us,” complain the activists.

For old lefties like Mr Talat and Mr Christofias, who take the line that their island's people would get along fine if ultra-nationalists in their respective motherlands would only allow it, this is a resonant, if rather Utopian, call to action.

Northern Italy and Alitalia

Good money after bad

Apr 24th 2008 | MILAN
From The Economist print edition

Why Milan resists any sale of Alitalia to Air France-KLM

ITALIAN taxpayers learnt on April 22nd that they had just lent €7.50 ($12) each to a near-bankrupt company. The outgoing centre-left government nodded through a loan of €300m to Italy's national flag-carrier, Alitalia, which is debt-laden and losing €1m a day. Normal business criteria have rarely mattered for Alitalia. But this time such considerations have been entirely blown away by the Italian election. The future of Alitalia will now be settled by politics, and maybe diplomacy. It presents Silvio Berlusconi, the prime minister-elect, with his first big challenge. And it constitutes an early test of his commitment to economic liberalism.

Romano Prodi, who will remain Italy's prime minister until early May, convened his cabinet after Air France-KLM, the only firm ready to buy Alitalia, withdrew its bid. It gave no reasons, but they are not hard to guess. Two conditions for the bid were approval by trade unions and by the incoming government. Air France-KLM secured neither. Talks with the unions broke down on April 2nd. One reason was that Mr Berlusconi had already called the bid “offensive” and announced an alternative deal with a consortium that would guarantee the airline's *italianita*.

His opponents accuse him of dreaming up a non-existent counter-offer so as to play the nationalist card in the election. He insists that there are interested investors, but that they need time to prepare an offer. And since Alitalia is running out of cash (at the end of March, it had only €170m in the kitty), a loan was essential.

Mr Prodi was only too happy to extend one. It dumps the question of Alitalia's future squarely into Mr Berlusconi's lap (although it may fall to Mr Prodi to persuade a sceptical European Commission that a loan to an otherwise insolvent company does not constitute illegal state aid). The outgoing government had contemplated a sum of, at most, €150m. But the loan was doubled at Mr Berlusconi's request.

Mr Berlusconi has dressed up his intervention in terms of national self-respect. Even after the election, when his attitude to Air France-KLM had mellowed, he was demanding that they agree to a new, three-country airline with Italy at the top table. One possible counter-offer may come from Moscow, where Aeroflot said it was awaiting proposals from Italy following an “instruction” by President Vladimir Putin. Mr Putin met Mr Berlusconi at his villa in Sardinia on April 17th.

In the background is a tangle of interests. Air France-KLM wanted to put Alitalia's only hub at Rome's Fiumicino airport, shedding its commitment to Milan's Malpensa. On March 31st, anticipating a change of ownership, the airline scrapped 886 of its 1,238 weekly flights from Malpensa. But the move is contested by businessmen in Lombardy, the region round Milan from which Mr Berlusconi himself springs. Antonio Colombo, director-general of the employers' federation, Assolombarda, notes that Lombardy accounts for 30% of Italy's exports. The shift to Fiumicino has meant losing flights to such places as Dubai, Mumbai and Shanghai.

“Save Malpensa” also became an electoral battle-cry for the Northern League, which handily increased its vote in the election and could yet hold the Berlusconi government to ransom. The League's leader, Umberto Bossi, is already flexing his muscles. This week he claimed (and Mr Berlusconi promptly denied) that he had secured for his party a deputy prime-ministership and the interior ministry in the next cabinet.

Mr Colombo says that the real objection to Air France-KLM's bid was that it bound the government to respect bilateral accords with countries outside Europe's “open skies” agreement. “That meant there was no possibility of other companies filling the gaps left at Malpensa by Alitalia.” Without direct links to countries such as India and China, Milan's attractiveness as a business centre would suffer. So would its role as an exhibition venue, an irony since it has just won the contest to host the World Expo in 2015.

Alitalia's *italianita* is not the only national interest at stake in this saga.

Economist.com WORLD EUROPE

Germany's generation gap

Oldies with muscle

Apr 24th 2008 | BERLIN
From The Economist print edition

Growing fears about the political power of pensioners

FORTY years after its invention, the generation gap is making a comeback in Germany. A former president, Roman Herzog, although well on the wrong side of 30, has issued the starkest warning of all. Germany risks becoming a “pensioners' democracy” in which “the old plunder the young”, he declared. The cause of his alarm was a decision by the government to give pensioners a bit more money than it had planned. Surely they deserve “at least a smidgen” of the benefit from an economic upswing, shot back Walter Hirrlinger, head of Sozialverband VdK, a group that speaks for the old, the handicapped and the sick.

Germany's allegedly greedy grandparents had already benefited from an expansion of unemployment pay for workers older than 50. This partially rolled back reforms enacted by the previous Social Democrat (SPD)/Green government. Too much of this sort of thing could be poison to an economy trying to remain competitive despite a rapidly ageing population. But the temptation to pander to the old is growing. In next year's federal election more than half the likely voters will, for the first time, be 50 or older.

Germany has done more than most rich countries to defuse its pension timebomb. Between 2001 and 2004 the government reined in future pension increases by linking them to the ratio of contributors to beneficiaries. It also introduced new incentives, financed in part by pensioners themselves, for today's workers to save for their own future pensions. The grand coalition government of the SPD and the Christian Democratic Union (CDU) followed this up by enacting a gradual rise in the pension age from 65 to 67, beginning in 2012.

Germany still has to worry about rising health-care costs. And the Bundesbank thinks the pension age should rise again, to 68 or more. Otherwise, on pensions, “there is not much room for further reform”, says Martin Werding of the Ifo Institute for Economic Research in Munich.

The new pension-rise formula has proved Scrooge-like, giving recipients no increase between 2004 and 2006, and a miserly 0.5% in 2007. Now the economy is growing, food and fuel prices are soaring—and the next election is looming. Surely the government can spare a little extra?

The CDU chancellor, Angela Merkel, certainly thinks so. Pensions are to rise by 1.1% in July and by 2% in 2009. The increase comes from giving pensioners a two-year holiday on their contributions to top up pensions for today's workers. It will be paid for by postponing a planned drop in payroll taxes. Pensioners' incomes will still fall in real terms, since inflation will be even higher, but by less than expected. Eventually the gift should cost almost nothing, because the government plans to take it back in 2012 and 2013.

But now that the government has set a precedent for tinkering with pensions on political grounds, it threatens “the credibility of the entire reform path,” claims Mr Werding. If it does not prove brave enough to reclaim its gift (before yet another election), the deal will not be as cheap as advertised. A slowing economy and other spending demands already endanger the goal of balancing the budget by 2011.

Pressure to do more for the old is still mounting. The trade unions want the government to prolong subsidies for early retirement that are due to expire next year. Jürgen Rüttgers, the CDU premier of North Rhine-Westphalia, has weighed in with a proposal to fight old-age poverty—not yet a widespread problem—by guaranteeing a minimum pension to people who have contributed for at least 35 years, regardless of how much they have paid in. Ms Merkel has said no, but for how long?

Yet the politicians may be panicking unnecessarily. Senior citizens do not tend to vote as a block, points out Achim Goerres, a political scientist at the University of Cologne. Rich pensioners have little in common with poor ones. And many invest time and money in the welfare of their children and grandchildren. Almost no European country has an oldsters' political party worth the name—or even a lobby group that can match the political power of America's AARP, a pensioners group.

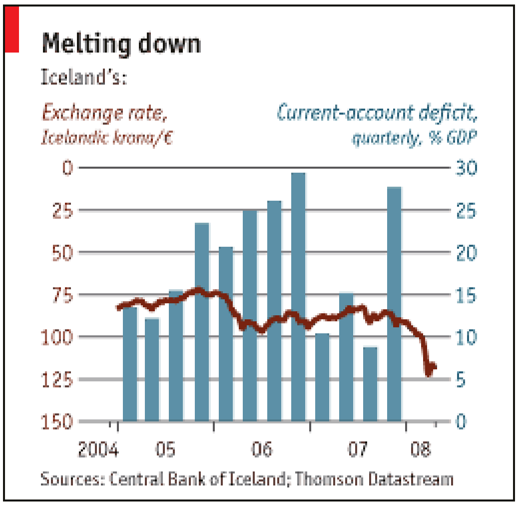
It is voters in general who are overlooking the benefits and counting only the costs of reform. Fully 90% either backed the pension giveaway or said it was too small. The Left Party is rejoicing, and other parties are trying to keep up. The problem for Germany may not be pensioners' democracy but plain old democracy.

Iceland's economy

Till debt us do part

Apr 24th 2008 | REYKJAVIK
From The Economist print edition

An island victim of the global credit crunch



ICELAND'S central-bank governor, David Oddsson, recently gave a gloomy speech, calling conditions “harsh and often stormy”. He said the “headwinds” were not going to “wash away on the outgoing tide”. Mr Oddsson's meteorological metaphors came at a moment when Iceland's much trumpeted foray into world markets was tainted by reports of financial disaster. In brief, the Icelandic economy is in trouble, thanks to a huge amount of foreign debt incurred by its banks.

The population of Iceland is just over 300,000. Except for sheep, fish and dairy products, virtually everything consumed on the island is imported. The current-account deficit is enormous (though the government's budget is in large surplus). To finance it, the island's three big banks—Landsbanki, Glitnir and Kaupthing—have borrowed freely on the international capital markets, stretching themselves far beyond their modest depositor base at home.

Traditionally, Iceland has staved off inflation through high interest rates. Mr Oddsson has taken to interest-rate rises with a zeal not seen since Paul Volcker ran America's Fed in the 1980s. Yet inflation has remained at least double the bank's 2.5% target—at present it is running as high as 8.7%. And one unhelpful result of high interest rates (recently raised to 15.5%) has been a widening differential with other currencies. That made Iceland a prime target for the “carry trade”: borrowing in low-interest currencies to invest in higher-yielding ones. The result last year was a sharp rise in the krona.

Ignoring high interest rates and taxes, Icelanders reacted to their strong currency by spending even more. Last summer an ugly spiral developed. Inflation stayed high, interest rates were raised, the krona strengthened—and the circle was completed by unfettered borrowing. Into this toxic mix fell the global credit crunch, triggered by America's subprime mess.

Iceland's banks have actually kept clear of most subprime assets, but they have been hit hard by the global credit squeeze. Inter-bank lending between European banks has slowed to a trickle, but it has stopped altogether for Icelandic banks. Risk premiums on their debt hit record levels last year. None of the banks needed to borrow at these rates, but the market signal was clear enough: the banks were in trouble, and there was a question-mark over the central bank's ability to stand behind them.

The outcome in 2008 has been a slump in the krona, which has fallen against the euro by almost 30%, as carry traders unwound their contracts and hedge funds shorted the currency. The impact on a small, open economy has been swiftly felt. Prices of basic goods are shooting up. Double-digit inflation and a recession both look inevitable. It adds up to a sorry end to a jolly spree on the world's capital markets.

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The press in eastern Europe

Less free speech

Apr 24th 2008 | BRATISLAVA, BUCHAREST AND SOFIA
From The Economist print edition

Tough laws and interfering politicians are shrinking media freedom

PICK up a Slovak newspaper, and you will find it a quick, if depressing, read. The main dailies have in recent weeks been appearing with blank, black-framed front pages, in protest at a new media law that will give anyone mentioned in an article sweeping rights to an equally prominent rebuttal. International media watchdogs have sharply attacked the law. They are worried by declining media freedom across eastern Europe.

Slovakia's new law comes into force on June 1st. If somebody referred to in a newspaper story complains, the onus will be on the editor to print their response unless he can persuade a court to rule otherwise. A rebuttal may not be accompanied by additional editorial comment. A refusal to print one can lead to big fines. Right-of-reply rules are common in several European countries, but Slovakia's law is the most punitive and, potentially, arbitrary.

The government, a populist-nationalist coalition, insists that the law will make the media more responsible. “It does not jeopardise freedom of the press. It merely upgrades the interest of the public above the interest of the publishers,” says Marek Madaric, the culture minister. The Slovak media are not above reproach. A forthcoming report by the Open Society Institute, a group financed by George Soros, talks of “plagiarism, refusal to make corrections and hidden conflicts of interest.”

Yet there is reason to worry about how Slovakia's prime minister, Robert Fico, may use the law. He has a prickly relationship with the media, which have harried his government for inertia and alleged corruption. He declines to give interviews and sometimes even to take questions from critical journalists, and he has called some daily newspapers “prostitutes”. Some journalists recall the dark days of the 1990s, when the authoritarian government of Vladimir Meciar (who is now Mr Fico's junior coalition partner) jeopardised the country's accession to the European Union and NATO. (To be fair, Mr Fico's predecessor, Mikulas Dzurinda, who was lionised abroad for his reforms, clashed with the press, and was once accused of bugging media opponents.)

Slovakia's new law is the most conspicuous in the region. But arbitrary legal constraints on press freedom are worrisome elsewhere, too. In Bulgaria defamation of public figures (a broad category that can include prominent businessmen) is a crime that can be punished with a fine. Journalists can also be sued for infringing somebody's “honour and dignity”. As many as 60 cases went to court in 2006, and a further 100 in 2007.

In Romania the constitutional court last year restored a tough defamation law that criminalises “insult”, though the effect on press freedom pales beside the ownership of most of the mainstream media by three politically active tycoons, plus political interference in public broadcasting. America's ambassador to Bucharest, Nicholas Taubman, has suggested that “legislators should strengthen their own accountability...rather than try to hamper the efforts of a free media to exercise its legitimate role in Romania, either through criminalising journalistic efforts or otherwise intimidating independent media.”

All this is bad news in a region that used to take pride in its reborn freedom. And bad laws are only part of the picture. In the annual report of Freedom House, a New York-based lobby group, to be published on April 29th, the ex-communist countries show the biggest relative decline in media freedom in the world, chiefly because of a perceived politicisation of public broadcasting. The drop is larger than in Asia, Africa and Latin America.

Thus Latvia's score slips from 19 to 22, after the government appeared to lean on public television to cover Russia more politely. Slovakia's falls from 20 to 22, Slovenia's from 21 to 23, and Poland's from 22 to 24. Mr Soros's media-watchers echo Freedom House's judgment. “Politicians think these public broadcasters should be ‘theirs’,” says Marius Dragomir, who is publishing a clutch of detailed reports on public-service broadcasting in the region. With EU accession safely negotiated, politicians now feel able to exploit the fruits of power more freely. Politicised public broadcasting is a useful tool to manipulate the voters, especially when commercial television is run by friendly tycoons.

Such trends are troubling. But everything is relative. Recently a Russian newspaper, *Moskovsky Korrespondent*, published a widespread rumour about the supposed relationship of President Vladimir Putin with a comely gymnast, Alina Kabaeva. After Mr Putin lambasted the tabloid, which is a sister publication to *Novaya Gazeta*, an opposition paper, it was promptly shut down by its publisher. Such an event would be unimaginable in the new EU members from central and eastern Europe. For now, at least.

Charlemagne

Europe's Marxist dilemma

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From The Economist print edition

It is easier to influence a country before than after it joins the club

Illustration by Peter Schrank

GROUCHO MARX once said that he did not care to belong to a club that accepted people like him as members. The European Union has a slightly different problem. Lots of countries want to get in, even though many of them, and indeed some that have already made it, are not fit to join. They seem to hope that EU membership will work miracles of its own, curing such ills as entrenched corruption, organised crime, judicial ineffectiveness and economic backwardness—all without their having to make painful reforms at home.

Consider Bulgaria, which joined the EU (with Romania) on January 1st 2007. The interior minister, Rumen Petkov, has just been forced to resign, after the 120th in a string of unsolved contract killings; he has admitted being in contact with suspected crime bosses. Last year the Romanian government dumped its bravely reforming justice minister, Monica Macovei, on the dubious argument that she was not a team player. Both countries do badly in the annual corruption rankings put out by Transparency International, a Berlin-based lobby group.

And they are by no means alone. In every one of the eight central and east European countries that joined the EU on May 1st 2004, reforms have since stuttered or halted. Anti-corruption drives in the Baltic countries have stalled. Slovakia, once the star among the region's economic reformers, has fallen to earth with a vengeance. Poland, the Czech Republic and Hungary have all been criticised for their slow pace of reform.

A common feature in all these tales is the limited leverage of Brussels. It is often said that the EU's enlargement policy has been the most potent tool yet devised to entice its neighbours along the road to free-market democracy—far more effective than anything the United States has found to wield over its southern neighbours. But the corollary is a loss of influence after a country actually joins. The pattern of intensive reform to qualify, followed by a let-up in the process once membership is achieved, is too common to be mere happenstance.

Olli Rehn, the enlargement commissioner, concedes sadly that “after a country has a seat round the table, it is much harder to apply pressure to it.” This, he adds, is why the European Commission has introduced benchmarks and closer scrutiny into the pre-accession phase. Even after accession, the commission can withhold farm subsidies and regional aid, as it is threatening to do for both Bulgaria and Romania. Another sanction in their accession treaties is that other EU members may refuse to recognise court judgments. Yet most post-accession sanctions are like nuclear weapons: threats that may be counter-productive actually to use. They have none of the power of pre-accession talks, when a single mis-step can easily mean another year of delay.

Politics always intervenes, in any case. In 1981 few countries considered Greece to be suitable for membership of the club, but none dared to incur the ignominy of vetoing it. In the run-up to 2004, some tried to differentiate among the east Europeans, giving membership only to leading reformers. But politics tipped the balance in favour of a “regatta”, under which all but the Balkan pair came in at once. Bulgaria and Romania were then guaranteed membership in 2007 or 2008, which instantly eased the pressure to keep reforming. A similar story played out with Cyprus in 2004: the moment its EU membership was secured, the urge to reach a settlement with the Turkish-Cypriot-controlled north of the island ebbed away.

Is there a better way to keep up pressure? Mr Rehn's benchmarks and monitoring may help; so might offering or withholding cash. Yet the only sure method is to keep membership tantalisingly near, but not actually to offer it. Croatia, Turkey and Macedonia all now have a big incentive to change, because they want to join. And Turkey shows the limits of this approach: since many Turks believe they will never get in, no matter what they do, they wonder why they should bother with more reforms.

Good and bad members

There is another big problem with this game: the behaviour of old EU members. Mr Rehn notes that, if one took the worst features of every old EU country, one could easily come up with an amalgam that would barely meet any of the criteria for EU membership. To take just one example often cited by new members, Italy can hardly claim to be free of organised crime.

Perhaps the most telling case of one rule for new members and another for old ones has come with the single currency, the euro. The commission and the European Central Bank insist that they must be rigid in applying to new EU members the “Maastricht criteria” before they can join the euro. Lithuania was rejected in 2006 because its inflation rate was just 0.1% over the prescribed minimum. Slovakia, which hopes to get into the euro next January, is being subjected to similarly fierce checks.

Yet the rules were openly bent to admit Belgium and Italy in 1999. Greece, which adopted the euro in 2001, subsequently admitted that it had done so with made-up budgetary figures. Several countries that had struggled to cut public borrowing to qualify for the euro stopped their fiscal reforms the moment they were let in. And when the two biggest, France and Germany, fell foul of the stability-pact ceilings on budget deficits in 2003 and 2004, they responded not by doing their utmost to get back in line but by tearing up the pact itself. Nobody dared to suggest that they should be subjected to the enormous fines specified in the pact for persistent offenders.

The Lisbon treaty offers a few other sanctions, notably the suspension of a country's membership rights by a majority vote of other members. It also contains the novelty of an exit clause, letting a country leave (though not yet giving the EU the power to throw a recalcitrant out). But you can bet your bottom euro that neither of these will be used to raise the club's standards. Groucho Marx would not have approved.

The Labour government

Beleaguered Mr Brown

Apr 24th 2008
From The Economist print edition

Looming local elections could make the prime minister's predicament much worse, or a little bit better

Getty Images

IT IS the sudden and unexpected event, requiring a spontaneous response, that is usually thought to confound Gordon Brown. The insolvency of Northern Rock last autumn was a case in point, as was the loss of data discs soon after.

Surprising, then, that the roots of the latest crisis to trouble the prime minister, whose party is already behind in the polls, go back a year. To pay for a cut in the basic rate of income tax in his final budget as chancellor last spring, Mr Brown removed the 10p ($0.20) starting rate. Within hours opposition parties and independent commentators claimed the changes would make many poor workers poorer. But it took a year for the policy to become a big political problem for the government.

Marshalled by their colleague Frank Field, a longstanding critic of Mr Brown, 48 Labour MPs recently signed a motion arguing against abolishing the tax band. Had they voted for an amendment that Mr Field planned to table on April 28th, the government would have been defeated. On April 23rd, however, an offer to backdate compensation for many of those who lose out from the tax changes was enough for Mr Field to withdraw his amendment.

This resolution avoids immediate disaster but will damage the government in the longer run, for it encourages the view that Mr Brown has neither a sense of political direction nor a firm grip on his party. The first charge need not be fatal—other meandering governments, such as John Major's, have survived for a respectable length of time. The second is more troubling. A revolt is expected next month when the government's plan to extend the maximum period a terrorist suspect can be detained without charge comes before Parliament. Mr Brown has had to speak to the Parliamentary Labour Party twice in three weeks to soothe concerns over the policy and his own leadership; he would normally address them every few months.

The problem is not confined to the backbenches; unseemly bickering has broken out higher up the party's food chain. On April 21st Charles Clarke, a former home secretary, mocked as hypocritical a plea for unity by Ed Balls, the schools secretary and a long-time confidant of Mr Brown. Some suspect Mr Balls of asserting his own leadership ambitions behind the scenes now. Attempts by David Miliband, the foreign secretary, to float big ideas to galvanise the government are also seized upon as an early pitch for the top job. Even if some of this speculation is wide of the mark, the fact that the Labour leadership is being discussed less than a year into Mr Brown's tenure is alarming.

The prime minister has himself to blame for much of this, but the people who come out of Labour's current malaise looking worst may be its rank-and-file MPs. Few objected to the tax changes when they were announced. “There's absolutely nothing about the effects of abolishing the 10p rate that we didn't know the day after the 2007 budget,” says Robert Chote of the Institute for Fiscal Studies, a think-tank. Nor, though they harboured doubts about his suitability for the job, did they put forward a candidate to challenge Mr Brown for the Labour leadership.

Just how bad is Labour's predicament? The local elections on May 1st will provide some insight. The last time most of the seats being contested this year were up for grabs, in 2004, Labour performed abysmally, losing almost 500 councillors. There aren't many more town halls for the party to lose (though one is Reading, a town near London, which would be a symbolic blow for a prime minister perceived to have a “southern problem”). So a better guide will be the popular vote. “A decent result for Labour would be 30%,” says John Curtice of Strathclyde University. A repeat of the 27% that the party managed a year ago, in the dying days of Tony Blair's premiership, would only heighten speculation that Mr Brown will not lead his party into the next election.

More resonant, perhaps, is the race for Britain's most important directly elected job: that of mayor of London. Either the Labour incumbent, Ken Livingstone, or the Conservative candidate, Boris Johnson, will win (see article). The Tory's once-vaulting poll leads have dissipated as he has struggled to answer questions about transport policy and the make-up of his putative administration. But bookmakers still expect voters in Britain's hedonistic capital to prefer his eccentric charisma to the mayor's not inconsiderable record. Mr Livingstone has been around a long time, and allegations of wrongdoing have sullied what charms he still has.

Mr Johnson is closer to David Cameron, the Tory leader, who backed his run for the party's nomination from the start, than Mr Livingstone is to Mr Brown, whose dislike for the mayor is famous. A defeat for his candidate would therefore be a particular setback for Mr Cameron. But the corollary is that a victory for Mr Johnson could boost the morale and momentum of Tories nationally; whereas the afterglow of a win for Mr Livingstone would shine only fitfully on Mr Brown.

What Labour has on its side is the knack of managing expectations. In the weeks before Mr Brown became prime minister last June, the party did nothing to challenge Tory claims that he would not enjoy a honeymoon bounce in the polls. So he was seen as a miracle-worker when ratings did rise, even though the increase was small by historical standards.

Labour has been similarly keen to downplay hopes for May 1st. A modest set of results—Mr Livingstone scraping home in London and a slight improvement on last year's share of the popular vote elsewhere—may end up being seen as a spectacular double-whammy. Mr Brown's underlying problems—a declining economy, his shortcomings as a communicator—would remain; but even a short respite from them would be welcomed.

London's election

Every vote counts—twice

Apr 24th 2008
From The Economist print edition

The capital's curious electoral system creates a market for second-hand votes

LONDON'S mayoral race is too close to call, but one thing is clear: the contest rests on voters' second choices. The pink ballot that Londoners will fill in on May 1st has two columns: one to mark their favourite candidate, and another to name their grudging second preference. Ken Livingstone, the Labour incumbent, and Boris Johnson, his Conservative rival, are expected to finish neck-and-neck in the top two spots, neither with a majority. The second choices of those who backed losing candidates will be added to their totals, to produce a winner.

The “supplementary vote” has never mattered much before in London, where Mr Livingstone has won the past two elections comfortably. (By contrast, three of England's 12 other elected mayors have at one point taken office only thanks to second preferences.) Now, it could swing things. The biggest prize is the votes cast off by the Liberal Democrats, Britain's third-largest party, which may account for nearly half the total. At London's last mayoral election Lib Dems backed Labour over the Tories. Their current candidate, Brian Paddick, has refused to say which of his rivals he dislikes least, but some polls show Lib Dems leaning towards Mr Johnson.

That may be misleading. For one thing, the polling samples are tiny (sometimes fewer than 100) at that level of detail. And it is tricky to get at true intentions, admits Nick Sparrow of ICM, a polling company. “We have a long history of casting one vote rather than two. The pollster may be asking about something that the poor old respondent has not previously thought about,” he says.

The London Assembly is also hard to predict, again owing to the way it is elected. In a system introduced in 2000 that no other English council uses, 11 of its 25 seats are allocated by proportional representation to any party that polls above about 5%. Small parties benefit: at the last election seats were won by the Greens and the right-wing UK Independence Party (UKIP), which have never elected an MP. The worry this year is that the British National Party (BNP), a thuggish far-right outfit, could win a seat, as it came close to doing last time.

In the past the far right was kept at bay by the electoral system. Tony Travers of the London School of Economics points out that in 1977 the National Front polled 5.3% in elections for the Greater London Council, but failed to win a seat because London then used a first-past-the-post system. If the BNP managed that share this year, it would win a seat. Their chances have been improved by the implosion of UKIP, whose supporters they hope to attract. Maybe—but only one in five UKIPers chose the BNP when casting their second-preference votes in the last mayoral election.

Much rests on turnout, which in past years has been little more than a third. Higher turnout will make it harder for the BNP to reach the 5% threshold, and may benefit Mr Livingstone, whose supporters are more reluctant to vote than Mr Johnson's. Turnout might be boosted by the candidates' larger-than-life personalities and intense rivalry. Which makes it all the odder that the outcome may be determined by people who don't much like either of them.

Credit markets

A lifeline for banks

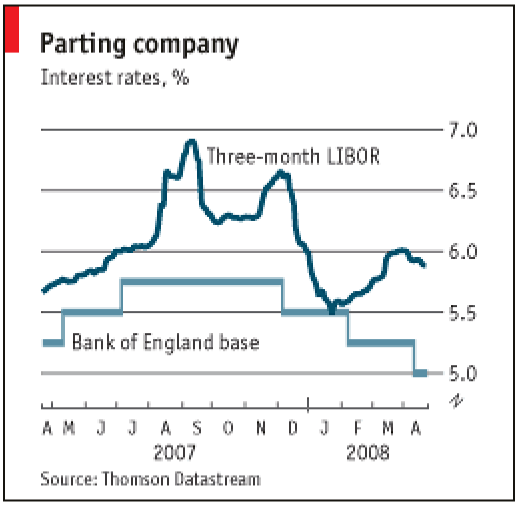
Apr 24th 2008
From The Economist print edition

The Bank of England's bold initiative should calm frayed financial nerves

EVER since the money markets capsized last August, top bankers have criticised Britain's central bank for a tardy and inadequate response to the gravest financial shock since the early 1930s. Now they no longer have cause to grumble. The Bank of England has taken a decisive step to restore confidence in the banking system.

The “special liquidity scheme” launched this week puts Britain's central bank at the forefront of international attempts to arrest the financial crisis. Although some have called the plan, which is likely to provide banks with at least £50 billion ($100 billion) of extra liquidity, a “bail-out”, Mervyn King, the Bank of England's governor, rejects that charge. He said on April 21st that the scheme was “designed to improve the liquidity position of the banking system and raise confidence in financial markets while ensuring that the risk of losses on the loans they have made remains with the banks”.

The initiative is a modern version of the time-honoured central-banking practice of ensuring that solvent banks do not trip up in troubled times for want of ready cash. The need for the Bank of England to reinterpret this sacred text has been apparent for several weeks. A telltale sign of the continuing distrust in and among banks has been the elevated interest rate at which they lend to one another for three months. This LIBOR rate, off which much lending is priced, is normally close to the central bank's base rate. The gap widened extraordinarily when the financial shock started last August (see chart). After falling back at the start of this year, the spread has recently opened up again.



The “special liquidity scheme” is similar to the $200 billion “term securities lending facility” which the Federal Reserve announced on March 11th. Like the American scheme, it involves the central bank swapping easily tradable assets for illiquid assets that the banks are holding. The British facility will let banks swap mortgage-backed and other securities for bills issued by the Treasury.

But three features of the British scheme make it more ambitious than its American counterpart. The first is that there is no cap on its size; and the expected initial take-up of £50 billion will be bigger, given the relative size of the two economies, than America's facility. Second, the asset swaps will not be provided through weekly auctions, as in America, but will be available to banks on demand at any time over the next six months. The third difference is that the swaps will be much longer than the Fed's, which extend for just 28 days. Instead they will last for a year and indeed, after renewal, for as long as three years.

Taxpayers are at risk, but there are several safeguards to protect them. Only high-quality securities will be accepted, and a fee will be charged. Banks will get less back in Treasury bills than the value of the assets they are swapping. For example, a bank offering mortgage-backed securities would receive roughly between 70% and 90% of their worth in Treasury bills; and it would have to provide more assets or return some of the bills if the value of the securities then fell. Taxpayers will have to pay up only if a bank defaults and the central bank has incurred losses on its swaps.

Although no explicit deal has been struck, the banks will clearly have to play a part now in resolving the financial crisis. But their side of the bargain will not entail steps to ease conditions in the mortgage market, as Alistair Darling, the chancellor of the exchequer, has suggested. The Bank of England has deliberately limited the assets eligible for the swaps to those existing at the end of 2007, which means that the facility cannot be used to finance new lending. Banks and building societies have been toughening the terms on which they extend new home loans and refinance old ones because they are recognising risk that they had underestimated before.

The Bank of England's scheme is designed to underpin the banking system, not to prop up the housing market. The *quid pro quo* expected of bankers is that they strengthen their balance-sheets. They must write down losses realistically and boost their capital (see article). Painful though this will be, it is an essential part of rebuilding the financial system.

Banks

Look Ma, no capital

Apr 24th 2008
From The Economist print edition

Racy balance-sheets looked great in the go-go years, but not any more

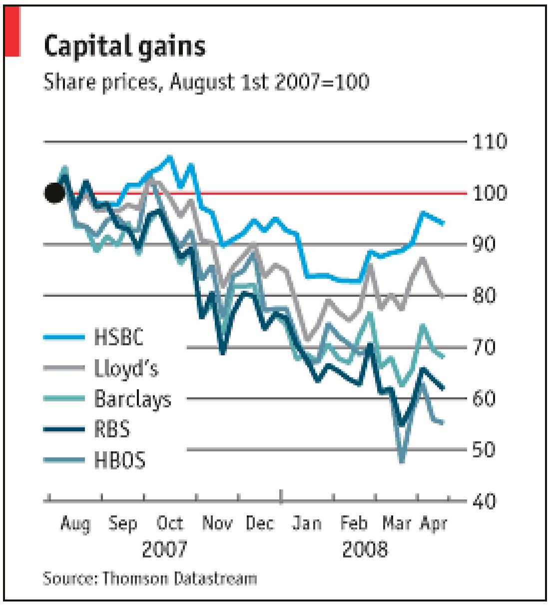
GENERALS stand accused of lacking foresight, inclined as many of them are to be preparing to fight the last war. What then of bankers, who show little sign even of hindsight? Most seem unable to grasp the lessons of the last crisis, still less to anticipate the next one.

Take Royal Bank of Scotland (RBS), Britain's second-largest bank, which in February merrily increased its dividends to shareholders despite ample warning that the worst of the global credit crunch was yet to arrive. Sir Fred Goodwin, the bank's well-regarded chief executive, confidently told investors that he had “no plans for any inorganic capital raisings or anything of the sort”.

After hubris comes the fall. On April 22nd Sir Fred went cap in hand to shareholders, asking them for £12 billion ($24 billion) in Europe's largest capital-raising to date. He says he may also have to pawn some family silver: he hopes to raise another £4 billion by selling the bank's profitable insurance business.

The cash is needed to rebuild RBS's balance-sheet, which has been strained by fresh write-downs totalling £5.9 billion on its investments in iffy American mortgage loans as well as by its badly timed purchase last year of a large part of ABN Amro, a Dutch bank. The volte-face prompted several large shareholders in RBS to call for Sir Fred's head. He has hung on to his job for now, but his days at the bank look numbered.

At issue is RBS's “core capital”, a cushion composed mainly of shareholders' equity that regulators insist banks hold against bad times. At the beginning of the year this stood at about 4.5%, the lowest of any big European bank and below the 5-6% level that most banks consider a prudent minimum.



Other big British banks are also sitting on a flatter capital cushion than their rivals in other parts of the world. Analysts at JP Morgan, an investment bank, reckon that British banks should be holding around £37 billion more in capital than they do at the moment.

Among banks that have capital concerns are Barclays and HBOS, which JP Morgan reckons will need £8 billion and £11 billion respectively. Barclays, whose securities business made profits in the first quarter of 2008, may prefer to retain earnings rather than raise fresh cash. But investors' worries about capital adequacy are showing up in share prices. Banks such as flush HSBC and solid Lloyds TSB, which have more capital, have performed far better this year than those that are short of it (see chart).

In good times a racy attitude to capital has helped to make British banks among the most profitable, with enviable returns on equity. In tougher times, however, they look too clever by half.

Breaking up BAA

Turbulence ahead

Apr 24th 2008
From The Economist print edition

Finding fault with Heathrow and its owner was the easy part

FOR as long as it has stood, Heathrow, the world's busiest international airport, has both awed and infuriated travellers. The much-vaunted opening of its Terminal 5 at the end of March, which had promised to transform the grubby old place into a miracle of modern transport, seemed merely to shift chaos from existing buildings to the new one. Nor can new terminals alone, however shiny, ease the delays that arise from overcrowding of the airport's runways.

On April 22nd the Competition Commission, which investigates whether markets are working properly, said that neither airlines nor passengers had been well served by the fact that London's three main airports (and several others too) are owned by the same firm.BAA had been slow to build new terminals and runways, it maintained. Although this report is just the commission's first word on the subject (more formal provisional findings are due to be published in the summer), it suggests that the watchdog is leaning heavily towards breaking up BAA. David Starkie, an expert in airport regulation, reckons the commission may force BAA to sell Gatwick, London's second airport, and possibly Stansted, its third.

BAA seems to be preparing itself already to divest some of its airports. Colin Matthews, the former boss of a water company who took over as chief executive of BAA in April, shook up the firm's management on April 21st in order to give senior executives a bigger say in what happens at Heathrow, the jewel in its crown.

But breaking up BAA may be easier ordered than done. It is not yet clear whether its dismembered bits will turn out to be serious rivals, and whether the bracing winds of competition can substitute effectively for the stifling hand of regulation. Complicating these deliberations are BAA's strained finances.

The firm, bought by Spain's Ferrovial nearly two years ago, is struggling under about £11 billion in debt, some of which its new parent took on in order to buy it. Turmoil in the credit markets and uncertainty over the firm's future has forced it to delay repeatedly the issue of new bonds. It will probably have to pay over the odds when it is finally able to raise more cash.

On current plans, BAA needs to spend about £5 billion over the next five years to modernise and expand Heathrow. Mr Starkie points out that the commission will have to tread carefully in forcing BAA to sell cash-generating airports such as Gatwick if the firm is to be left with enough cash to fix Heathrow.

It is not only BAA that came in for the Competition Commission's ire: so too did the Civil Aviation Authority, which regulates airports' fees and services, and the government, which decides where airports should be built or expanded. BAA has led both by the nose, the commission suggested, and encouraged policies that have exacerbated the shortage of runways and terminals. The government's great mistake, it said, was in trying to second-guess the market by deciding, when it set out the broad sweep of airport policy in 2003, when and where new runways should be built.

This unintentionally forestalled development at the main airports when new capacity proved to be required earlier than expected. Planning officials blocked expansion of a passenger terminal at Coventry airport, for example, because the government had said it played only a niche role for freight airlines. Ruth Kelly, the transport secretary, has now promised a broad review of airport regulation.

Splitting apart London's airports should change things for the better. Yet optimism must be tempered. New facilities take years to build, and Heathrow has a tendency to disappoint. In 1946, before it was converted from a wartime airfield into London's main hub, this paper confidently predicted that Heathrow would be “a fine airport when it is finished”. In less than a decade we were bemoaning cost overruns on its new terminal building and pitying passengers “queuing in crocodile through the huts on the north-east side”.

Refinery strike

Running on empty

Apr 24th 2008 | EDINBURGH
From The Economist print edition

The workers may be biting off more than they can chew

SCOTTISH motorists have suddenly woken up to the fact that their freedom to take to the road depends on a company most of them have never heard of before. Ineos is Britain's biggest private firm and largest chemical business. But its unheralded rise to the top of the corporate rankings—ten years ago it did not exist—hit trouble on April 20th. A planned strike forced it to start shutting down its Grangemouth oil refinery, which supplies most of Scotland's petrol stations.

Despite reassurances from oil firms that Britain's eight other refineries could take up the slack, and ignoring official entreaties not to panic, drivers began queuing in petrol-station forecourts. Some sellers began to ration fuel, worried that panic buying would contribute more to any shortages than the actual closure of the refinery.

The dispute, which centres on pension rights, pits generously treated workers against a firm with a reputation for ruthlessness. Ineos was founded in 1998 by Jim Ratcliffe, a chemical engineer turned venture capitalist. It has been a voracious acquirer of chemical works, mainly in Europe and America. Mr Ratcliffe, who has described his strategy as “completely opportunistic”, bought reasonably equipped plants with decent technology being off-loaded by blue-chip companies, and then tried to push up their productivity to pay off the debt incurred to acquire them. By 2007, says PriceWaterhouseCoopers, an accounting firm, Ineos had sales of £18.1 billion and profits of £727m.

Ineos bought Grangemouth from the oil giant BP in 2005; it now produces 84% of the company's £5 billion in British revenues and 18% of its world-wide income of £22.2 billion. Ineos is now looking, as usual, to boost profits. But it has run into a problem in the shape of a remarkably generous pension scheme inherited from BP. The refinery's 1,350 employees make no contributions towards their pensions but nevertheless receive 1/60th of their final salary for every year of service.

Ineos reckons that annual pension costs (some £10,000 per employee) account for a quarter of labour costs, a proportion that may rise to one-half as pensioners live longer. It has planned, it says, to invest £750m in Grangemouth but says that pension costs may undermine the economic case for doing so. So, like many employers in many places, it wants to phase in contributions for existing employees and substitute a defined-contribution scheme for new ones.

Final-salary schemes are rare in the modern workplace; a scheme in which employees contribute nothing even more so. But Unite, the workers' union, is irate, and around 85% of its members voted to strike on April 27th and April 28th. Early hopes for a compromise faded on April 22nd, when Ineos issued a defamation suit against Unite for claiming that the firm had pinched £40m from the pension fund.

Negotiations to stop the strike had broken down as *The Economist* went to press. But whatever the eventual outcome, the company could be left with a big headache. Oil refineries cannot be switched on and off instantly, and Ineos says that getting Grangemouth back to full production may take a month.

That could cause wider problems. BP's Forties pipeline from the North Sea, which comes ashore at Grangemouth, carries about 700,000 barrels of crude oil a day—between a quarter and a fifth of Britain's offshore production. The oil goes into a de-gasification plant, and then four-fifths of it is stored for export. That plant relies on steam and power from Grangemouth, which the union may no longer be prepared to supply. If the pipeline were to close, it would be a disaster for many North Sea firms. For example, ConocoPhillips, an oil and gas company, warned on April 23rd that without the pipeline it would be forced to suspend production from its giant Britannia field.

Ineos is no stranger to high-stakes poker games. When it bought a chemical plant in Cheshire in 2001 and found it in worse-than-expected shape, it demanded £300m from the government, claiming that up to 133,000 jobs were at stake. It got £50m, and squeezed £60m out of the former owner ICI, which had kept a 15% stake. Last year Ineos pulled out of building a factory at Wilhelmshaven despite backing by the German government, saying that increases in “material and labour costs” had made it too costly.

Both disputes took place in private, away from the public eye and from politicians, who worry about things such as fuel shortages and interruptions to North Sea production. But public opinion could favour Ineos. Scotland's motorists—whiling away the petrol queues by comparing the Grangemouth pension scheme to their own—seem unlikely to sympathise much with its workers.

Cycling

Four wheels bad...

Apr 24th 2008 | CAMBRIDGE
From The Economist print edition

...two wheels good, or so says the government

WHEN John Major, Britain's most recent Conservative prime minister, wanted to evoke the spirit of England in 1993, he bowdlerised George Orwell, talking romantically of "old maids bicycling to Holy Communion through the morning mist". It was an anachronistic image: by the time Mr Major delivered his speech cycling accounted for only 1% of distance travelled on British roads, down from around a third of the total just after the second world war.

Today the proportion is even lower, at around 0.9%. But if the government has its way, the decline could soon be stopped. Whitehall is pouring money and effort into two-wheeled transport. Cycling England, a government-funded outfit that promotes pedal power, will see its budget increased from £10m to £60m by 2009. The cash will be spent on connecting schools to the national cycle-lane network, training for children and propaganda aimed at motorists. Six towns have already been singled out as test-beds; 11 more are planned.

Besides helping to reduce congestion (a growing problem on the roads in most places) and air pollution, the ambitious argue that bicycles can help to save both the nation and the world. Cycling is hard work and therefore likely to cut obesity in the fattest country in the European Union. And carbon-free bicycles could help ministers meet their elusive climate-change targets.

Enthusiasts point to the two-wheeled renaissance in London as a source of good ideas for aspiring local councils. Transport for London (TfL) claims that cycling in the capital has increased by 83% since 2000, thanks to a combination of investment in cycle lanes, free lessons for the curious, a push from the congestion charge and a five-fold hike in funding. Ken Livingstone, the city's mayor, wants to see the number of cycling trips rise by 400% by 2025.

Concerns about safety, which keep many would-be cyclists wedded to their cars, seem overblown. Despite the surge of new cyclists, London has seen the numbers killed or seriously injured fall by around a third over the past decade, and national data show a similar trend.

TfL attributes this partly to education campaigns and partly to safety in numbers: the more cyclists there are, the better motorists become at sharing the road with them.

Another shining example for cycling fans is Cambridge, where an echo of Mr Major's Albion can just about be discerned in the dons and students cycling between ancient colleges. Cambridge is widely regarded as the most cycle-mad city in Britain, with around a quarter of its residents biking to work, eight times the national average. That reflects some natural advantages (the place is mostly flat) and some deliberate decisions (such as plenty of cycle lanes and places to lock up bikes). But historically, no conscious decision is responsible for cycling's popularity. Other, less tangible cultural factors seem to be at work, harder to export to the rest of the country. "Everyone does it and always has," explains one Cantabrigian. "It's just the way Cambridge is."

Bagehot

Methuselah's lament

Apr 24th 2008
From The Economist print edition

Gordon Brown's big problem is not 10p or 42 days. It is 11 years

Illustration by Steve O'Brien

THE trouble with marriage, some evolutionary psychologists believe, is not immorality but life expectancy. Human beings were indeed designed to be monogamous, runs the argument, but they were supposed to live only to 30: ten years of fidelity is in the genes, but golden anniversaries are not. A similar rule applies to political unions. Voters' devotion to governments, however passionate at first blush, cannot last forever; eventually the couple become rancorous and recriminatory. Gordon Brown and Labour seem to be entering this supernumerary phase—the phase of having stayed too long.

Until April 23rd the government faced a humiliating parliamentary defeat over its abolition of the 10p income-tax band, a change that will leave several million poor people worse off—a botched reform that, say MPs of all parties, voters bitterly resent. Then Mr Brown and Alistair Darling, the chancellor, promised only slightly less humiliatingly to make good some of the losses. As he did so, Mr Brown extolled the poverty-reducing virtues of the minimum wage, introduced in 1999. But the minimum wage, along with the fiddly but generously redistributive tax-credit system he devised, is now just part of the economic furniture. Likewise, when Mr Brown harks back to the early 1990s, lots of voters can scarcely remember the darkness he tries to conjure, and a few were barely born.

Mr Brown's approach to redistribution helps to explain the shortage of credit he gets for it: his neo-Victorian concept of the deserving poor (essentially working parents and pensioners); his gloomy conviction that the sharing had to be surreptitious. But just as, in a long marriage, partners forget how lonesome they were before it, so voters have forgotten or “banked” most of Labour's achievements. Lots of people, for example, tell pollsters that the National Health Service is worse than in 1997, even though on any sensible measure it isn't. Expectations rise and cynicism abounds, but memory fades and patience wears out.

Conversely, if governments have the mixed fortune to survive long enough, their mistakes and myopic compromises catch up with them. The controversial tax reform itself epitomises the fiscal tricksiness with which, as chancellor, Mr Brown raised money through subtle but cumulatively burdensome tax ruses. He also borrowed copiously to finance his spending plans—a technique whose political consequences he might have escaped had Labour left office before the current downturn. Another thing that ultimately catches up with long-lived governments is the economic cycle.

As with voters, so with Mr Brown's cooling romance with his own MPs. Part of the explanation is that parliamentary rebellion, rather like adultery, is habit-forming: at first it feels impossible, then transgressive and finally mundane. There is also, inevitably, a swelling cadre of alienated MPs—has-been ex-ministers and never-going-to-be-and-know-it backbenchers—for whom infidelity seems costless. As Mr Brown's poll ratings wane, self-interest (ie, keeping their seats) actively motivates some MPs to distance themselves from him.

Meanwhile Labour's majority has declined from the landslide proportions of its first two terms to the merely healthy. So whereas Tony Blair comfortably survived early left-wing revolts, over a miserly increase to the basic state pension and cuts to single parents' benefit, the 10p guerrillas rapidly extracted their concessions. So, maybe, will another impending rebellion over bizarrely stubborn plans to increase to 42 days the time those suspected of terrorism can be held without charge. That makes the government look even weaker and more exhausted.

The spiral of indiscipline has also exacerbated another habit that took hold during Mr Brown's resentful decade as chancellor, and is proving its own revenge: regicide. Internecine briefing seems to have become almost a socially acceptable pastime among some ministers, just as it eventually did under the Tories. As the "assassins" who brought down Margaret Thatcher begat the "bastards" who almost did for John Major, so the Brownite-Blairite struggle has been elided, almost uninterruptedly, with intra-Brownite strife. Blood, it turns out, will indeed have blood.

Yet, in this case, the blood is likely to flow in small quantities rather than a great murderous gush. Despite heady speculation about a coup, Mr Brown is probably safe in his job, for now. Labour has already copied the Tory manoeuvre of changing the front man; to do so again would look undemocratic as well as absurd. But another reason Mr Brown is safe is that he has deprived himself of what ought to be one of the few advantages of long incumbency. Almost all the Labour politicians who have developed reputations to match those of, say, the Tories' Ken Clarke or Michael Heseltine have left government, voluntarily or otherwise. There is, for the moment, no obvious alternative to Mr Brown. There is also no one to share his Methuselan burden.

Himself, alone

Because they tend to be built on ideas, which can run out, Labour governments have generally found it especially tough to stay in office. The longevity of this one, after the long Tory imperium, suggests that the life expectancy of British governments, like that of humans, has lengthened. But the basic physics of politics will not change. Eventually the equilibrium between hope and trust on the one hand, and disappointment on the other, must shift against the incumbent.

That is Mr Brown's big problem. It is not that he lacks a "vision" (his egalitarian meritocracy is perfectly serviceable), or that he is indecisive and uncharismatic (though he is). It is not 10p or 42 days. It is that Labour has been in office for 11 years. It will very likely be 13 by the time of the general election—two more years in which Mr Brown must bear the gathering weight of grievance and ingratitude, more or less alone.

Economist.com WORLD INTERNATIONAL

The UN and human rights

A screaming start

Apr 24th 2008 | GENEVA
From The Economist print edition

Getty Images

A new UN institution is struggling to prove that it is doing better than its unloved predecessor. Thanks to an obsession with Israel, it isn't, yet

TWO years ago, the 60-year-old UN Commission on Human Rights was dumped. Kofi Annan, who was then the UN's secretary-general, gave the reason: the world's worst abusers had used the agency “to protect themselves against criticism or to criticise others”. When its successor, the Human Rights Council, started up a couple of months later, he urged it not to “squander” the new opportunity.

Many feel the council has done just that. Dominated by the Organisation of the Islamic Conference and the Non-Aligned Movement, the new body stands accused of being just as politicised, and just as intent on one-sided Israel-bashing, as its predecessor. Most human-rights organisations say privately that they are bitterly disappointed.

Among the complaints: its inclusion as members of some serial human-rights abusers; its decision to stand down “special rapporteurs” for Cuba, Belarus and Congo; and its failure to protect the integrity of the Office of the High Commissioner on Human Rights. Press-freedom groups were appalled last month when the council's Islamic members, backed by Russia and China, pushed through a resolution saying free speech could be limited out of “respect for religions and beliefs”.

Its defenders say the council should be given a chance to improve. Yes, they say, it replicates many of the former body's failures: with so many of the same states, often represented by the same people, sitting (literally) in the same seats, instant change could not be expected. “It's not yet what I want, and is still far from what we should aim for,” says Luis Alfonso de Alba, a Mexican who was the first holder of the council's annually rotating presidency.

He thinks the council may stand or fall by a new process, known as universal periodic review. This marks the main difference between the council and its predecessor. The commission often focused on just a dozen states, which complained they were singled out because they lacked enough big friends to keep critics at bay. In a way they were right: abuses by weak or friendless countries (Cambodia, Somalia, North Korea, Sudan) were denounced, but similar sins by, say, China, Russia, Saudi Arabia or Pakistan were passed over.

Now, everyone—including the Security Council's permanent five—must submit to a peer review every four years, with hearings held in public and webcast live. Critics fear a charade; defenders say the process should be given a chance to work.

Under the review system, three reports are made: one by the country itself in collaboration with local

NGOs; another by the Office of the High Commissioner with input from other UN bodies; and a third by international human-rights groups. After studying these reports, council members get three hours to quiz the country under review. An assessment by three council members, with recommendations, is then presented to the council.

Hearings for the first 16 countries were completed last week. Most states prepared carefully; many fielded big delegations headed by a minister. Next month's second lot of hearings, including Pakistan, may be a tougher test. Some abusers could try to wreck the process by filibustering, but that will be caught on camera. Serial offenders may tell their critics to get lost, but that does not mean that the process isn't being taken seriously—by the accused or by the accusers. The review could sway decisions on multilateral aid, and embolden local activists.

If the council's workings sound arcane, that is because its birth pangs were long. When a panel on UN reform first suggested replacing the “discredited” 53-member commission, it mooted a council of leading human-rights experts from all the UN's 192 member states. This was rejected by Mr Annan, who adopted the American idea of a smaller, more focused body of 20 to 30 members, committed to upholding the “highest standards” of human rights.

After much haggling there emerged a 47-member group, barely smaller than its predecessor. Elected by a simple majority of the General Assembly (instead of the proposed two-thirds majority), its members faced no prior test other than a “voluntary pledge” on human rights. Many of the worst rights offenders have avoided standing for election. But China, Cuba, Russia and Saudi Arabia are back on.

A claimed strength of the new council is the fact that it is at work most of the time. The old commission met for a single six-week session once a year; this council sits for at least ten weeks a year in three regular sessions, plus “special” sessions, called by at least one-third of members, as the need arises. No longer are emergencies ignored if they occur at the wrong time.

What few foresaw was the extent to which Islamic states would use this procedure to single out Israel. Four of the six special sessions called so far, and almost all the single-country resolutions, have been devoted to Israel. Two special sessions have been held on Myanmar and Darfur, but nothing has been said about human-rights issues in China, Zimbabwe, Colombia, Iran, Pakistan, Turkmenistan, Saudi Arabia, Egypt, Cuba or Belarus.

Sponsors of the anti-Israel resolutions insist that there is no other forum where they can denounce acts that are widely agreed to violate international law: the use of cluster bombs, the blockade of Gaza, ill-treatment of detainees, “targeted killings” and so on. When they try to raise such matters at the Security Council, they say, they face an American veto. Arguably, however, Israel-bashing simply masks the council's reluctance to tackle other issues.

The Muslim and non-aligned states often blame the West for focusing on abuses in poor countries while ignoring its own faults. But they rarely take any action in the council over alleged rich-world misdeeds such as the mistreatment of terror suspects. That may be because poor, angry countries hesitate to threaten their relationship with powerful partners and aid donors by taunting them over human rights. Easier to home in on Israel.

Of the council's 47 current members, 23—just one shy of an absolute majority—are ranked by Freedom House, an American think-tank, as “free”, compared with only ten described as “not free”. Why don't the “free” states form a counterweight to the Islamic and non-aligned blocks? Perhaps because they don't want to tie their hands in the broader trade-offs that are going on all over the UN system, including some 17 bodies in Geneva alone. Deals over “more important” issues, like trade, are constantly being done in Geneva's corridors; civil liberties can easily lose out.

Human rights are one of the three pillars on which the UN is supposed to rest. The Universal Declaration of Human Rights, signed 60 years ago, is seen as a great achievement. But there is huge disagreement about which rights matter most. The rich world says priority should be given to civil and political rights; poorer countries say economic, social and cultural rights matter more. The new council has emerged at a time when such debates are especially sharp. But after barely two years, hopes of a real dialogue are fading in the face of the obsession with Israel.

In January America denounced a session at which the council condemned Israel's actions in Gaza but refused to criticise Palestinian rocket attacks on Israel. It was right, said Ban Ki-moon, the UN secretary-general, to keep following conditions in Gaza. But “I would also appreciate it,” he added, “if the council will be looking with the same level of attention and urgency at all other matters around the world."

Olympic games

The ghosts of Mexico 1968

Apr 24th 2008
From The Economist print edition

AP

When hundreds died for a good show

A massacre that was hushed up to ensure a “successful” sporting event

A DEVELOPING country gets the Olympic games as an acknowledgment of its new, exalted status. An authoritarian government, awash with money, exploits the chance to project a peaceful, progressive image. Critics of the regime use the games as a chance to demand more democracy and human rights. There are demonstrations, forcefully broken up.

This is the story, more or less, of the Beijing Olympics 2008—so far. But it also describes the run-up to the Mexico City Olympic games of 40 years ago. Then, the protests ended in a massacre, an awful sign of how far governments can go to protect a cherished sporting show.

Other Olympics have also been bloodied by people drawing attention to their causes. The Munich games of 1972 were supposed to exorcise dark memories from the ones in Berlin, staged by the Nazis in 1936. But Munich was horribly marred by the killing of 11 Israeli athletes by Palestinian gunmen. At the Atlanta games in 1996, a terrorist set off a bomb that killed one person. But it was in Mexico that politics and the games intersected most lethally.

It was the first—and only—time that the games were held in Latin America. Mexico's economy was growing fast, and its rulers were keen to show that their newly modern country could afford to stage an event as costly as the Olympics. President Gustavo Díaz Ordaz decreed the construction of shiny new stadiums.

But despite its outward modernity, Mexico's politics were (like those of China) trapped in another age. There was a one-party state, a muzzled media and judiciary, and an oppressive security apparatus. And 1968 was a natural time for Mexico's youth to challenge the regime; it was, after all, the year of global student revolt. All Mexico's demonstrations that summer had an especially dramatic feel because of the imminent arrival of the games.

The president, a narrow-minded bigot, was determined that nobody would hijack or derail them; the games would go ahead whatever happened. He also realised how hard that would be when, on August 27th, about 400,000 people converged on the centre of Mexico City to hurl abuse at him.

Another rally was planned for October 2nd, just ten days before the opening. Thousands gathered in the Plaza de las Tres Culturas, part of the vast new Tlatelolco housing project. Security forces were waiting for them. Plain-clothes agents tried to mingle with the crowd, but they stood out by wearing a single white glove.

They were subsequently found to belong to the self-styled “Olympia Battalion”, a shadowy paramilitary squad. Acting as agents provocateurs, just after 6pm they fired on the crowd, prompting army troops to open up with machineguns. As people tried to flee, some were killed by soldiers wielding bayonets.

Unofficial estimates of the death toll ranged from 150 to 325. But the official body count was just 20 dead, and the government said its soldiers had been provoked by terrorist snipers. With editors in the pockets of the government, any journalist wanting to write more was given short shrift. “There's an order,” one was told by her editor. “We're going to concentrate on the Olympic games.”

Astonishingly, the International Olympic Committee went ahead as planned. Ten days after the massacre Mr Díaz presided over the opening ceremony. The truth about the massacre would not be revealed for another three years; the one-party state continued for another 32 years. Unlike China today, most of the protests over Mexico 1968 were internal rather than external. But it was an awful example of what governments will do for a superficially successful games.

Half-way from rags to riches

Apr 24th 2008
From The Economist print edition

Eyevine

Vietnam has made a remarkable recovery from war and penury, says Peter Collins (interviewed here). But can it change enough to join the rich world?

KNEES and knuckles scraping the ground, the visitors struggle to keep up with the tour guide who is briskly leading the way through the labyrinth of claustrophobic burrows dug into the hard earth. The legendary Cu Chi tunnels, from which the Viet Cong launched waves of surprise attacks on the Americans during the Vietnam war, are now a popular tourist attraction (pictured above). Visitors from all over the world arrive daily at the site near the city that used to be called Saigon, renamed Ho Chi Minh City after the Communists took the south in 1975.

Alongside the wreckage of an abandoned M41 tank another friendly guide demonstrates a dozen types of improvised booby-traps with sharp spikes that were set in and around the tunnels to maim pursuing American soldiers. The Vietnamese not only welcome the tourist dollars Cu Chi brings in, but are also rather proud of it. They feel it demonstrates their ingenuity, adaptability, perseverance and, above all, their determination to resist much stronger foreign invaders, as the country has done many times down the centuries.

These days Vietnam also has plenty of other things to be proud of. In the 1980s Ho Chi Minh's successors as party leaders damaged the war-ravaged economy even more by attempting to introduce real communism, collectivising land ownership and repressing private business. This caused the country to slide to the brink of famine. The collapse soon afterwards of its cold-war sponsor, the Soviet Union, added to the country's deep isolation and cut off the flow of roubles that had kept its economy going. Neighbouring countries were inundated with desperate Vietnamese “boat people”.

Since then the country has been transformed by almost two decades of rapid but equitable growth, in which Vietnam has flung open its doors to the outside world and liberalised its economy. Over the past decade annual growth has averaged 7.5%. Young, prosperous and confident Vietnamese throng downtown Ho Chi Minh City's smart Dong Khoi street with its designer shops. The quality of life is high for a country that until recently was so poor, and its larger cities have retained some of their colonial charm, though choking traffic and constant construction work are beginning to take their toll.

An agricultural miracle has turned a country of 85m once barely able to feed itself into one of the world's main providers of farm produce. Vietnam has also become a big exporter of clothes, shoes and furniture, soon to be joined by microchips when Intel opens its $1 billion factory near the capital, Hanoi. Imports of machinery are soaring. Exports plus imports equal 160% of GDP, making the economy one of the world's most open.

All this has kept government revenues buoyant despite cuts in import tariffs. The recent introduction of company taxes is also helping to fill the government's coffers. Spending on public services has surged, yet public debt, at an acceptable 43% of GDP, has remained fairly stable.

The making of modern Vietnam 1

Date	Event
1959-65	Gradual build-up to Vietnam war
1968	Communists launch Tet Offensive against American and South Vietnamese forces
	My Lai massacre by American troops
1969	President Richard Nixon announces gradual troop withdrawal
1973	Paris peace accords signed
1975	Communists capture south and reunite country
1979	Vietnam invades Cambodia and topples Pol Pot. Brief war with China ensues
1986	*Doi moi* economic liberalisation launched
	Pro-Moscow diplomatic policy replaced with "friends everywhere" doctrine
1989	Number of "Vietnamese boat people" fleeing penury hits peak
1991	The Soviet Union, Vietnam's cold-war sponsor, disintegrates
1994	America lifts trade embargo
	UN brokers pact on resettling and repatriating Vietnamese boat people
1995	Vietnam joins ASEAN
	America and Vietnam restore diplomatic relations
2000	Vietnam creates stockmarket and legally recognises private enterprises
	America-Vietnam trade pact signed
2006	Vietnam hosts Asia-Pacific summit
2007	Vietnam joins World Trade Organisation
2008	Vietnam wins temporary seat on UN Security Council

Source: *The Economist*

Having made peace with its former foes, Vietnam hosted Presidents Bush, Putin and Hu at the Asia-Pacific summit in 2006 and joined the World Trade Organisation in 2007. This year it has one of the rotating seats on the UN Security Council.

Vietnam's Communists conceded economic defeat 22 years ago, in the depths of a crisis, and brought in market-based reforms called *doi moi* (renewal), similar to those Deng Xiaoping had introduced in China a few years earlier. As in China, it took time for the effects to show up, but over the past few years economic liberalisation has been fostering rapid, poverty-reducing growth.

The World Bank's representative in Vietnam, Ajay Chhibber, calls Vietnam a "poster child" of the benefits of market-oriented reforms. Not only does it comply with the catechism of the "Washington Consensus"—free enterprise, free trade, sensible state finances and so on—but it also ticks all the boxes for the Millennium Development Goals, the UN's anti-poverty blueprint. The proportion of households with electricity has doubled since the early 1990s, to 94%. Almost all children now attend primary school and benefit from at least basic literacy.

Vietnam no longer really needs the multilateral organisations' aid. Multilateral and bilateral donors together have promised the country $5.4 billion in loans and grants this year, but with so much foreign investment pouring in, Vietnam's currency reserves increased by almost double that figure last year. At least the aid donors have learned from the mid-1990s, when excessive praise discouraged Vietnam from continuing to reform, prompting an exodus of investors. Now the tone in private meetings with officials is much franker, says a diplomat who attends them.

Vietnam has become the darling of foreign investors and multinationals. Firms that draw up a "China-plus-one" strategy for new factories in case things go awry in China itself often make Vietnam the plus-one. Wage costs remain well below those in southern China and productivity is growing faster, albeit from a lower base. When the UN Conference on Trade and Development asked multinationals where they planned to invest this year and next, Vietnam, at number six, was the only South-East Asian country in the top ten.

The government's programme of selling stakes in publicly owned firms and exposing them to market discipline has recently gathered pace. At the same time the switch from a command economy to free competition has allowed the Vietnamese people's entrepreneurialism to flourish. Almost every household now seems to be running a micro-business on the side, and a slew of ambitious larger firms is coming to the stockmarket.

Much of the praise now being showered anew on the country is deserved. The government is well on course for its target of turning Vietnam into a middle-income country by 2010. Its longer-term aim, of becoming a modern industrial nation by 2020, does not seem unrealistic.

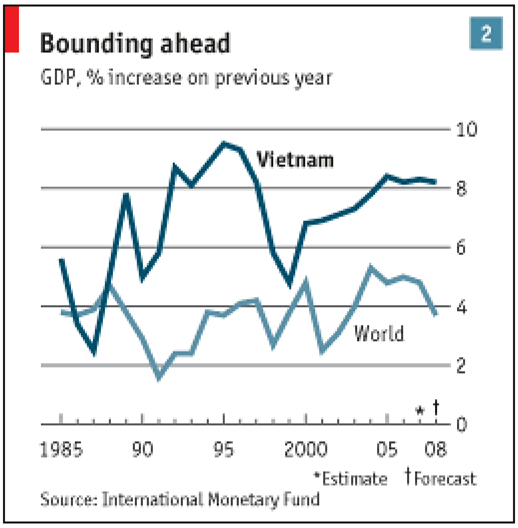
But from now on the going may get tougher. As Mr Chhibber notes, few countries escape the “middle-income trap” as they become richer. They tend to lose their reformist zeal and see their growth fizzle. A study in 2006 by the Vietnamese Academy of Social Sciences concluded that further reductions in poverty will require higher growth rates than in the past because the remaining poor are well below the poverty line, whereas many of those who recently crossed it did not have far to go.

The stench of corruption

The Communist Party leadership openly admits that the Vietnamese public is fed up with the endemic corruption at all levels of public life, from lowly traffic policemen and clerks to the most senior people in ministries. In 2006, just before the party's five-yearly congress, the transport minister resigned and several officials were arrested over a scandal in which millions of dollars of foreign aid were gambled on the outcome of football matches. The leadership insists it is doing its best to clean up, but a lot remains to be done.

Almost as bad as the corruption is the glacial speed of legislative and bureaucratic processes. Proposed laws have to pass through all sorts of hoops before taking effect, with endless rounds of consultations to build consensus. The dividing line between the Communist Party, the government and the courts is not always clear. The justice system is rudimentary. Lawyers have no formal access to past case files, so they find it hard to use precedent in legal argument.

The government is part-way through a huge project to slim the bureaucracy and streamline official procedures. It recently cut the number of ministries from 28 to 22. Yet for the moment the bureaucratic logjam is stopping the country building the roads, power stations and other public works it needs to maintain its growth rate. Nguyen Tan Dung, the prime minister, says that if growth is to continue at its current rate, the country's electricity-generating capacity needs to double by 2010. That seems a tall order, to put it mildly.



Soaring car-ownership is leaving the country's underdeveloped roads increasingly gridlocked. In an admirably liberal attempt to limit price distortions as oil surged above $100 a barrel, the government slashed fuel subsidies in February. But one effect will be to stoke inflation, already worryingly high at 19.4% in March. Bank lending surged by 38% last year as firms and individuals borrowed to speculate on shares and property.

The government is finding it much harder to manage an economy made up of myriad private companies, banks and investors than to issue instructions to a limited number of state institutions, especially as the public sector is currently suffering a drain of talent to private firms that are able to offer much higher pay.

What could go wrong

All this leaves Vietnam's continued economic development exposed to a number of risks:

• Rising inflation—which is hurting low earners in particular—and a growing shortage of affordable housing could create a new urban underclass among unskilled workers who have left the land for the cities. Combined with rising resentment at official corruption and the increasing visibility of Vietnam's new rich, this could cause social friction and bring strikes and protests, chipping away at the political stability that has underpinned Vietnam's strong growth and investment.

• Trade liberalisation and increased domestic competition will benefit some firms and farmers but hurt others—especially inefficient state enterprises. These could join forces and press the government to halt or even reverse the reforms.

• The slumping stockmarket or perhaps a property crash could cause a big firm or bank to fail. Given the country's weak and untested bankruptcy laws and financial regulators, the authorities may find it hard to deal with that kind of calamity.

• Natural disasters, from bird flu to floods, could cause chaos.

• The economy could come up against the limits of its creaking infrastructure and the shortage of people with higher skills. Jammed roads, power blackouts and the inability to fill managerial and professional jobs could all bring Vietnam's growth rate crashing down.

Vietnam has set itself such demanding standards that even if some combination of these factors did no more than push annual growth below 5%, it would be seen as a serious setback. The foreign minister, Pham Gia Khiem, notes that Vietnam's current growth of around 8-9% is lower than that in Asia's richest economies at the same stage in their development.

Despite the risks ahead, Vietnam has already provided the world with an admirable model for overcoming war, division, penury and isolation and growing strongly but equitably to reach middle-income status. This model could be followed by many impoverished African states or, closer to home, perhaps by North Korea. If it can be combined with gradual political liberalisation, it might even offer something for China to think about.

A bit of everything

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From The Economist print edition

Vietnam's quest for role models

A BELL chimes at noon in the pastel-coloured Cao Dai Grand Temple, about 100km (63 miles) from Ho Chi Minh City, and hundreds of worshippers in coloured robes and a variety of headgear file in. They sit cross-legged among pink columns with carvings of gaudy green-and-white dragons. All around them is their religion's symbol, the all-seeing eye. The place looks like a cross between a Chinese temple, a mosque and a Catholic church, with a touch of the Wizard of Oz's Emerald City.

Cao Dai, Vietnam's syncretistic home-grown religion, mixes Buddhism, Taoism, Christianity, Islam and other religions, teaching that all faiths are manifestations of “one same truth”. The religion was founded in 1926 by Ngo Van Chieu, a government official. By the 1940s it had become a powerful force, maintaining its own private army. It supported the Japanese occupation and at times the pro-American South Vietnamese regime, so after 1975 it was repressed by the Communists. Now, as the government eases up on religion, Cao Dai is back in favour, albeit strictly controlled. In February members of the government committee for religious affairs joined 200,000 Caodaists for a grand ritual at the temple.

Corbis

All-encompassing Cao Dai

Cao Dai's sunny, ecumenical message chimes well with Vietnam's foreign policy of seeking “friends everywhere”. More broadly, the faith reflects a quintessentially Vietnamese trait: casting around for role models, then trying to meld the best aspects of several of them into something uniquely suited to Vietnam.

That may come naturally to a country that has been occupied and influenced by so many foreign powers. The Vietnamese legal system is based mainly on Napoleonic principles but with bits adapted from the Chinese and Soviet models. When Vietnam was under the Soviet Union's wing during the cold war, it copied its collectivist economic model, with disastrous results. Next, it emulated Deng Xiaoping's market socialism. More recently it has grafted on elements of the World Bank's and UN agencies' anti-poverty growth models and, increasingly, the rudiments of a welfare state along European lines.

China lite

It is tempting to view Vietnam as a mini-China, since both countries are run by ardently capitalist communists, but there are differences. A foreign diplomat in Hanoi who used to serve in Beijing says that “everything here is more moderate than in China.” Vietnam is a bit less harsh with dissidents than China, and its capitalism too is less red in tooth and claw. Its health and education services have adapted more successfully to the transition to a market economy. Its press is strictly controlled, as in China, but the growing numbers of internet surfers have free access to most foreign news websites: there is no Vietnamese equivalent of the Great Firewall of China.

Whereas China is led from the top down and one man is clearly the paramount leader—Hu Jintao, who is both the head of the Communist Party and the state president—Vietnam has a consensual leadership. Its triumvirate of president, party boss and prime minister must reach accommodations with an increasingly independent national assembly and a host of other forces, and avoid upsetting the many surviving heroes of Vietnam's independence wars. China's leadership can ram through public-works projects regardless of the consequences. In contrast, the decision-making process in Vietnam can seem painfully slow—but also more equitable.

China enforced a one-child policy harshly; Vietnam had a two-child policy, pursued half-heartedly. Whereas China is already greying, Vietnam's post-war baby-boomers are now coming into their prime, and rapid economic growth has been providing jobs for them all. HSBC's chief in Vietnam, Tom Tobin, notes that in a decade or two, when much of the rest of the world will be ageing rapidly, Vietnam's boomers will still be at the most productive phase of their careers.

China remains the most obvious role model for combining market reforms with communist ideology, though most Vietnamese would be loth to admit to copying their ancient foe. But Vietnam's ruling party also looks to rich Singapore, nominally a free-market democracy but in practice a one-party state whose government still controls the commanding heights of the economy. For example, Vietnam has created a carbon copy of Temasek, a Singaporean investment agency, to retain its stakes in part-privatised firms.

Clearly Vietnam is too big and too decentralised to be able to copy tiny Singapore, but its Communist Party hopes to pull off the same trick as Singapore's People's Action Party (PAP), persuading the voters to accept its continued rule as the price of prosperity. Like the PAP, the Vietnamese Communists seek to recruit academic high-flyers and budding thinkers to their inner circle at an early stage.

Noting that higher education and scientific innovation were the keys to riches for Japan, South Korea and Taiwan, Vietnam is wooing foreign high-tech firms and inviting rich countries to set up universities and training facilities on its soil. An Australian university, the Royal Melbourne Institute of Technology, has already opened state-of-the-art campuses in Ho Chi Minh City and Hanoi. A German university and several South Korean technical colleges are planned. Meanwhile families from the prime minister's downwards are sending their youngsters to study abroad.

So what shape will Vietnam's syncretistic economy take? As the country seeks to build strong national companies, it is as yet unsure whether to model them on Japanese *keiretsu*, Korean *chaebol* or Anglo-Saxon companies that focus on their core business. Maybe it will manage to take the best bits of each model. But Tony Salzman, an American businessman in Vietnam, worries about the danger of “the collars not matching the cuffs”.

Two wheels good, four wheels better

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The rich are ever more visible—but where are the poor?

AS OSTENTATIOUS gestures go, splashing out $1.5m (including taxes) to have a custom-made Rolls-Royce Phantom air-mailed to you half-way around the world takes some beating. But Duong Thi Bach Diep, one of Vietnam's new breed of property tycoons, was tiring of being driven round in a mere BMW. “I cried when I first saw it,” she told reporters in January. “All the security and customs officials at the airport shared the joy with me when it arrived.” Naturally her motives were patriotic and noble: “This will show the world that Vietnam is not a country of poverty and war but a lucrative market.”

So it is, these days. And despite remaining nominally communist, Vietnam, like China, is now a country where it is all right to flaunt what you have. Ms Diep's Roller arrived two months after the first consignment of Porsches landed in Vietnam. In the cities, sleek black Mercedes cars glide among the buzzing swarm of motorbikes on the ever more congested streets. The Mercedes factory in Ho Chi Minh City has a five-month waiting list for some models. The country's state-controlled press enthusiastically prints league tables such as the top 20 stockmarket tycoons and the 50 richest women in Vietnam (Ms Diep is not even in the top ten).

Even in the countryside, signs of wealth are becoming increasingly visible. Visiting Quang Ngai, a quiet town set among rice paddies, your correspondent was startled by a snappily dressed young Vietnamese couple flashing down the main street in an open-topped red Ford Mustang. The town has quite a few bank branches (farmers are coining it, thanks to high rice prices) and smart shops selling fancy clothes.

Watch the extremes

All this prosperity is hard to square with the official figure for Vietnam's GDP per person, a mere $839. Even after allowing for higher purchasing power in a low-cost country, the World Bank puts national income per person at only $3,300, below that of several sub-Saharan African states. There must be huge numbers of dirt-poor people to bring the average down, but where are they? Despite waves of migration to the cities, there are no shanty-towns to be found on their peripheries. There are a few beggars and pavement-dwellers on the city streets, but notably fewer than in officially richer Bangkok.

Ralf Matthaes, the boss in Vietnam of TNS, a market-research firm, thinks there must be something amiss with the figures. In a recent survey of the country's “deep rural” zones he found surging numbers of consumers: one-third of the people in such areas already have mobile phones, which cost at least $100 apiece—a whole month's income for this slice of the population, according to the official figures. More than nine out of ten rural homes now have cookers and televisions.

The explanation may lie in Vietnam's age-old tradition of hiding wealth from the authorities. When TNS asked a sample of consumers to keep spending diaries, the incomings and outgoings of the very poorest roughly tallied but better-off consumers were spending up to seven times their declared incomes. Plenty of people run micro-businesses alongside their formal jobs. Until 2000, when private firms were officially recognised, many prosperous people had no legal way to explain their wealth, so they got used to hiding it.

A big rural electrification programme has brought power supplies to more than 90% of Vietnamese homes. Almost all children now enter lower secondary school and nearly two-thirds stay on to upper secondary level. Increasingly, deep poverty is confined to small communities of ethnic minorities in remote mountain areas. Health services are expanding, though from a low base: a recent study by the *Lancet*, a medical journal, found that around a third of Vietnamese children under five years old were still below their expected height because of poor nutrition.

A welfare system along European lines is slowly emerging. In 2003 the social-security system, providing cover against sickness and work accidents as well as pensions, was extended from state employees to private-sector workers. A national unemployment-insurance scheme is due to start up next year. A 2006 study by the Vietnamese Academy of Social Sciences concluded that the country could now afford a universal old-age pension.

Over the past decade or so of rapid growth, the country's Gini coefficient, a measure of inequality, has hardly budged. But then the coefficient is an attempt to sum up all income differences in a single number. In Vietnam it may be the rapid expansion of the middle class that has kept the index steady, despite the creation of so many limousine-buying millionaires. What the government may need to start worrying about in the coming years is not the average but the two extreme ends of the income scale.

In recent months rising world commodity prices and Vietnam's economic boom have sent prices soaring: in the year to February, food prices rose by over 30% and housing and construction costs by more than 20%. Low-income workers who have moved from the country to the city no longer grow rice but still want to eat it. If they are tenants, they are facing steep rent rises and the possibility of eviction, whereas property owners stand a fair chance of compensation when their home is demolished for redevelopment. Rising prices and a growing shortage of affordable housing may be helping to create a new low-paid urban underclass.

A small but visible underclass; an ever more ostentatious millionaire set; and a concerned middle class in-between. Could this one day cause social unrest in placid Vietnam? Richer countries have found that the extreme ends of the income spectrum can cause disquiet even when, overall, everyone is pretty well off and getting more so. Despite its attempts to create social safety-nets, Vietnam's government may increasingly have to contend with this particular problem of success.

Entrepreneurs unbound

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Business of all kinds is booming

VINAMILK is a company based in Ho Chi Minh City, made up of various dairies left behind by the Swiss, Dutch and Chinese after America withdrew from Vietnam in 1975. A recent study of Vietnam's leading firms by the UN Development Programme describes how the firm was shuttled from one ministry to the next after being nationalised. Despite this neglect, the firm became one of the first state enterprises to extend its operations across the whole of the reunified country. Today Vinamilk is a flagship for the government's huge programme of “equitising” state firms, and most of its shares are privately held. TNS, a market-research firm, reckons that Vinamilk is the second-fastest-growing brand in the country.

In the dark post-war days all that Vinamilk could offer its customers was tinned sweet condensed milk. Gradually it expanded into powdered milk and later fresh milk. Now that it is free to set its own strategy, the firm is pushing upmarket. Tran Bao Minh, its marketing chief, says it is promoting a “Pure Premium” fresh milk brand that costs 10% more than the equivalent product of Dutch Lady, a European competitor. It is also moving into drinking yogurts, fruit juices and other health drinks. Under state control it could never have been so bold, says Mr Minh.

Thanks to Vietnam's rapid economic development, demand for dairy products has been soaring, though from a low base: as yet only one in five Vietnamese drinks milk. Last year consumption rose by 20%. There is growing competition from big foreign dairy groups, but at least Vinamilk is in there with a chance.

The privatisation programme has moved in fits and starts. The government has been anxious to avoid accusations of selling state assets too cheaply but has sometimes leant too far the other way. The number of state firms, about 12,000 in the early 1990s, has dropped spectacularly. Counting them is tricky because many are bunched into holding companies, subsidiaries and sub-subsidiaries, but Vu Tien Loc, the chairman of Vietnam's Chamber of Commerce and Industry, says only about 2,000 are still fully owned by the state. By 2010 only some 500 will be left, mainly in sensitive areas such as defence.

Late last year the government launched an initial share offering in Vietcombank, one of five state-owned commercial banks. The rest will follow in the next few years. They are having to shape up quickly against competition from fast-growing privately owned Vietnamese banks and from foreign giants such as HSBC.

Foreign multinationals are now piling into a huge range of projects across the country, from golf courses to microchip factories. America's General Electric is opening its first plant in Vietnam this year, to make turbine components. Stuart Dean, the firm's South-East Asia chief, says the main consideration was the quality of the workforce, not its low cost. But the multinationals also see Vietnam as an attractive market in itself.

Perhaps the most dynamic sector of the economy is made up by the Vietnamese-owned private firms that have come from nowhere since being legally recognised in 2000. The country's latent entrepreneurialism has burst back into life.

This private-sector activity is difficult to measure. Some workers in state enterprises are holding on to their jobs, despite pitiful salaries, waiting to get their share allocations when the firms are equitised. Meanwhile they are running private firms alongside their jobs, sometimes siphoning business from their state employers.

Home-grown sparklers

Until 2000 the country had no stockmarket, but by the end of last year 221 firms (including partly privatised ones) with a combined market capitalisation of $28.7 billion had listed on the Ho Chi Minh market and the smaller one in Hanoi. A slew of recent laws will remove the current bias in favour of state firms, making it easier for private companies to raise capital.

Until a couple of years ago most of these private firms were small, but some of them are growing rapidly. For example, THP, a drinks firm that started out brewing beer, moved into fizzy soft drinks and is now, like Vinamilk, slaking the growing thirst for healthy beverages. The firm's Khong Do (“Zero Degree”) carbonated tea drink is thought to be the country's fastest-growing brand, with sales almost doubling last year. The firm's owner, Tran Qui Thanh, is determined to build THP into a multinational using world-class marketing and distribution techniques.

Back in the mid-1990s, when most private firms were technically illegal, he set up in business with the army, at first using home-made machinery. When the business reached a point where heavy investment was needed, the military men pulled out, says Mr Thanh, leaving him to raise money from friends and relatives. This remains a popular way of financing business in Vietnam. But it has become much easier to raise money from banks: HSBC's boss in Vietnam, Mr Tobin, reckons that businesses with good collateral can now borrow up to $50m without much trouble.

By 2000, as THP was moving from beer to soft drinks, Coca-Cola and Pepsi had entered Vietnam and were using their financial strength to create big distribution chains. THP sought to tap into Pepsi's distribution chain, selling small quantities of an energy drink called Number 1. As sales gradually rose, distributors insisted on continuing to carry it despite Pepsi's objections. Mr Thanh says that when he got started in the 1990s, he had to spend a lot of time persuading the authorities just to let him do business. Now, he says, the government sees people like him as “soldiers in an economic war”.

Some businesses are taking advantage of the growth of an aspiring class in Vietnam's cities. One such is VTI, which owns a chain of fancy coffee shops, Highlands Coffee, as well as a smaller chain selling genuine Nike sportsgear. The firm's owner, David Thai, fled Vietnam with his family in the 1970s but returned when things were beginning to look up. He says that when his smartly furnished Highlands Coffee shops first opened, selling drinks for up to $4, people could not believe that his targets were Vietnamese customers, not expats. Mr Thai thinks affluent urban consumers are looking for something—whether it is a tall latte or a pair of expensive trainers—that says “I have arrived”.

Some Vietnamese firms now hope to compete internationally. The largest, PetroVietnam, is already exploring for and producing oil in several countries, from Algeria to Cuba. Its contribution to the government is equal to 30% of the state budget, so its continued success is vital to Vietnam's future. Vinamotor, a state-run maker of cars (among other things) is building a bus factory in Dominica and two lorry factories and an asphalt works in Venezuela, but as yet Vietnam is not a mass producer of cars.

A mountain still to climb

Private firms are bounding ahead despite bureaucracy, corruption, poor regulation, a feeble legal system and a creaking infrastructure. In the World Bank's latest annual league table measuring the ease of doing business in different countries, Vietnam does not come out well, though overall it now beats Indonesia, the Philippines and India. Compiling tax returns in Vietnam takes longer than in almost any other country, according to the World Bank. Likewise, the corruption index produced by Transparency International, a not-for-profit organisation, shows Vietnam as a poor performer, but better than some of its local competitors. At least it is an orderly sort of place, so businesses may be able to find out whom they must bribe, how much and how often, which makes it somewhat more bearable if still costly.

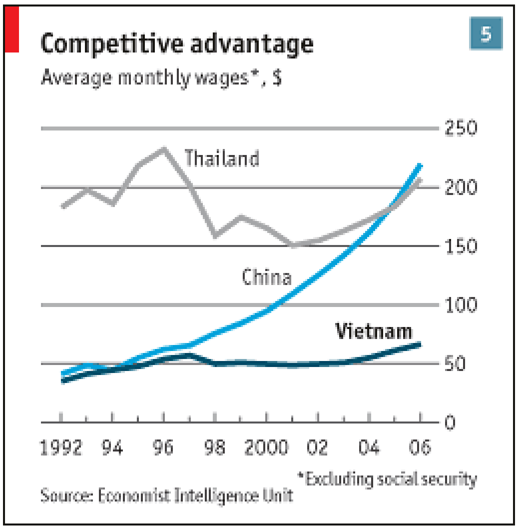
AP

Investors excited by opportunities in Vietnam should note that standards of corporate governance are pitiful. Even stockmarket-boosters admit that companies' accounts are largely works of fiction. The World Bank says that there is no legal mechanism to hold rogue directors to account and it is extremely hard to enforce contracts. Sin Foong Wong of the World Bank's private-sector arm, the International Finance Corporation, explains that with the stockmarket booming until recently, it was so easy to raise money that firms were under little pressure to improve standards of governance. Now that the equity bubble has deflated, companies may have to do more to coax investors back. Tung Kim Nguyen, a director of Indochina Capital, an investment bank, says the lack of openness in companies and financial markets still makes it hard to find good firms to invest in, despite the obvious potential for growth. Office space and industrial land is scarce.

An aspirational latte, please

Against all that, Vietnam's labour costs have remained pretty low as China's have taken off, despite increasing numbers of wildcat strikes over pay claims. Highly skilled people are hard to find, but that is true everywhere. At least, say foreign firms, their Vietnamese staff are hard-working, disciplined and eager to learn.

Plenty could still go wrong. Vietnam's novice regulators have not yet had to prove themselves in an Enron or Northern Rock disaster, but the time may come. Who knows if some of the country's shining corporate stars, and some of the fast-growing private banks, have taken shortcuts on the way up? Many firms have been dabbling in property and shares, but with the stockmarket now sliding and talk of the property bubble bursting, some could be sitting on big, undisclosed losses. The country's bankruptcy laws are rudimentary and if there were a high-profile failure the authorities might well mishandle it.



Political risk is significant, even though there is little prospect of a change in the ruling party. Regulators sometimes overreact, criminalising civil disputes or suddenly coming down hard on fairly widespread fiddles. In 2006 staff at ABN AMRO, a Dutch bank, were put under house arrest after the firm was blamed for foreign-exchange losses it had run up (though a subsequent report by government inspectors held the central bank responsible). In 2005 the French-Vietnamese boss of Dong Nam, an importer of mobile phones that competed with a big part-state-owned firm, was sentenced to 20 years in jail for dodging $6m of taxes.

Many foreign investors and multinationals have paid large sums for stakes in firms that are still controlled by the government, with foreign ownership remaining restricted. The government talks of continuing liberalisation but there is no guarantee that this will happen. Some investors may find that their fingers get burned.

As a big exporter, Vietnam would be hurt by a global downturn, but its economy is already fairly diversified and becoming more so. Besides exporting a wide variety of farm produce, it is also a sizeable producer of furniture, clothes, shoes and crude oil. Exports of electronic components and software will rise as factories built with foreign money come on stream. Dominic Scriven of Dragon Capital, an investment firm, sees five driving forces that will propel Vietnam's economy in the next ten years: the China-plus-one strategy for multinational manufacturers; producing and processing food and drink; non-food agriculture (eg, rubber); tourism; and the “intellectual economy”. To demonstrate Vietnam's potential in this last area, Mr Scriven notes that the country won all eight gold medals for chess at the 2005 South-East Asian Games.

The biggest risk facing Vietnamese firms may be that they will end up like many in the rest of South-East Asia: bloated, over-diversified, too dependent on their contacts with those in power and not especially good at what they do. Such “crony capitalist” firms in neighbouring countries may struggle as globalisation advances and stronger, more focused firms encroach on their turf.

So far the signs in Vietnam are good: instead of handing monopolies to cronies, the government is encouraging free competition. A few promising Vietnamese firms are trying to professionalise their management, business plans and marketing to reach for world-class status. THP's Mr Thanh dreams of creating a renowned Vietnamese brand on a par with Japan's Sony one day. But it won't be soon.

The return of the boat people

Apr 24th 2008
From The Economist print edition

Former refugees bring back skills and money

THEY cast themselves on the seas in leaky boats in their hundreds of thousands, so desperate to escape penury and oppression that they would risk being drowned, murdered or shot. There was a time when the word "Vietnamese" was almost invariably followed by "boat people". They began arriving soon after the fall of Saigon in 1975. By 1994 liberalisation in Vietnam was lifting the economy, the flood of refugees had become a trickle and the UN had found a way to resettle or repatriate them.

Millions of others left Vietnam by less risky means during and after the country's independence wars of the mid-20th century. But in recent years many of the estimated 2.7m *Viet kieu* (overseas Vietnamese) have begun trickling back, encouraged by the government. The initiative to welcome them back comes from the very top. In January Nong Duc Manh, the general secretary of the Communist Party, said Vietnam's recent economic achievements were partly due to the efforts of "patriotic" returned exiles.

RAPHO

In unhappier days

Among them is Philip Owings, who fled on a boat when he was eight, ending up in a refugee camp separated from his family. He was adopted by Americans and grew up on the West Coast but is now back as assistant manager at one of Hanoi's top hotels. Mr Owings first returned seven years ago as an exchange student and admits it was a culture shock. Now, with a promising career, he has married a Vietnamese and feels settled. Locals still charge him "foreigners' prices" when they hear his accent, but he says it is not hard to be accepted by his compatriots.

David Thai, a coffee-shop entrepreneur (see article), was born in Saigon to a family that had fled the north after the war to expel the French, left on a boat in 1975 and ended, via the Philippines and Vanuatu, in America. He describes growing up aspiring to be American but later longing to seek out his Vietnamese identity. Returning as a student, like Mr Owings, he was met with polite curiosity, not the hostility he had feared.

Tracy Le, a Vietnamese-Australian from Melbourne with an accent straight out of "Neighbours", visited the country her parents left in the 1970s for a holiday, but accepted a job at Indochina Capital, a Ho Chi Minh City firm that is channelling foreign investors' cash into Vietnamese businesses. She reckons she is typical of younger exiles: planning only a brief visit, they end up staying. But most of them see no need to tear up their foreign passports yet. The government plans to offer them dual citizenship.

Vietnam does not have a super-rich diaspora like China's. Last year the Vietnamese government recorded business investment by *Viet kieu* of only $89m, though they are probably spending much more on personal consumption, from cars to property. A much more important contribution are the remittances—officially $5.5 billion last year, but probably more—that Vietnamese emigrants send home to their families.

The large number of well-educated professionals returning from the rich world are just what Vietnam needs to relieve its shortage of higher-level skills. Ms Le's boss at Indochina Capital, Tung Kim Nguyen, a Vietnamese-American, reckons there is a bigger wave to come as older exiles return to spend their final years back in their homeland. They will not need jobs, but will bring their pension money with them and build retirement homes in the suburbs.

Might the waves of returning exiles who have got used to living in democracies also help transform Vietnam's politics? So far most of them are keeping their heads down. One says that although they are officially welcomed, he is sure that they are closely watched by the authorities to see if they belong to exiled pro-democracy groups (some of which are indeed sending in *Viet kieu*). Yet in the longer term they are bound to become a force for political liberalisation.

From basket case to rice basket

Apr 24th 2008
From The Economist print edition

Can the agricultural miracle last?

NOTHING illustrates Vietnam's remarkable turnaround better than its farm sector. In the mid-1980s, with farm collectivisation going horribly wrong, the country was on the brink of famine. But by the early 2000s Brazil, the world's largest exporter of robusta coffee, was astounded to find itself being overtaken by a country most of its people had barely heard of. More recently, Vietnam has surpassed India as the world's second-largest rice exporter after Thailand.

Reuters

Watching the profits grow

Vietnam's farmers have become important competitors in all sorts of agricultural produce, from nuts to peppers to rubber. They are even selling tea to the Indians. Its fishermen and foresters are also doing well by feeding the world's growing demand for seafood and timber (though not always sustainably). Vietnam's exports of farm, forest and fisheries produce rose by 21% last year, to $12.5 billion, and further growth is expected.

The success of Vietnam's economic transformation is often measured by the falling share of agriculture in the country's gross domestic product. Industry and services are indeed growing even faster than farming and absorbing its surplus labour. Agriculture, forestry and fisheries now provide barely half of all jobs in Vietnam, compared with over two-thirds only ten years ago. Even so, over 70% of the population still live in the countryside, so a successful rural economy will remain the key to maintaining Vietnam's impressive progress on cutting poverty.

Vietnam's agricultural miracle was achieved by a simple but powerful device: the invisible hand of Adam Smith's free market. Having snatched the land from the people in the disastrous collectivisation, the government gave it back to them (evenly shared among households) on longish leases, starting in the late 1980s. This was similar to China's agricultural reforms around the same time, which also greatly reduced poverty by giving small farmers exclusive rights to work their plots. However, in China the freehold of the land remains vested in local collectives, without a clear indication of who represents them. That allows unscrupulous local officials to sell land to developers from under the feet of farmers. In Vietnam the freehold remains with the central government, so such problems are rarer.

Creating large-scale and equitable land ownership—one of the biggest privatisations yet seen—was one of several steps that freed Vietnamese farmers to conquer the world, explains Vo Tri Thanh of the Central Institute for Economic Management in Hanoi. Another was the stabilisation of the economy in the mid-1980s, bringing inflation down from a hair-raising 1,000% or so. A third was the gradual liberalisation of farm prices. Also important, says Mr Thanh, was Vietnam's increasingly open trade policy.

None of this would have happened had Vietnam not had fertile soil and plentiful rains, with large tracts of coastal plain and river deltas ideal for cultivation. But Vietnam's experience shows that economics is as important as geography for agricultural success. One reason why the remaining pockets of poverty in Vietnam are concentrated in the forested highlands is that the market-based agricultural reforms have been slowest to reach those parts. Some of the country's diverse ethnic minorities depend on foraging in the forests and until fairly recently were regarded by the authorities as wreckers rather than guardians of the woodlands. In truth, say academics, plantation owners migrating from the lowlands have been more of a threat to the trees. The solution, being worked on rather slowly, is to give minority communities patches of forest to tend.

Stick with it

Until now the government and the international agencies advising it wanted farmers to move away from bulk commodities and diversify their crops faster. However, says Mr Chhibber, the World Bank's boss in Vietnam, the recent recovery in commodity food prices should prompt a rethink. Perhaps, with the world crying out for just the sort of staples Vietnam is good at growing, it should stick to them. In February President Gloria Macapagal Arroyo of the Philippines, which is struggling to feed its growing population, publicly asked Vietnam to guarantee its supplies of rice. The Vietnamese government is beginning to worry that diversification may have gone too far, with many rice growers in the Mekong Delta having switched to shrimp farming.

In Ba village, in the central province of Quang Ngai, Bach Ngoc Re, a 61-year-old farmer, is more than happy to go on growing rice on the two small plots that he and his wife were given in the land redistribution. Standing barefoot in one of them, measuring just 810 square metres (8,700 square feet), he says he now comfortably gets 200kg of rice in each of the year's two harvests. And the price has been rising for four years. He got 3,000 dong a kilo for his last crop, against 2,500 dong a year earlier.

The local officials who managed the land redistribution tried to share out the best and worst land fairly, so families often got several tiny scattered plots. Mr Re is lucky to have only two; in northern Vietnam the average family has six or seven. More recent land reforms have aimed to consolidate holdings to improve productivity: Vietnam's output may be impressive, but it takes far more input of labour than in neighbouring countries (see chart 6).

Scott Robertson, an economist at Dragon Capital, says that time will solve the problem, because the children of today's farmers are getting an education and will find better jobs off the land. Moreover, many leases will come up for renewal in the next decade—Mr Re has only nine years left on his—which will provide opportunities for consolidation. A further leap in productivity will be needed just to maintain the current output because industrialisation is chewing up farmland on the edges of towns.

Vietnam's free-trade policies have increasingly exposed farmers to volatile world markets. They might enjoy more bargaining power if they clubbed together in producer co-operatives, says Atsuko Toda of the UN's International Fund for Agricultural Development, but farmers are resisting the idea because it reminds them of the failed collectivisation of the past.

Farmers in Vietnam are vulnerable not only to price swings but also to floods, drought and other natural disasters, yet attempts by insurance companies to create policies for them have not got far. Their best insurance policy might be to diversify into non-farm cottage industries. Vietnam's government, like Thailand's, has been promoting "craft villages" specialising in homespun products. The country's booming tourism industry (see article) could bring hordes of rich customers eager to buy such things.

Vietnamese farmers have concentrated so hard on quantity that they may be neglecting growing concerns about food quality and hygiene among rich-country consumers. Mr Nguyen of Indochina Capital, which is keen on investing in agribusiness, predicts that Vietnamese agriculture will soon face a "quality-control crunch". Consumer pressure will force farmers and food processors to make it easier to trace foodstuffs and use fertilisers and antibiotics more sparingly.

In the longer term, however, another, far bigger risk looms. Climate change could devastate Vietnam. Most of its farmland and population are near sea level and there is evidence that the sea is rising already. The latest forecast by the UN climate-change panel envisages a 28-58cm rise in the sea along Vietnam's coast by 2100 but does not rule out a 100cm rise. Vietnamese scientists say that would submerge one-eighth of Vietnam's land area, as well as making extreme (and crop-destroying) weather more common.

Revealing its hidden charm

Apr 24th 2008
From The Economist print edition

Tourism could do a lot of good if Vietnam handles it properly

IT IS not so long since Vietnam was a place to escape from at all costs, not one that people would pay to visit. However, like its industry, agriculture and diplomacy, its tourism is now firmly on the map. In the latest annual survey by the World Travel and Tourism Council (WTTC), it moved up from sixth to fourth place in the league table of the world's fastest-growing destinations. Last year it had 4.2m foreign visitors, 16% more than in 2006. After the backpackers and a few nostalgic American war veterans, tourists with fatter wallets are now arriving in large numbers.

A fair chunk of the foreign investment currently pouring into Vietnam is going into new hotels, resorts and golf courses, many aiming at the top end of the market. InterContinental, an American hotel operator, has just opened its first project in the country, an opulent waterside hotel on Hanoi's West Lake. Jon Nielsen, its general manager, says the firm has four other big projects under way and its development team is scouring the country for more. Rival international hotel companies such as France's Accor have similarly big plans. The expansion cannot come soon enough: the best hotels in Hanoi and Ho Chi Minh City can get booked up weeks in advance and room rates have soared.

You name it, we've got it

Along the central coast, from Danang's China Beach (a famous rest spot for American troops in the Vietnam war) down to the historic city of Hoi An, new beach resorts are rising from the sands. Besides endless stretches of as yet untouched beach, the country has a wealth of attractions for all tastes and pockets: the ruins of ancient civilisations such as the vanished Hindu Champa culture; quaint tribal villages with wooden stilt-houses, colourful festivals and craftwork; historic cities and churches from French colonial times; war sites like the Cu Chi tunnels and the grisly but informative museum on the site of the My Lai massacre; and enormous potential for ecotourism, with many new species still being discovered in the remote forested mountains.

Vietnam is fortunate in being surrounded by populous countries with rising spending power. China is the biggest source of visitors, sending over half a million of them last year. South Korea, Taiwan and Japan sent hundreds of thousands. The budget for the government's worldwide marketing campaign, “Vietnam: the Hidden Charm”, is tiny compared with the sums spent plugging “Amazing Thailand” and “Incredible India”. But Amir Girgis, the WTTC's South-East Asia analyst, is not worried: “In tourism, word of mouth is the strongest advertising.”

Madison Quakers

A sustainable crop

Vietnam's best bet, says Mr Girgis, is to concentrate its resources on “sustainability”—in particular, ensuring that the country's most picturesque sites are protected. This is already a worry, for example, on Mount Fansipan, Indochina's highest peak, where uncontrolled tourism is degrading the top of the mountain. The same is true in Hanoi, where the city authorities are battling to stop new housing and retail developments encroaching on historic buildings in the old quarter.

For a young country that needs to find jobs for over a million people joining the workforce each year, tourism is the perfect industry because it creates employment at all levels, from master chef to bottle-washer. Patrick Basset of Accor says his firm's 15 hotels in Vietnam already employ 3,000 people and he expects the staff to double in the next three years. The Vietnamese hunger for learning will be an asset: almost 95% of the staff that the InterContinental's Mr Nielsen recruited speak some English. In a previous assignment, in Bangkok, he was lucky to get 50%.

One often overlooked benefit of tourism is the boost it can give to exports. Many of the richer visitors to Vietnam come looking for contemporary art. Mr Nielsen expects to spend much of his time organising gallery tours for his guests. The great thing for small exporters is that their customers seek them out, pay on the spot and often make the shipping arrangements themselves.

Having discovered tourism's hidden charms, every town and province in Vietnam now wants a share. In rural Quang Ngai province the authorities are seeking hoteliers to develop its golden, palm-fringed and empty beaches, and dream of building spa resorts around the hot-water springs that bubble up through the province's rice paddies. Some developments sound rather ambitious, such as the film studio cum holiday village that is being planned for one of Quang Ngai's beaches. In Vietnam's false dawn of the mid-1990s, when investors rushed in, then out again as economic reform stalled, several giant tourism projects were abandoned. The same thing could happen again.

Vietnam's tourism may be booming, but its transport infrastructure is nowhere near ready for the onslaught. Ho Chi Minh City's new airport terminal has only just opened but is already close to capacity. Quang Ngai is a three-hour drive from the nearest airport along a dangerous single-lane highway. Partly because of poor transport, the World Economic Forum's latest travel and tourism competitiveness index ranks Vietnam a lowly 96th out of 130 countries. But if properly managed, the rush of tourists could provide the revenue for improvements to road, rail and air transport that would benefit the whole economy.

We want to be your friend

Apr 24th 2008
From The Economist print edition

And yours, and yours, and yours too: foreign policy made simple

HAVING won what they called the “American war”, chased off a brief Chinese incursion and reunited the country, Vietnam's Communist leaders chose a diplomatic policy that turned out to be a disaster: cosying up to Moscow. As the party's general secretary told the 1982 congress, “the unity and comprehensive co-operation with the Soviet Union are always the cornerstone of the foreign policy of our party and country.” Even before Soviet communism's collapse, a near-starving Vietnam had begun switching from collectivisation to a market economy—and rethinking its foreign policy. By the 1986 party congress, a new policy, “to be friends with all people”, was under discussion.

EPA

And how was reunification for you, Mrs Merkel?

That line has been followed with increasing conviction ever since, as Vietnam has emerged from isolation to become a significant presence on the diplomatic stage. In 1993 an American-led boycott on aid was eased. Two years later relations between the governments in Washington, DC, and Hanoi were restored and Vietnam joined the Association of South-East Asian Nations (ASEAN).

Since then the country's diplomacy, like its economy, has come on in leaps and bounds. In 2006 it won admission to the World Trade Organisation and hosted Presidents George Bush, Vladimir Putin and Hu Jintao, among other world leaders, at the Asia-Pacific (APEC) summit in Hanoi. A senior Western diplomat says Vietnam had a wobbly start to its year of chairing APEC but, as people often say about the Vietnamese, they learned extremely quickly and by the time of the summit they had become a supremely smooth diplomatic team. This year Vietnam won a temporary seat on the United Nations Security Council, causing its views to be more assiduously courted than perhaps at any time in the country's history.

Vietnam's soaring trade and large population are making it an increasingly important commercial partner. Hardly a week passes without a foreign leader visiting Hanoi. Vietnamese leaders, for their part, find themselves welcomed in the world's capitals. In March the prime minister, Nguyen Tan Dung, toured Europe, getting warm receptions from his German, British and Irish counterparts.

Vietnam has carefully rebuilt relations with both America and China. It is probably more enthusiastic about its friendship with America, which has more to offer it in terms of foreign investment and expertise. In November two American warships became the first to visit northern Vietnam in peacetime. Even before the restoration of relations Vietnam was co-operating with America in searching for the remains of soldiers missing in action.

There is still friction over paying compensation to the many Vietnamese said to be suffering the ill-effects of Agent Orange, a defoliant that America and its allies used in the Vietnam war. In February Vietnam criticised the rejection by an American federal appeals court of a case that Vietnamese sufferers brought against the chemical's makers. But Vietnam's leaders are not allowing such disputes to hold up progress in other areas.

Vietnam has also learned to tread carefully in its relations with China, a serial invader and dominator down the centuries. Again, it does not want to let old enmities get in the way of doing business. But there is still a dispute over who owns the Spratlys and the Paracels (to the Vietnamese, the Truong Sa and the Hoang Sa), two potentially hydrocarbon-rich archipelagoes in the South China Sea which other nearby countries also claim. In 1988 China and Vietnam fought a brief naval battle off the Spratlys. Last December Vietnamese students held “spontaneous” anti-Chinese protests in Hanoi, after reports that China was creating a new municipality incorporating the islands.

Even so, the exchanges between Hanoi and Beijing have remained restrained and the two are trying to finish the long-delayed job of demarcating their land borders by the end of this year. Despite heavy investment by Taiwanese firms in Vietnam, the Hanoi government continues to appease the government in Beijing by firmly supporting a “one China” policy. With their own country having so recently been reunited, the Vietnamese feel obliged to support a close neighbour that harbours similar ambitions.

Finding its voice

Fellow ASEAN members, on whose territory Vietnam had encroached during its centuries-long southwards expansion from the Red River delta, long saw it as an expansionist “Prussia of Indochina”, but these days relations are relatively smooth. Vietnam's main interest in ASEAN is pushing the block to hurry up and become a proper single market. Vietnamese firms are investing in Cambodia and Laos, with which relations have greatly improved, but Cambodia's opposition remains virulently anti-Vietnamese.

Vietnam's bosses recently bade a fond farewell to Fidel Castro, their fellow revolutionary, when he resigned as Cuba's leader, but the days when Vietnam clung to the diminishing band of communist countries are long gone. “It's amazing how they really do convince you that they are your best friend,” says a Western diplomat in Hanoi. It used to be hard to get the Vietnamese government to comment on anything of more than parochial concern, but now it has become an enthusiastic issuer of statements on world affairs, especially since joining the Security Council.

Vietnam has tried to keep to a multilateralist line, for instance urging compliance with UN resolutions in various African conflicts, but it is now discovering that in diplomacy it is not possible both to be important and to stay friends with everyone. Sitting on the Security Council involves making controversial choices. In February Vietnam came down against recognising Kosovo's independence, disappointing Western powers which had tried to persuade it that the Balkans were a special case and recognition would not set a precedent for separatism elsewhere.

Shortly afterwards the vote on sanctions against Iran over its nuclear programme set another test for Vietnam's diplomacy. The Vietnamese insisted on changing the wording, but they then joined Russia, China, America, Britain and France in supporting the resolution, whereas Indonesia, a fellow ASEAN member that also currently holds a Security Council seat, abstained.

Vietnam's overriding interest in its foreign relations has been to accelerate its economic development. The main point of having “friends everywhere” is to seek their investment and their technical help. Another goal is seeking and maintaining trade access for Vietnamese farm produce and manufactures. Vo Tri Thanh, a trade economist in Hanoi, argues that Vietnam could play a positive role in the Doha round of world trade talks as a fairly poor country that nevertheless strongly supports freer trade. In the absence of progress on the Doha round, Vietnam is seeking bilateral and regional trade deals. It has started talking to Japan about a free-trade agreement, and diplomats say there is a chance that the limited trade-liberalisation pacts struck with America could develop into a full-blown free-trade deal.

Some ASEAN members, such as the Philippines, would like the block to develop a stronger security aspect. The Filipino military commander, General Hermogenes Esperon, recently called on neighbouring countries to join his country's annual war games with America. But Vietnam is likely to remain wary about such things. Its leaders still remember being vilified over their intervention in Cambodia in the 1970s, even though it brought down the ghastly Pol Pot regime. Still, with a big well-disciplined army and no domestic conflicts, Vietnam would make a good provider of UN blue helmets. In March its ambassador to the UN announced that Vietnam was preparing for some involvement in peacekeeping missions.

Vietnam could play a broader role in some of the world's destitute and conflict-ridden zones. Having emerged from war and penury to become peaceful, stable and increasingly prosperous, Vietnam sets an example for others. Because it is clearly not in the pocket of a former colonial power, it is more likely to be listened to. It is already chairing the Security Council's committee on Sierra Leone and is helping the country with its agriculture.

Vietnam is also edging towards becoming an important intermediary between North Korea (with which it has unusually good relations) and the outside world. In October the Communist Party's Mr Manh got the red-carpet treatment from North Korea's Kim Jong Il on a visit to Pyongyang. America is gently encouraging Vietnam to offer the North Koreans advice on reforming their economy.

Vietnam's leaders, along with its youthful and optimistic population, genuinely seem to have overcome any bitterness about past conflicts and are looking firmly to the future. If the country can show other starving and war-ravaged nations how to escape from their predicament, its seat at the diplomatic top table will be richly deserved.

How long can the party last?

Apr 24th 2008
From The Economist print edition

The Communists have relaxed everything except their grip on politics. Might that be next?

A QUEUE of people hundreds of metres long, mainly Vietnamese but including some foreigners, shuffles into the Ho Chi Minh mausoleum in Hanoi, shepherded by stern guards in white uniforms and peaked caps. They file silently into a room where the revolutionary leader's embalmed corpse lies in a well-lit glass case with a guard at each corner, his long, grey-white beard extending over his black tunic. The guards usher small children on to a ramp alongside the glass case. This gives them the best view of the illustrious Uncle Ho, the visionary nation-builder with the "exemplary morals" that they will be instructed to revere from kindergarten to university.

Dreamt up by a Marxist-Leninist chartered accountant

Vietnam's leaders have embraced the parlance of the market economy and the trendy development-speak of the UN agencies, but when they talk politics they revert to cold-war communist language as embalmed and stiff as the old man's body. Party meetings still pass declarations that "the working class is the leading class of the revolution" and the party itself is "the vanguard class in the socialist building". As for those "hostile forces" who question the party's right to a monopoly on power, they are "terrorists", however mildly they may advocate change. The huge propaganda posters in the rice paddies along the main highways read as if they were devised by Marxist-Leninist chartered accountants. "Organisations and individuals paying tax is a factor to push national economic growth and the national budget!", declares one.

Since the start of the *doi moi* reforms 22 years ago a great deal has changed in Vietnam, almost all for the better. Most significantly, its people have been given sweeping economic freedoms, whether in setting up their own business or choosing between a growing variety of providers of goods and services. They can travel abroad and are positively encouraged to send their children to foreign universities, and increasingly they can afford to do both. Many are able to receive foreign television and radio and look at foreign websites.

Yet even as the government tolerates a wide range of outside influences, it still tries to keep control over all things political and cultural. Foreign universities are being encouraged to build campuses in Vietnam, yet a recent official circular stipulates that they have to teach "Ho Chi Minh ideology" to all Vietnamese students. Bookshops are full of the translated works of authors from Mother Teresa to Jackie Collins, yet under a 2004 regulation actors are banned from dyeing their hair or even appearing bareheaded on stage.

It remains difficult to know what to make of all this because the internal workings of the Communist Party's leadership remain as mysterious as ever. In China, Hu Jintao is clearly the paramount leader, combining the jobs of president, party chief and head of the party's military commission. Vietnam, by contrast, is led by a rather self-effacing triumvirate: Nong Duc Manh, the party's general secretary;

Nguyen Minh Triet, the president; and Nguyen Tan Dung, the prime minister. No individual is praised except the late Uncle Ho. The national assembly and the party's central committee are forces in their own right, not rubber stamps.

Some foreign diplomats and experts in Hanoi think it is Mr Dung who is driving the continued economic liberalisation; others reckon the party leadership as a whole is pushing reform against a reluctant government bureaucracy. What is clear is that in terms of personal freedom, cautious liberalisers seem to have the upper hand. Vietnam's regime can be less nasty than those of some of the country's democratic neighbours: anti-government activists and clerics are in little danger of being murdered, as in the Philippines, and orderly protests are more readily tolerated than in uptight Singapore.

The Communist Party has all but given up religious persecution, though Buddhist monks, Catholic priests and Cao Dai followers are still arrested for political activities. Indeed, senior officials now praise the positive contribution of religion to society, though they still insist on vetting senior clerical appointments.

Ethnic minorities are being treated better too. In the 1990s, as Vietnam's agriculture was expanding, little was done to stop lowland ethnic Vietnamese grabbing land traditionally farmed by minorities in the mountains. Big protests in 2001-04 in Central Highlands province forced the government to provide more protection for the rights of minorities, some of which still live in poverty. Provision of electricity and water to minority villages has been stepped up. An American academic who has made a close study of Vietnam's minorities says they have an easier time than in most other South-East Asian countries.

Newspapers and broadcasters are still tightly controlled by the party, but reasoned criticism of government policy—for instance, the recent handling of inflation—is now permitted. A recent study of the Vietnamese press by Catherine McKinley, a former Dow Jones correspondent, found many upstanding young editors and reporters who want the country to be better-run. Quite senior people may face corruption probes and often prosecutions.

Clean up

Party leaders are well aware that public disgust with official corruption is the biggest threat to their continued rule. However, as Ms McKinley's study notes, it is not clear whether the latitude given to journalists really amounts to the “no-holds-barred corruption crackdown” that senior leaders like to talk about. For example, one editor was told to stop reporting a scandal in the transport ministry if it “reached beyond ministerial level”. The authorities have allowed the media to expose corruption since the start of *doi moi*, and two decades later Vietnamese public life is not obviously cleaner. Still, in its reporting of stories embarrassing to important people and its comments on policy, Vietnam's press is no less free than its neutered Singaporean counterpart.

The legal system is unreliable and chaotic, and even the cautious World Bank expresses worries about a tendency to “criminalise” civil disputes. This often seems to happen in cases where one side is a state enterprise. America's State Department, in its annual human-rights report published in March, expressed worries at the Communist Party's continuing influence over the selection of judges, but then it says much the same about Singapore and its ruling People's Action Party. The government insists that there are no political prisoners in its jails, though some detained dissidents have done nothing more than call for democracy. But China has a worse record of using the courts as political tools and treats its dissidents more harshly.

Magnum

Uncle Ho is still watching

A diplomat with experience of China and Vietnam notes two other key differences. In China the revolutionaries are mostly dead, and party chiefs are cut off from reality by layers of sycophantic bureaucrats. Vietnam's revolutionaries, who were young men in the 1950s-70s wars, are still around—in government, business, academia and elsewhere. Continuing social links between these “war heroes” may make the leadership more sensitive to ordinary people's concerns. If so, rising tensions such as those that caused China's Tiananmen Square protests may be dealt with and detected sooner—and a Chinese-style crackdown would also be less likely.

So where is the party heading? As the state becomes less important as an employer and a provider of goods and services, the party also matters a little less, particularly in the cities—until someone runs afoul of it. It is still feared, despite the relative mildness of the regime. Vietnamese are reluctant to talk about it, even if they are living abroad, in case it hurts their families back home. They worry that if they say the wrong thing they will be jailed on trumped-up charges. One Vietnamese businessman interviewed for this report visibly squirmed when asked about the party cells that remain mandatory for all businesses, even private ones. Another affected not to know about this requirement, then remembered when pressed.

As Vietnam continues to open its economy to business and meet the UN's poverty-reducing Millennium Development Goals, both foreign investors and the multilateral agencies like to play down the iron fist that still inhabits the velvet glove. There are no reliable polls on what the Vietnamese public thinks of its country's politics. Perhaps the nearest is a recent poll by TNS and its affiliates, which found Vietnam's youthful population to be the most optimistic in Asia. That seems to support the view that the public, however grudgingly, gives the party credit for reuniting and rebuilding the country and, more recently, improving living standards. But continuing corruption and rising inequality may be using up this goodwill. A recent World Bank report notes that big business can afford the bribes but most individuals have trouble finding the money.

An economic setback that reverses the recent rise in living standards might make people turn against the party. Or, as they get used to economic freedom and learn more about richer, freer countries, they may hanker after more political freedom too. Unlike, say, the Thais, the Vietnamese are not at all deferential. If, one day, they get too fed up with the party, they may lose their fears and ditch it.

A flicker of democracy

A university student says her generation is “interested in doing business, not politics” and does not have much respect for those in power. Like some of the returned exiles interviewed for this report, she feels that the government will have to open up to change one day. A Catholic priest says many people want change now but, having suffered so much in war, they have become peace lovers and are “making do” with the current government.

In the past two years there have been glimmers of a pro-democracy movement. As the Communist Party held its tenth congress in April 2006, a new dissident group, Bloc 8406, emerged with a “manifesto on freedom and democracy”. An exile-backed political party, Viet Tan, is sending members back home to recruit members and agitate for change, and several have been detained or expelled. When Hoang Minh Chinh, the leader of another group, the Democratic Party of Vietnam (DPV) and one of the founders of Bloc 8406, died in February, hundreds of activists turned up for his funeral in Hanoi.

Having spent so much effort making Vietnam respectable, the leadership might find it hard to know how to react if the nascent pro-democracy movement gathered momentum. Would it tell the army to shoot its own people if confronted with the equivalent of China's Tiananmen Square, and would the army obey? So far all the party has done is to allow some debate about whether it should drop the obsolete “C”-word from its name and become the Labour Party or some such.

David Koh, a Vietnam expert at Singapore's Institute for South-East Asian studies, says some degree of political liberalisation is being considered, though perhaps not as much as the West would like. Mr Koh thinks there might be change from within once it is seen to have become inevitable. He quotes a Vietnamese saying to the effect that “it is time to jump when the water reaches the feet.”

The party, which claims almost 3.2m members, still recruits from among the high schools' brightest pupils, a student says, but those who join are resented by their classmates for the privileges they get. It may be that most of them are motivated by a desire to make useful political connections for their own advancement rather than a wish to serve the nation. The danger is that Vietnam may end up like some other South-East Asian countries, stuck firmly in the middle-income trap it is trying so hard to avoid, and suffering from predatory elites, weak institutions, crony capitalism and a pseudo-democracy.

Fortunately it has two much more attractive models close by. In both Taiwan and South Korea, one-party dictatorships in the late 1980s embarked on gradual political liberalisation. These countries' politics can be rather rough-edged, but their democratic transition helped them develop a high-prosperity, high-tech economy of just the sort that Vietnam wants.

One possible route is already becoming clear. Elections for national-assembly seats are often contested, sometimes by people who are not party members. Allowing more non-party candidates to run would be a good first step.

As the Vietnamese leadership is finding, running a vibrant market economy is much harder than running a stunted command economy. The question is whether it can accept that a market economy works best when there is a free market in politics too, as in almost all the world's rich countries. Exiled dissidents are often pessimists, but Ngai Nguyen, the DPV's spokesman in America, sees some hopeful signs. Some members inside Vietnam have identified themselves as belonging to his party without being arrested so far, he says. He even thinks there may be a chance of the DPV being allowed to run candidates in the 2011 national-assembly elections.

This may all seem rather optimistic now. But if the Communist Party, which inherited a war-wracked, divided and impoverished nation, could deliver a united, prosperous and, at long last, free and democratic Vietnam, it would surely be rewarded at the ballot-box.

Sources and acknowledgments

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Business and human rights

Beyond the “genocide Olympics”

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Imaginechina

As the row over corporate sponsorship of the Beijing Olympics shows, firms are increasingly expected to take a lead in promoting human rights

BY THE standards of any previous boss of Coca-Cola, Neville Isdell is remarkably enlightened. Under his leadership, the soft-drinks giant has adopted a strategy of extending access to water supplies in the developing world, especially in Africa, where Mr Isdell spent 26 years. It is an active member of several organisations committed to promoting human rights, including the United Nations Global Compact and the Business Leaders Initiative on Human Rights. Even so, Mr Isdell now finds himself accused by human-rights activists of “complicity” with one of the world's most prominent human-rights abusers—the government of China.

No doubt sponsoring this summer's Beijing Olympics once seemed like a good idea to Coca-Cola and a gaggle of other big companies such as General Electric, Johnson & Johnson, Kodak, McDonald's and Samsung. The marketing benefits of the Olympics are believed to be huge, which is why Coca-Cola has been doing it continuously for 80 years, as Mr Isdell pointed out in a recent article in the *Financial Times*.

Yet by branding the Beijing games the “genocide Olympics”, after the Chinese government turned a blind eye to the Sudanese government's atrocities in Darfur, human-rights activists are threatening to lay waste to the $1 billion or so that sponsors have paid—and turn what they hoped would be an association with a joyous celebration of sport into a tricky exercise in reputational damage limitation. Firms that criticise China publicly over human rights risk antagonising not just its government, but also its people—a billion-odd potential customers. Recent protests in China against Carrefour, a French retailer, in response to pro-Tibet demonstrations in France, highlight the dangers, and may explain why Mr Isdell's article focused on Coca-Cola's work in Darfur, and said nothing about the recent bloodshed in Tibet.

To be fair, Coca-Cola is doing some good things in Darfur, from providing immediate relief on the ground to meeting other “stakeholders” to try to figure out solutions to the crisis. But is this enough to buy Coca-Cola the right to remain silent in public about China? As Mr Isdell puts it, “rather than make public statements, we have chosen a more direct and, in our view, more effective route to help address the staggering human suffering in Darfur.” Not good enough, retorts Human Rights Watch (HRW), along with other campaigning NGOs. According to Arvind Ganesan, director of HRW's business and human rights programme, the Olympic sponsors' “silence on abuses in the run-up to the Beijing games makes their claims to support human rights especially disingenuous.”

It is tempting to dismiss this as yet another example of the old divide between political activists who favour protest and business realists who favour “constructive engagement”, which has cropped up dozens of times—not least during the debate over sanctions against apartheid South Africa. Business leaders still like to point out that Nelson Mandela later thanked some of the multinational firms that defied sanctions and stayed in South Africa to do what they could to help bring about change. Peter Mandelson, the European Union's trade commissioner, argues that antagonising the Chinese government over the Olympics would drive the final nail into the coffin of the Doha trade negotiations.

Yet in many ways the battle over the Olympics paints a false picture of the current relationship between business and human-rights activists. What is striking today is how often activists, big firms and governments are now in agreement about the importance of human rights, and are working together to advance them.

This new consensus is reflected by the lack of serious opposition to a new report by John Ruggie, the UN Special Representative on Human Rights, which proposes a new framework that states clearly that firms have a responsibility actively to respect human rights. If this is adopted by the Human Rights Council in June, as seems likely, it will be the first time that the UN human-rights machinery has taken a substantive position on companies' responsibilities. Among other things, Mr Ruggie says his report makes it clear that firms should include human rights in their due diligence, and that rich-country agencies that provide finance to firms operating or exporting overseas, especially in conflict zones, should be required to take human rights into account.

Mr Ruggie hopes that the result will be greater clarity over the duties of firms and governments, and a better balance between protecting the legitimate interests of investors with the needs of host states to discharge their human-rights obligations. In recent years many deals have been struck between multinationals and governments that agree to indemnify the company against the cost of any legal changes in the country—including those that improve human rights. Such contracts have been enforced by independent arbitrators, and can be a disincentive to governments to improve human rights. One European mining firm is seeking compensation from South Africa's government because it is required to hire a certain number of black workers under the country's “black economic empowerment” law.

The adoption of a UN standard is likely to trigger a new spurt of activity in defining best practice, much of it involving collaboration between businesses and NGOs. This will build on much good work in recent years, which began after Royal Dutch Shell, an oil giant, was embroiled in the scandal surrounding the death of Ken Saro-Wiwa, a Nigerian activist and writer, in 1995. Among other things, a campaign by Global Witness, an NGO, resulted in the Kimberley Process, which attempts to keep “conflict diamonds” off the market; another collaboration led to a code of practice requiring firms to oversee the human-rights compliance of those responsible for ensuring their security in dangerous places, including government soldiers.

The Global Compact, which obliges signatories to uphold certain basic standards, has also been extremely popular. Over 3,000 companies have signed up, including several in China, where a summit was held in 2005. Though weakly policed, the compact has some teeth: 335 firms were struck off its list of signatories in 2006.

Chinese firms are slowly becoming more sensitive to human rights, says Sir Mark Moody-Stuart, chairman of Anglo American, a mining giant, and a veteran advocate of businesses promoting human rights. Rather than criticism, says Sir Mark, Chinese bosses respond far better to patient explanations that older multinationals became supporters of human rights because they learnt to their cost that when those rights are ignored, bad things happen. “I tell them that there is now a whole culture of multi-stakeholder designed initiatives that are helpful, and can stop you getting into trouble in five years' time,” he says. Despite the Chinese government's many failings, its promotion of the “harmonious society” is taken seriously by Chinese bosses, says Sir Mark. Invoke this term, he says, and they get the message.

Economist.com BUSINESS

Samsung

Lee bows out

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A giant South Korean conglomerate is shaken by corruption charges

AP

SOUTH KOREA'S judiciary is notoriously easy on white-collar crime. The higher up the errant corporate chieftain, the more likely his prison sentence will be suspended for the good of the nation's economy—especially if he hands over a portion of his wealth to charity. On April 17th, when prosecutors charged Lee Kun-hee, the chairman of Samsung, with tax evasion and breach of trust, but cleared him of allegations of bribery, the outcome was widely seen as a whitewash. “Many Koreans must feel they have just watched a farce,” declared the *Chosun Daily*, a conservative newspaper.

Yet a penalty may be extracted after all. On April 22nd Mr Lee shocked the country by resigning, on live television, from the conglomerate his father founded 70 years ago and which he led for two decades. “I sincerely apologise to the people, and I will take legal and moral responsibility,” said the 66-year-old patriarch, before bowing deeply in apology.

Samsung is South Korea's largest company. During Mr Lee's reign, the sales of the group—comprising 59 firms that span shipbuilding, sports teams and shopping malls, along with its famed consumer-electronics division—grew from around $17 billion to almost $160 billion, equivalent to 18% of the country's GDP. Samsung successfully weathered the Asian financial crisis of the late 1990s. But its corporate governance did not keep step with its international prominence. As well as being a symbol of South Korea's stunning industrialisation, the company came to represent the unhealthy dominance of the *chaebol*, or powerful family-run conglomerate.

Samsung has long been accused of corrupt practices. Mr Lee was even convicted of bribing politicians in the 1990s, though he avoided penalties. Last year Mr Lee was accused by Kim Yong-chul, Samsung's former chief lawyer, of controlling a huge slush fund, from which he was alleged to have doled out bribes. An independent counsel, Cho Joon-woong, was called in by the National Assembly to investigate, rather than leaving matters to the usual prosecutor's office.

As a result of the investigation Mr Lee has now been charged with evading 112.8 billion won ($113m) in taxes and hiding 4.5 trillion won in some 1,200 accounts under various names. He was also charged with arranging for Samsung subsidiaries to sell shares to his son, Lee Jae-yong, at artificially low prices to transfer control to his heir. Mr Cho said that there was not enough evidence to support the accusations of bribery, and that in any event the statute of limitations had expired. Nine other Samsung officials were also charged. But nobody was arrested, Mr Cho said, in part because the investigators were worried about harming the economy.

Alongside Mr Lee's resignation, and those of other managers, Samsung announced a series of reforms. It will donate a large sum to “a good cause”, undo some labyrinthine cross-shareholdings, and (to assuage concerns about its dominance) will not enter the retail-banking market when it is opened up later this year. Samsung's strategic planning office, which concocted a variety of dodgy schemes, will be closed. The younger Mr Lee, who was not charged, resigned as a senior executive at Samsung Electronics and will move to a different role in the group, based abroad.

By South Korean standards these are drastic moves, and may represent an acknowledgment that corporate-governance reforms are needed. But sceptics wonder whether the changes are merely cosmetic. The Lee family will still be Samsung's largest shareholder, and many of its loyal lieutenants remain in senior positions. Although Mr Lee technically faces a life sentence, few believe he will spend time in jail. He will not be replaced as chairman, and it is assumed that his son will return home after a couple of years to take up the post, once public anger has dissipated. That could prove to be the real test of how much things have changed.

Carmaking in China

Collision ahead

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A shake-out looms in China's booming but overcrowded car market

THE fierce competition for attention at Beijing's motor show says something about the increasing brutality of China's auto market, now the second-biggest in the world. On nearly every stand, young women in eight-inch heels pose and pout beside the cars. At regular intervals, deafening rock music erupts and the crowd rushes to ogle skimpily clad dancers strutting their stuff. The loudest music and tallest girls are invariably to be found where the domestic manufacturers are exhibiting their wares. That is partly because some of them have products that are rather unexciting, so they need all the help they can get. But mostly it is because China's carmakers are locked in a vicious battle to emerge as genuine competitors to the foreign brands that, in partnership with local firms, dominate the market.

Last year 6.2m passenger vehicles were sold in China, around 20% more than in 2006, and there is no sign of the growth flagging. Around 4% of the population owns a car, compared with 60% in Europe and 80% in America. Nick Reilly, the head of Asia Pacific operations for General Motors (GM), America's biggest carmaker, predicts that the Chinese market will overtake America's within the decade. With sales accelerating at such a rate, surely there is enough growth to sustain China's throng of manufacturers? In fact, competition is intensifying. According to J.D. Power, a market-research firm, China's home-grown brands increased their market share only from 27.7% to 28.7% last year.

The local carmakers face a series of difficulties. The first is that foreign carmakers, which operate in China through joint ventures with local partners, are well dug in. Volkswagen has a 17% market share and GM has 10% (it sells more Buicks in China than in America). Second, Chinese buyers are extremely status-conscious. They like large, well-specified cars and can increasingly afford to pay for them. Last year sales of luxury cars were up by 35% and those of sport-utility vehicles by 50%, but sales of the small cars offered mainly by the domestic manufacturers rose by only 4%.

What makes it still tougher for the local carmakers is that sales are spread among a plethora of firms. Carlos Ghosn, the boss of Nissan, which after a late start five years ago has grabbed a 5% share of the Chinese market, reckons there are over 100 domestic vehicle-makers jostling for position.

Only Chery, by far the biggest local maker (it sold 489,000 vehicles last year, 120,000 of them for export), has anything approaching viable volume. Geely, the second biggest, sold just 220,000 units last year. But both have big plans. Chery has just increased its capacity to 700,000 vehicles a year and is striving to meet safety standards that will allow it to sell cars in Europe and America. Geely claims to have five new platforms under development and says it will launch an astonishing 42 new models by 2015. Both will struggle to achieve their goals, but American and Japanese executives regard them as the two most competitive Chinese firms.

One consequence of the overcrowding is that average prices are falling: they went down by 5.7% last year. The Chinese brands, forced to trade on value, are priced about 30% below the equivalent foreign brands, putting pressure on the whole market. A shake-out among the smaller firms seems inevitable. In December the government prompted SAIC, a big Chinese carmaker, to take over Nanjing Automobile, an ailing smaller company, which may be a sign of things to come. Mr Ghosn says it would be “very abnormal if at least one, if not more than one” of the Chinese carmakers did not emerge as a global player. The question that nobody can answer—and few are even asking—is how quickly that will happen, and how much blood will be spilt on the way.

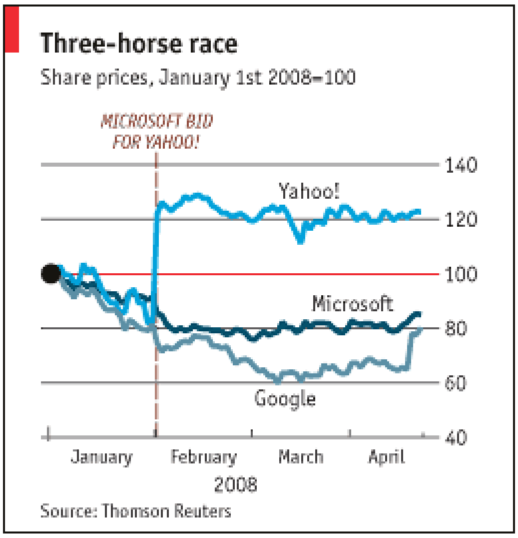
Economist.com BUSINESS

Yahoo! and Microsoft

Still No

Apr 24th 2008 | SAN FRANCISCO
From The Economist print edition

Yahoo!'s Jerry Yang braces himself for Microsoft's hostility



EVEN by the low linguistic standards of earnings calls, Yahoo!'s have long been stultifying. Jerry Yang, the internet company's boss and co-founder, and his top lieutenants read a prepared statement of banalities and clichés in a robotic monotone, then recycle them when pretending to answer questions from Wall Street analysts—until the tedium overwhelms all concerned. This week, however, Mr Yang had listeners hanging on his every word. That is because he spoke four days before Microsoft was due, on April 26th, to carry out its threat to turn its takeover offer for Yahoo! hostile, by launching a proxy battle to oust Mr Yang and the other directors.

Industry-watchers thus dialled into the conference call fully expecting, as one analyst put it, that Yahoo! would have “pulled out all the stops” to make this quarter's results look good. And so it had. Mr Yang has been arguing that Microsoft's offer “substantially undervalues” Yahoo!, so the onus was on him to prove it. In Mr Yang's mind, Yahoo!'s latest numbers did just that. Its revenue, net of the share going to partner websites, was $1.35 billion, 14% more than in the first quarter of last year and slightly above analysts' forecasts. Not thrilling but, as Mr Yang said, “solid”.

It may not make any difference. “I wish Yahoo! all the success with its results but it doesn't affect the value of Yahoo! to Microsoft,” Steve Ballmer, Microsoft's boss, had already told the press before Mr Yang spoke. That value has everything to do with combining Yahoo! and Microsoft, which run a distant second and third in the lucrative business of web search and related advertising, in order to challenge the clear leader, Google.

Google, whose earnings calls tend to be more lively, reported much stronger results than expected on April 17th. ComScore, an online-measurement firm, had estimated that Google's paid clicks—the number of times that web users click on its advertisements—were stagnating in America. As it turned out, “paid-click growth is much higher than has been speculated by third parties,” said Eric Schmidt, Google's chief executive. Mostly that is because Google grew fast outside America; Yahoo!, ominously, did not, and looks much more exposed to America's slowing economy. Google also places “fewer but much better ads,” said Mr Schmidt.

Yahoo! has been trying to catch up with Google for years, but has consistently failed. Now beset by Microsoft, Yahoo! has hinted that it is ready simply to give up and, in effect, piggy-back on Google's superiority in order to boost its own profits and persuade shareholders not to sell to Microsoft. For the past two weeks Yahoo! has been running a limited trial in which it allowed Google to place text advertisements on Yahoo!'s search pages in America. Mr Yang stayed mum as to how it fared, but Susan Decker, his number two, dropped hints that Yahoo! is “exploring options” relating to a Google partnership.

If the intention of such a deal is to make Microsoft increase its offer, it is likely to fail. Microsoft does not want to buy Yahoo! for the profits it can generate with Google's help; it wants Yahoo! to add critical mass to Microsoft's own advertising platform, adCenter, in order to make it competitive.

That leaves Yahoo! with one other option, long discussed but never quite achieved: to strike a deal with Time Warner, a media giant, to combine its web portal, AOL, with Yahoo!. Both websites are big in web-mail, instant messaging and display advertising. But they would never be as nimble as Google is already, or as Microsoft wants to become with Yahoo!. After almost three months of fighting Microsoft's offer, Mr

Yang has yet to propose a genuine alternative. With every passing day he becomes more likely to be forced into a deal—or forced out altogether.

Computer security

Pain in the aaS

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Online crooks adopt the software industry's new service-based model

IT WAS bound to happen. One after another, pieces of software have been moving online in a trend towards “software as a service” (SaaS). You can now manage your e-mail, write documents and edit spreadsheets using online services that run inside a web browser. This month Intuit, the maker of TurboTax, an accounting program, said more Americans filled out their tax returns this year using the online version of its product than the traditional one in a box. But now the trend has reached the darker corners of the software universe. Computer-security firms say criminals have adopted the new model too, and are offering “crimeware as a service” (CaaS).

Once the remit of malicious hackers vying for bragging rights, cybercrime is now about making money. “Criminal attacks are moving upmarket—they're now real businesses,” says Bruce Schneier, a security guru. A few years ago online outlaws started selling e-mail addresses, credit-card numbers and other personal information. Then they began trading information about weaknesses in computer systems and selling software kits to exploit them, complete with technical support and updates. More recently they have taken to setting up and then renting out “botnets”—huge groups of hijacked computers, infected with malicious software, that can be activated remotely to flood a website with bogus requests or send millions of “spam” e-mails.

The new offerings, which go by names such as NeoSploit and 76service, take commercialisation to the next level by allowing criminals to use and pay for such nefarious services via a web browser. Just as companies that adopt SaaS no longer need armies of support technicians, says Yuval Ben-Itzhak of Finjan, a computer-security firm, criminals using CaaS no longer need to be hackers. One web-based service he found even allows customers to specify a target group, such as British lawyers or American doctors. Once enough of their machines have been infected, documents and other data are siphoned out of them.

Renting a website that distributes malware to personal computers costs a few cents per target machine; access to a computer infected with software that grabs personal information (such as credit-card details) can cost $1,000 or more a month. How much money is made through such services is anybody's guess, says Raimund Genes of Trend Micro, another computer-security firm, but he has no doubt that the market will grow. Yet as in the case of benevolent SaaS, there may be a limit to the business model for CaaS. Many companies are wary of SaaS for security reasons: they do not want an outside firm looking after their customer lists, for example. Similarly, some criminals may be reluctant to use CaaS providers, which need to market their services—and hence may attract the attention of the authorities.

One thing seems clear. CaaS is proof that everything and anything computer-related will end up being offered “as a service”. There are now at least a dozen kinds of “aaS”, including data mining (DMaaS), virtualisation (VaaS) and even hardware (HaaS). Perhaps, as with the “.com” suffix, overuse of the term will put people off. A revolt is already brewing. Nicholas Carr, author of “The Big Switch”, a book about how computing power is turning into a utility, vowed recently on his widely read blog that he would no longer use the term “aaS” at all. “Join me in this crusade,” he wrote: “Death to aaS!”

Lawyers in India

Legally barred

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Will India open up to foreign lawyers?

IF YOU want to find the legal chiefs of big defence companies such as Boeing or BAE Systems, a good place to start looking is the foyer of the Taj Mahal Hotel in Delhi. The in-house legal bosses are in town to appoint law firms to support their push into the Indian market, as the government updates its military equipment. They have to go in person, rather than sending their usual lawyers, because of the 1961 Indian Advocates Act, which prevents foreign firms from practising in the country.

Global law firms see India as one of the last untouched goldmines of the international legal scene. It has a booming economy, a strong legal system and a deep well of talented lawyers. The recent purchase of Jaguar and Land Rover, two luxury car brands, by Tata Group, a giant conglomerate, is the latest sign that Indian companies are ready to do the kind of deals that get international lawyers salivating. For the moment, however, all they can do is crane their necks to get a better look.

But that could change. On April 25th some of India's most distinguished judges were due to hear the final submissions in a High Court case that could be the first step towards opening the country to international competition. The judgment in the dispute between three international law firms and a group of prominent local lawyers will be a deciding factor in how the 47-year-old rule is interpreted.

The disagreement came about in the 1990s, after a British firm, Ashurst, and two American firms, White & Case and Chadbourne & Parke, opened representative offices in the country. The Indian lawyers sued. A heated debate ensued about the merits of opening up the market. India's 15,000 corporate lawyers worry that they are not ready for international competition. Strict rules have stymied growth while other firms around the world have been able to develop into global organisations. Indian firms are not allowed to have more than 20 partners, cannot advertise their services via websites, and cannot even give someone a business card unless it has been specifically requested. The big global firms, with their vast resources and long experience of international transactions, make fearsome opponents.

“Outside India, legal services are a business,” says Rajiv Luthra, founder and managing partner of Luthra & Luthra, one of India's biggest law firms. “Here it is a profession—we still have archaic rules.” He understands the argument for opening up, he says, “but I can't compete with a Clifford Chance. I don't have 6,000 lawyers.” For their part, British firms think it is unfair that Indian lawyers are allowed to set up in Britain—and, with the assistance of their parent firms back home, can then offer services to companies doing business in India that British firms cannot match.

India's business lawyers will be most directly affected by any steps towards liberalisation because the international firms will focus their attention on corporate deals. Litigators, who make up the majority of lawyers in India, are concerned for other reasons. They occupy an important position in Indian society as the guardians of democracy and are associated with independence from the old British Empire. Tampering with that role is seen as a threat to India's sovereignty. “What they don't want is another East India Company,” says Alex Pease, head of the Indian practice at Allen & Overy, a British law firm.

With the drawbridge to India's legal market raised, foreigners have had to dig tunnels beneath the moat. Many British and American firms have set up “virtual” Indian practices based in London, Dubai, Hong Kong or Singapore, or forged “best friends” alliances with leading domestic firms to refer work in and out of India.

Most lawyers agree that it is a question of when, rather than if, the Indian market will be liberalised. But change will happen slowly. Even if the foreign firms win their court case, the Indian lawyers are likely to appeal. And although there is political support for the legal market to be opened up to international competition, there is an election looming. Doug Peel of White & Case's India practice, based in Singapore, says political will is “wavering” as a result.

The consensus among Indian lawyers in favour of liberalisation is that the market should be opened gradually, to give Indian firms more chance to compete against the foreigners. For this to happen, the strict rules regulating domestic firms would need to be relaxed, perhaps over five years. “We'll learn a lot from the international profession, and maybe we'll teach them a bit too, but before we open we must correct all these ills,” says Mr Luthra.

International firms will have to sit tight for the time being, like expectant children waiting for Disney World to open. Meanwhile their clients will have to keep racking up the air miles to India.

Antitrust in Europe

Race to confess

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From The Economist print edition

Why it pays to be at the front of the queue

WHEN Britain's Office of Fair Trading (OFT) announced in 2005 that it was investigating cartels in the construction industry, its clemency hotline was so swamped by would-be whistleblowers that it had to close the confessional window a full year before its report was published earlier this month. Britain was first to import into Europe the American idea of immunity or clemency for whistleblowers, but now the practice has spread, thanks largely to the European Competition Network, a scheme through which European Union trustbusters co-ordinate action, pool experience and share best practice.

Spain has just set up its own antitrust confessional, which opened on the last day of February. One law firm was so determined to win immunity for its client that lawyers slept in a car for several nights in order to be first through the door when the office opened.

There are strong incentives to make sure you are at the front of the queue. The stakes are high: so far the biggest fine imposed by the EU for price-fixing has been €479m ($630m), but that could easily increase in future, given the European Commission's growing enthusiasm for clamping down on offenders. The first company to confess to membership of a cartel can be granted total immunity, provided it has dropped out of the scheme and produces material evidence that can secure convictions. That is what happened to Virgin Atlantic after it told the OFT about co-ordinating fuel surcharges for passengers with British Airways: BA paid a heavy fine, whereas Virgin got off.

Runners-up in the confessional race can also be rewarded with a reduction in the fine of between 30% and 50% for the second company to provide “significant added value” to an inquiry. Third place gets only a 20-30% reduction at best, and the rest of the field earn smaller rewards for their tardier virtue.

But the legal penalties do not always flow one way. This week it emerged that the OFT has had to pay damages of £100,000 ($200,000) to Morrisons, a supermarket chain, for defamation. In a press release about provisional findings of an inquiry into milk and dairy products, issued in September 2007, the OFT wrongly suggested that the company may have broken competition rules over milk, cheese and butter in 2002 and 2003. In fact the OFT's only allegation against Morrisons related solely to liquid milk, and referred only to 2002. The OFT confessed that it had erred, and apologised.

Face value

Fuld of experience

Apr 24th 2008
From The Economist print edition

By learning from past mistakes, Dick Fuld has brought Lehman Brothers back from the brink

Landov

ELEVATION to chief executive is usually a cause for celebration. But when Dick Fuld was picked in 1993 to run a newly independent Lehman Brothers, as it emerged from a difficult decade as part of American Express, he had a panic attack so severe that he stopped breathing for 45 seconds. After this inauspicious start, Mr Fuld soon got the hang of things. The firm he inherited had $3 billion in revenues, mostly in the United States. Last year it clocked up a record $19.3 billion, half of that from outside the Americas, making Mr Fuld not only the longest-serving Wall Street boss but also one of its most admired.

Recently Mr Fuld has had ample cause for another sudden shortage of breath. Heavily exposed to subprime mortgages and other assets that have nosedived amid the credit crisis, Lehman, the fourth-largest Wall Street investment bank, has had a torrid few months. March was especially traumatic. No sooner had Bear Stearns been driven into the arms of JPMorgan Chase for a pittance than the short-sellers turned on Lehman, widely considered the next most vulnerable bulge-bracket securities firm because of its relatively small size and its heavy involvement in mortgage-backed securities. Its share price fell by half in a single day. But Lehman was no Bear: it relied far less on fickle overnight funding from wholesale markets, or on clients' cash balances to fund its own trading positions. Nor was the work-obsessed Mr Fuld much like the boss of Bear, Jimmy Cayne, who spent more time playing bridge than playing the markets.

That Lehman did not implode is thanks, in part, to the Federal Reserve's decision to lend directly to securities firms for the first time. But equally important were Lehman's smart counter-attacking moves. Quickly, it called key clients and trading partners, giving them unprecedented detail on its ample liquidity position. Rating agencies and the media were wooed, too. Bear, by contrast, had unconvincingly insisted all was well without providing evidence. To calm nerves further, Lehman rushed to raise $4 billion in fresh capital that it did not technically need (and made sure everyone knew it had drawn $11 billion of orders). It was, says Sam Hayes of Harvard Business School, like the scene from “It's a Wonderful Life” in which panicking depositors are calmed after the bank manager, played by James Stewart, takes out his own honeymoon money and cheerily offers to return funds to anyone who wants out.

Whether or not he was inspired by the 1946 classic, Mr Fuld certainly applied lessons learned in the three global financial crises he had already faced as boss, in 1994 (mortgages), 1998 (currencies and more) and 2001 (the internet meltdown). Lehman had a near-death experience in 1998, after Mr Fuld ignored nasty rumours, vainly hoping they would fizzle out, and Lehman's liquidity all but dried up. “We put our heads down. I was wrong,” he says. But it taught Lehman to jump on speculation immediately and “get the story out” this time around, he says.

A former trading-desk star, once dubbed “The Digital Mind Trader” by awed colleagues, Mr Fuld thrives in choppy credit markets. Direct knowledge of their dangers has equipped him with experience that some of his erstwhile peers—think of Citigroup's Chuck Prince and Merrill Lynch's Stan O'Neill—lacked. So last summer he had no need to take lessons from (not always forthright) line managers. Stephen Schwarzman, the chief executive of Blackstone, a private-equity group, and a former Lehman man, has praised his “sixth sense” of when markets are turning.

Accordingly, despite its big presence in mortgages, Lehman has suffered only modest damage, thanks partly to $6 billion of gains from hedges placed as early as 2006. It managed a net profit of $489m in the first quarter, while Merrill Lynch and Citi lost a combined $7.1 billion (though the results were buoyed by clever accounting, sceptics argue). “Smart risk management is never putting yourself in a position where you can't live to fight another day,” says Mr Fuld.

A strong alignment of incentives also played a part: Lehman claims to pay a higher percentage of compensation in stock than other Wall Street firms. A five-year lock-in cuts the temptation to do reckless deals that could blow up later. Even so, couldn't Lehman have done even better by trading aggressively on the housing slump, as Goldman Sachs did? Perhaps, says Mr Fuld, but his priority was to “protect mother”, not to speculate. He has long had less taste than his peers for “proprietary” trading of the firm's own capital—a strategy that is now losing popularity.

Purring along

Mr Fuld says he is “thrilled” with Lehman's response to the latest crisis. It now has almost $200 billion of liquidity and collateral that can be readily turned into cash. That may just be enough to see off the shorts. But it is not out of the woods yet. It is still sitting on $87 billion of troubled, hard-to-sell assets, many of which could continue to lose value. Mr Fuld will be particularly annoyed at having “substituted capital for wits” in building up a $55 billion book of leveraged loans, says Peter Solomon, a former Lehman vice-chairman (and a big admirer). “He got talked into following the crowd in an area he wasn't so familiar with. Left to his own devices, he wouldn't have got in so deep.” For Wall Street as a whole, lower leverage and the need to service more capital will usher in an era of lower profitability. It could wipe five percentage points off returns on equity for years, reckon analysts at Bank of America.

Mr Fuld, 62 this week, shows no sign of wanting to leave. Unnervingly intense, he detests quitters. What is more, he fancies that Lehman's tight culture and deep client relationships will propel it through rough seas. And if another crisis of confidence strikes, who else would the board want at the helm? It was once said that Lehman under Dick Fuld was a cat with 19 lives. They have not all been used up yet.

Correction: Oil and gas in Peru

Apr 24th 2008
From The Economist print edition

The photograph that appeared alongside our article on oil and gas in Peru ("A warm welcome", April 12th 2008) showed Alejandro Toledo, Peru's former president, rather than his successor Alan García, who was named in the story. Our apologies.

Economist.com OPINION

Fiat

Rebirth of a carmaker

Apr 24th 2008 | TURIN
From The Economist print edition

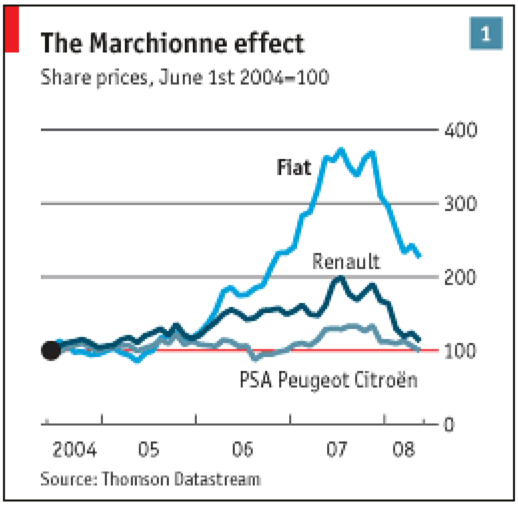
With some fine new cars and financial figures to match, Fiat has staged an astonishing recovery

AP

THE dominating image at last month's Geneva motor show, Europe's most glamorous, was a giant mock-up of a tiny car: the new Fiat 500. It was Fiat's way of celebrating the crowning of its achingly fashionable baby as European car of the year, ahead of a strong field and with one of the biggest winning margins in the competition's history. At the same show, Fiat launched the first all-new Lancia for four years and revealed the Alfa Romeo 8C Spider, judged by some to be the most beautiful car in the world today.

Underpinning the display of confidence in Geneva is a remarkable industrial and financial turnaround that is likely to be pored over in business schools for years. On April 24th Fiat Group, which as well as car marques includes Iveco, a truckmaker, and CNH, a producer of agricultural and construction equipment, reported a trading profit for the first quarter of €766m ($1.1 billion), 29% more than a year earlier and beating expectations. In the whole year it is aiming for €3.4 billion-3.6 billion.

Good news is no longer unusual: despite a stumble in recent months, the share price has outpaced its closest rivals over the past three years (see chart 1). In 2007 Fiat Group made a record trading profit of €3.2 billion, 66% more than in 2006, while eliminating its net industrial debt. The progress of the once loss-making car business was even more dramatic. Fiat Group Automobiles, which comprises Fiat, Alfa and Lancia, raised its trading profit from €291m to €803m. Ferrari and Maserati chipped in a further €290m. By 2010, Fiat (with joint ventures) expects to make 3.5m vehicles.

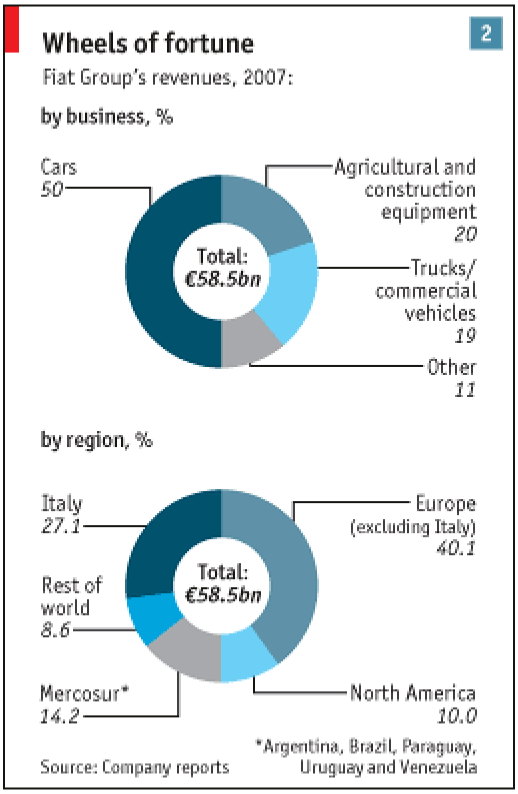


This is a far cry from the business Sergio Marchionne walked into in June 2004 when he agreed, at the urging of the Agnelli family, Fiat's dominant shareholder, to take on the job of reviving the company's fortunes. Attempts to trim costs were under way and the tiny new Panda had hinted at a much-needed return to form. But otherwise the picture, especially in cars, was grim.

Held back by either ageing or unappealing models, car production was running at about 70% of its annual capacity of 2.5m. Fiat's Italian factories were notoriously inflexible thanks to intransigent unions and a lack of investment. The group's net debt had risen to €4.4 billion and cash was flowing out at an alarming rate. And a €3 billion convertible bond would fall due in 15 months.

The banks were eventually repaid with the help of a rights issue in late 2005—which would have been impossible to get away without signs of improvement. Before that, however, the issue of Fiat's put option with General Motors had to be resolved. Both troubled companies were looking for a way out of an ill-starred partnership, but Fiat was insisting that to extinguish the option, which gave the group the right to sell its car business to GM, the American firm must pay for the value it represented. But as Fiat's plight worsened, so did the claim to any value in the put.

In turning to Mr Marchionne, a corporate troubleshooter who at the time was running SGS, a big Swiss inspection and certification firm in which they had an interest, the Agnellis knew that it was their last roll of the dice with Fiat. A shambling bear of a man with unruly grey locks and a penchant for shapeless black sweaters and straight talk, he is the antithesis of the archetypal smooth Italian executive. In part that may be because Mr Marchionne, though Italian-born, grew up in Canada, where he qualified as both a lawyer and an accountant. His approach to business is decidedly Anglo-Saxon, as is his frequent use of expletives. He demands complete openness, fast communication, accountability; he abhors corporate politics and hierarchy.



So poor was the state of Fiat's carmaking business, which represents half the group's turnover (see chart 2), that Mr Marchionne felt he had no choice but to act quickly. He says: “The single most important thing was to dismantle the organisational structure of Fiat. We tore it apart in 60 days, removing a large number of leaders who had been there for a long time and who represented an operating style that lay outside any proper understanding of market dynamics. We flattened out the structure and gave some relatively young people, in terms of both age and experience, a huge amount of scope.”

A divorce to celebrate

Mr Marchionne's next task was to extract Fiat from its five-year partnership with GM on the best terms possible. It had not worked, for several reasons. Sharing platforms, engines and purchasing had not produced the expected economies of scale and Fiat's ability to act independently had been gradually eroded. Mr Marchionne says that since 2000 Fiat had been like a rabbit frozen in the headlamps. He says: “Every time I saw GM it felt like going out on a date and not having been invited. But we had a contract, an exchange of a promise for a promise. I was ready to uphold my side of the promise.”

In the event, GM was prepared to write Mr Marchionne a cheque for $2 billion to escape being forced to own Fiat's declining car business. The couple split up on the eve of St Valentine's Day 2005. Mr Marchionne celebrated on the plane back to Italy. He recalls: “When I signed the divorce, I had the sense that we had got our independence back, but there was also the knowledge that we'd lost our only parachute, which was alarming for some people given how much money we were losing. But I now had the chance to run this business and run it properly. If I had walked away without monetising the GM put, I would not have had the credibility for the next phase. But more importantly, with $2 billion you can make a lot of small cars.”

The most pressing priority was Fiat, which accounted for more than 80% of the 1.6m cars the company was selling each year. The Panda had shown that Fiat could still build great small cars, but the rest of the range was in desperate need of renewal. The first car to be delivered on Mr Marchionne's watch was the Grande Punto, a bigger than usual B-segment hatchback (a class that includes the Renault Clio and GM's Corsa). Built, ironically, on the Corsa's platform, the car came to market at the end of 2005. Stylish and with a feeling of quality rare in a Fiat, the car was an instant success. Sales are likely to reach a million later this year.

Next, in 2007, came the Bravo, a replacement for the Stilo in the C-segment (with the Volkswagen Golf, Peugeot 308 and GM's Astra). Although the Bravo breaks little new technical ground, it brings together two elements that Mr Marchionne and his team of “kids”, as he calls them, identified as critical three years ago. One is the importance of styling. The Bravo is as crisply handsome as the Stilo was stodgy. Mr Marchionne observes: “We used to make too many ugly cars. We really pushed the envelope on that one. We thought we had the right to do whatever we wanted. It was arrogance.”

The era of the brilliant but hideous Fiat Multipla and the bug-eyed Lancia Thesis (aiming at the refinement of the Mercedes S-Class, it was a €1.2 billion flop) is over. Mr Marchionne has brought all the group's styling divisions together in a strikingly restored building in Turin's Mirafiori complex, known simply as Officina 83, and put them under the overall charge of Lorenzo Ramaciotti, a former design chief of Pininfarina, a renowned car-styling house.

Mr Ramaciotti says that at Fiat design had ceased to be seen as a core competence of the manufacturing process, but that has now changed. Referring to Lancia, Mr Ramaciotti argues that you can't be successful if your cars look odd. But nor can Fiat be as conservative as the German premium marques. “Italian brands must be extrovert and innovative,” he says. “We have more freedom, but more risk as well.” The reason that the new 500 is so important is that it has given Fiat's designers the self-confidence to believe they can compete with the best in the world.

The second way in which the Bravo symbolises the new Fiat is the extraordinary speed of its development. The company's urgent need for fresh products and its limited resources forced it to take risks. Harald Wester, Fiat's German head of engineering, claims that the key has been to “trust your virtual world”. In designing both the Bravo and the 500, Fiat chose to rely entirely on computer simulations rather than to take the lengthy traditional route of making a series of prototypes. Mr Wester says: “With virtual engineering, we can test and validate hundreds of different solutions and configurations—much more than we possibly could with prototypes.” Fiat, he says, did not even make a prototype for crash testing.

As a result, Fiat was able to cut the time from “design freeze” to production on the Bravo and the 500 to just 18 months, from 26 months on the Stilo. Mr Marchionne says that cutting time to market is a critical source of competitive advantage for “the guys running the brand who are mostly not engineers, but are people with a very strong consumer product bias”. Because they don't have to forecast the market so far ahead, they have a better chance of getting the car right when it is launched.

Another advantage that Fiat is determined to exploit is its cars' relative fuel efficiency. When new European Union rules on carbon-dioxide emissions come into force (supposedly in 2012, but subject to intense political negotiation), Fiat expects its fleet to have lower average emissions than any competitor. That is a reflection partly of the fact that the company makes lots of light small cars and few big heavy ones, but also of the strength of its power-train technology. It has already become the first carmaker to offer diesel engines that comply with so-called Euro 5 fuel standards. And it has another trick up its sleeve: a new generation of petrol engines, called Multiair.

Using a patented Fiat technology that does away with camshafts and valve gear, the first engine to be launched next year will be an 80bhp twin-cylinder turbo 900cc engine that will emit only 69g of CO_2 per kilometre—just over half the proposed EU target for 2012. It will also cost far less to make than an equivalent four-cylinder engine. A few years ago Fiat made the mistake of licensing another important innovation, “common rail” diesel technology, to Bosch: being financially weak, it could not afford to keep common rail to itself. This time it will protect its advantage by not licensing Multiair to other manufacturers for at least four years.

One area, however, where Fiat is still playing catch-up with rivals such as VW and PSA Peugeot Citroën is in standardising parts and platforms across model ranges. According to Mr Wester, before 2005, every part in an Alfa Romeo, down to the last screw, could be slightly different from that on a similar-sized Fiat. In 2006 the group was using 19 different platforms. By 2012 it will have just six.

From pandas to spiders

With Fiat now in good shape and with the prospect of a new Panda next year as well as a city car and various spin-offs from the 500, the next task is to revive the group's two underperforming, supposedly “premium” brands, Lancia and Alfa Romeo.

Olivier François, Lancia's chief executive, says that Lancia should stand for Italian style and character, what he calls “elegance with attitude”. The new Delta, which in size is midway between a Golf and bigger, D-segment cars, certainly looks different from anything else on the road without descending into the lethal eccentricity of the recent past. But Mr François may have a difficult job persuading non-Italians to try it precisely because it is a hard car to categorise.

He and Mr Marchionne have, however, had one stroke of luck in fuelling interest in the brand—the inspired decision to hire none other than Carla Bruni, now married to Nicolas Sarkozy, to star in Lancia's advertisements. Mr Marchionne says: “She wasn't sleeping with the French president when we approached her. There was a headline in an Italian newspaper saying Marchionne got there first. Typically Italian, but I'm afraid absolutely false!”

Keystone

Blooming again

Although Mr Marchionne sees Lancia as a purely European marque, he has said that he wants Alfa Romeo to return to America for the first time since the early 1990s. He is looking for a partner, possibly Chrysler, to build the cars there within the next three or four years. Mr Marchionne believes that despite having lost its way many years ago, Alfa is still a world brand that people identify with. He says: “Alfa was known for lighter, faster, more agile vehicles. Who doesn't remember the Duetto in 'The Graduate'? It's just a pity we ended up doing the exact opposite of what Alfa drivers wanted. The 159 is one of the heaviest D-segment cars around. We have to go back and clean that up.”

That is a job for Luca De Meo, a 40-year-old regarded by some inside the firm as a possible heir to Mr Marchionne. Mr De Meo, who is the group's head of marketing as well as Alfa's new chief executive, admits that the expensive, limited-edition 8C Spider is a “halo” model rather than a practical contribution to Alfa's recovery, “a sign of competence and a blueprint” for Alfa's brand values. The cars that will decide Alfa's immediate future are the new MiTo, which is based on the Punto and has been designed to match the driving dynamics of BMW's Mini, and the 149, successor to the compact 147 hatchback.

Mr Marchionne says that the MiTo (the name stands for Milan and Turin), which will be launched this summer, will “come up looking and smelling like Alfas of the future”, but that it is the 149 which will really set the mark for the rest of Alfa's range. He says: “We threw the 149 back for more than 30 months because it wasn't enough of an improvement. It was the smartest thing we've ever done.” Mr Marchionne has set Alfa and Lancia sales targets of 300,000 each in 2010. Last year they managed only 275,000 combined.

In common with most of the world's leading manufacturers, Fiat is expecting a good deal of its growth to come from emerging markets. In 2006, 37% of Fiat's vehicle sales, including vans and joint ventures, came from outside western Europe. By 2010, that is due to increase to 46%. Fiat is the market leader in the rapidly expanding Brazilian market, but apart from a truckmaking joint venture between Iveco and SAIC in China, it is weak in China, India and Russia. Fiat's performance in Russia, which will soon overtake Germany as Europe's biggest car market, has been particularly poor. Although (or perhaps because) Fiat designs were the basis of much of the Soviet car industry, the company sold only 2,000 cars there in 2006. However, the new, booted Fiat Linea, which is manufactured in Turkey and will also be made in China, India and Russia, provides ammunition it has previously lacked.

So far, for all its small-car expertise, Fiat has yet to decide whether to join the low-cost bandwagon that Renault started with the Logan, a basic four-door saloon made in Romania. Mr Marchionne says: “We want to play in low-cost, but not with one of our existing brands—it would destroy all the work of the last four years. We have the technical skills, but the big issue is how deep is the market and how long will it last." Fiat has a joint venture with Tata in India and has recently signed a similar deal with Chery with the intention of launching Alfa and Fiat in China. But Mr Marchionne is wary: "China is damned if you do, damned if you don't. The market is exploding, but it's very competitive. Can you make real money there?"

Although it is occasionally suggested that Mr Marchionne may not stick around long enough to find out the answer to that and other questions (he is vice-chairman of UBS, a troubled Swiss bank, and some shareholders would like him to become chairman), he gives the impression he is there for the long-haul. "We set targets to 2010. Any speculation before that is nonsense," he says. "The first phase of this story finished last year. We'd shown we're not the dumbest people on Earth and that we could make some money. The next phase is the really important one. Can we build a great industrial group or not?"

What does he mean by that? Closing the gap, he explains, with the industry's very best: making cars as well as Toyota, trucks as well as Scania and agricultural equipment as well as John Deere. As for his own role, he says: "The kids are truly devoted to the cause. They are the heart of the success. I've been a conduit for change and that's about it."

UBS

Wealth mismanagement

Apr 24th 2008 | BASEL
From The Economist print edition

The Swiss bank gives a candid account of where it all went wrong

Illustration by Satoshi Kambayashi

OF ALL the banks to be caught up in the implosion of America's subprime market, none has caused more surprise than UBS. How did a Swiss bank whose core business is the staid discipline of wealth management come so spectacularly to lose $38 billion betting on American mortgage-backed assets, battering its core capital and share price (see chart)? “It's breathtaking,” says the head of investment banking at another European bank. Shareholders, who were out in force at the bank's annual meeting in Basel on April 23rd use slightly riper language.

The mystery of how UBS (latest nickname: Used to Be Smart) got into this mess is being resolved. On April 21st the bank released a summary of an internal investigation demanded by the Swiss Federal Banking Commission into the causes of the write-downs. The investigation was conducted by 20 lawyers from UBS, and their 400-page report is now being chewed over by the regulator. Rivals should read it too. Like one of Tolstoy's unhappy families, UBS is unhappy in its own way; but the lessons from its sorry tale apply to all.

The report gives three broad explanations for the bank's woes. The first was the investment-banking arm's preoccupation with growth. Another was the reliance of the control team on flawed measures of risk. A third was the culture of the bank.

Start with those growth plans. Many had assumed that Dillon Read Capital Management (DRCM), a hedge fund set up by UBS in 2005 and closed in 2007, was the primary culprit for the write-downs; in fact, it contributed only 16% of the red ink spilt up to the end of last year. The more pernicious effect of DRCM was to deprive UBS of some of its most experienced people and to distract its senior managers at a time when the investment bank was pursuing helter-skelter expansion.

The push for growth was concentrated in fixed income, where UBS particularly lagged behind its competitors. The goal was to climb the league tables by expanding in areas such as structured credit and commodities. The effect, says the report, was to grow too fast and to emphasise revenue at the expense of risk. The bank's collateralised-debt obligation (CDO) desk in New York responded with aplomb, structuring ever more CDOs of mortgage-backed securities for sale and keeping the supposedly safer tranches of CDOs on its own books as a source of easy profit.

Where revenues could be boosted, they were. The CDO desk concentrated on riskier “mezzanine” CDOs, which generated higher fees but suffered heavier falls in value when markets seized up in August. Cheaper hedging strategies based on buying protection on just a tiny proportion of the bank's “super senior” (least risky) positions tended to win out over more effective but pricier ones, such as insuring the lot. The end result: a desk that numbered just 35-40 people at its peak was responsible for write-downs of around $12 billion in 2007, two-thirds of the total. The other main source of write-downs is almost as staggering: it comprised asset-backed securities bought as part of the bank's liquidity reserve.

If the bank's business leaders overlooked risk, its risk controllers miscalculated it. Confidence in the AAA ratings on CDOs explains the decision to hedge only 2-4% of many super-senior exposures. Those same reassuring ratings also led to more generous treatment of CDO exposures in the bank's value-at-risk (VAR) calculations, a way of working out the maximum loss that it was likely to suffer. Liquidity was simply assumed, enabling assets to be placed in the bank's trading book, where they attracted a lower capital charge. Unforgivably, neither the CDO desk nor their risk handlers made efforts to analyse the quality of underlying assets.

Worst of all, the belief that the bank's hedges were foolproof led to their being netted to zero—the positions simply did not show up in the VAR numbers or in many risk reports. This focus on net rather than gross exposure was not unique to UBS (remember Société Générale?) but its effects were particularly harmful. The investment bank's bosses only realised the depth of the hole they were in in late July 2007; the chairman and chief executive were given their first comprehensive view of the bank's subprime exposures on August 6th, by which time it was too late to do much about it.

Probing questions could and should have revealed the extent of the risks that UBS was taking. Concerns were aired at various times in 2006 and 2007. The bank's top brass was sufficiently attuned to the deterioration in the American housing market to have raised it in September 2006. But the report says that they were fobbed off by assurances from the investment bankers that all was well. Proposals from the bank's treasury in early 2007 to cap the level of the investment bank's illiquid assets also came to nothing.

There is no suggestion that anything untoward was going on. Assurances that risks were being properly managed were given in good faith, says Rupert Jolley, the UBS managing director who led the investigation: “The culture of the bank was to rely upon each other's word.” But there was also a clear incentive to set aside any doubts as long as revenues were rising.

The report only deals with write-downs up to the end of last year. Nonetheless its conclusions implicitly raise awkward questions about the bank's new leaders. If the culture of the bank was at fault, then can an insider such as Peter Kurer, who was confirmed as chairman at the annual meeting, fix it? The report forlornly noted the “reactive” appointment of the investment bank's leadership team to replace those who had left to join DCRM; could the same be said of Mr Kurer, who was plucked from the position of general counsel to replace Marcel Ospel, the former chairman? One large shareholder describes the combination of Mr Kurer and Marcel Rohner, the newish chief executive, as “terrifyingly weak”.

The report also notes that subprime exposure jostled unsuccessfully with several other items on the agenda of group-level meetings (leveraged finance got plenty of attention, in contrast): that will reinforce the doubts of those who think that the bank has become too complicated to manage. Perhaps most worrying of all for battered shareholders is the implication of the investigation's findings for UBS's remaining exposures to the American housing market. There is scant reason to assume that the $16 billion-worth of Alt-A positions still on the balance sheet in March were researched or hedged any more effectively than their subprime sisters.

The rest of the industry can hardly rest easy: Credit Suisse, which has done a lot better than its local rival, still announced a first-quarter loss on April 24th. UBS got more things wrong than most but the traps it fell into will be familiar to its peers. Lots of other investment banks measure their status via league tables and seek to bulk up where they are weakest: Mr Rohner told shareholders that UBS no longer aims to “offer everything to everyone”. Compensation and funding structures that fail to distinguish “alpha”, or skill, from simple carry trades are widespread. The flaws in VAR, and the emphasis on net rather than notional exposures, are also known hazards. The investigation found no evidence to suggest that regulators criticised the way UBS managed its risks. The Swiss banking commission sits in judgment now. It might usefully have done so earlier.

Buttonwood

Swap shop

Apr 24th 2008
From The Economist print edition

Why one part of the credit markets just keeps on growing

NOT all credit products are created equal. The credit-default swap (CDS) market is going from strength to strength, with outstanding volumes rising from an already staggering $34.4 trillion at the end of 2006 to $62.2 trillion at the end of last year. In contrast, issuance of collateralised-debt obligations (CDOs) has fallen dramatically. It was a paltry $11.7 billion in the first quarter, down from a record $186.5 billion in the same period the year before.

At first blush, this might seem surprising. After all, during the boom years for CDOs, the two products were closely intertwined. Traditional CDOs bundled bonds into portfolios and then split those portfolios into tranches, depending on investors' appetite for risk. Some investors wanted a higher return but were willing to take the first hit from bond defaults; other investors were more concerned about the safety of their capital and were willing to accept a lower return.

The idea was so popular that there were not nearly enough corporate bonds to go round. So managers created so-called "synthetic" CDOs, in which the portfolios consisted of credit-default swaps. In a CDS, one party agrees to insure the other in the event of a bond default, in return for a fee (the equivalent of an insurance premium). So in a synthetic CDO, those who owned the riskiest tranches got more of the premium but lost out when defaults occurred.

There is, in theory, no limit on the amount of default swaps that can be created. So when managers wanted to sell a synthetic CDO, they simply created some more CDSs. Now that the CDO market is in the deep freeze, thanks to all those subprime-related losses, that source of demand has dried up.

But there have been plenty of other buyers. After all, it is only natural that, with the likelihood of bond defaults increasing, more investors should want to buy insurance against such events.

More importantly, however, the CDS has become the product of choice for those investing in credit as an asset class. Five to ten years ago, the corporate-bond market was a lot less active; there was little trading in the bonds themselves, which were often locked up in the portfolios of pension funds and insurance companies.

The invention of the CDS increased the liquidity of the market and, crucially, allowed investors to take a "short" position on bonds. Traditionally, you would buy a corporate bond at, say, 95 cents on the dollar. The best you could hope for was that interest would continued to be paid and that the bond would be repaid at par; at worst, the issuer could default and you could conceivably be left with nothing.

Now investors who believe that credit conditions will deteriorate for a particular company can buy a CDS on the bond, whether or not they own it. The value of such an insurance contract will rise if default becomes more likely. The creation of index contracts on the market allows you to bet whether all corporate bonds (or, indeed, different segments of the market such as investment grade and junk bonds) will rise or fall in value.

As a result, the CDS is such a useful instrument for hedge funds and the trading desks of investment banks that it seems inconceivable it will go away. Just as the future on the S&P 500 index is a key part of the equity market, the CDS is central to non-government debt.

But could it be the Achilles heel of the financial markets? One clear problem is counterparty risk; insurance is worth nothing if the insurer cannot pay up. The involvement of Bear Stearns in the credit-derivatives market was one reason why there was a public interest in the firm's rescue; a default might have caused chaos as other counterparties struggled to calculate their risk exposure.

Another problem could emerge if a sudden surge in defaults was accompanied by a further widening in spreads. The market might become illiquid if those that had in effect sold insurance tried to exit their positions.

Market insiders are confident the CDS sector can stand up to the strain. Ashish Shah of Lehman Brothers says that the CDS market showed itself robust in the face of the Enron and WorldCom defaults in 2001 and 2002, and of other bankruptcies since then.

However, many market participants were equally reassuring about the health of the CDO market in early 2007—and look how that turned out. Independent observers will not be really reassured until the system survives the test of a big, juicy default. Given the weakness of the American economy and the scale of the credit crunch, it probably will not be long before that test comes along.

Economist.com FINANCE & ECONOMICS

Interest rates

On second thoughts

Apr 24th 2008
From The Economist print edition

Is America's aggressive monetary easing about to end?

YET another big rate cut: until recently that is exactly what many investors were expecting of the Federal Reserve's next policymaking get-together on April 29th and 30th. After all, bold rate cuts have become the Fed's hallmark. Between late-January and mid-March, America's central bank slashed short-term interest rates by two percentage points, to 2.25%, as it staunchly sought to cushion America's economy from the fallout of the credit crunch. Earlier this month, Fed funds futures indicated that financial markets expected the trend to continue, with at least a quarter-point cut on April 30th and a 50% chance of a half-point move.

No longer. Expectations have shrivelled in recent days, and the price of Fed funds futures now imply that investors see no chance of a half-point cut and an almost 20% likelihood of no cut at all. The reassessment makes sense. Depending on how you measure inflation, real short-term interest rates are already around zero or negative. And although America's economy is still heading downhill, the Fed's calculus about the benefits and risks of even cheaper money is shifting fast.

First, the odds of financial disaster have receded. Although important parts of the credit plumbing, notably the interbank market, are still surprisingly gummed up (see article), spreads on riskier bonds have narrowed. Steep rate cuts were partly meant as a (blunt) tool to forestall financial calamity. More of that insurance now seems unnecessary. Second, America's economy is not deteriorating any faster than the central bankers had expected. According to the minutes of the Fed's last meeting, its staff and several governors believed output would contract in the first half of 2008. The latest statistics do not show an economy in freefall. Industrial production rebounded in March after plunging in February. The pace of existing home sales fell slightly in March, but was stable over the first quarter as a whole.

Thanks to the rate cuts so far, there is a lot of monetary stimulus in the pipeline. And the economy is about to get a fiscal boost, as millions of Americans receive their tax-rebate cheques in the next few weeks. Economists disagree on how much of this money cash-strapped and debt-laden consumers will spend, but it will doubtless provide some benefit.

If the case for more rate cuts is weakening, the risks of cutting further are becoming ever clearer. Commodity prices continue to soar while the dollar plumbs new depths. The oil price hit a new record of almost $120 a barrel on April 22nd. The same day the dollar fell to a new low of $1.60 against the euro after members of the European Central Bank's rate-setting council expressed concern that inflation in the euro zone might not fall sufficiently fast from its 16-year high of 3.6%.

America's central bankers, too, are becoming more worried about inflation, Two members of the Fed's rate-cutting committee, Richard Fisher of the Dallas Fed and Charles Plosser of the Philadelphia Fed, who voted against a big rate cut at the last meeting on March 18th, were already worrying that inflationary expectations could become “unhinged”. Lately even some doves, such as Janet Yellen of the San Francisco Fed, have sounded concerned.

For the moment, America's price picture is murky. “Core” measures of inflation—which exclude food and fuel and which Fed officials tend to prefer—have improved of late, largely because rents are no longer rising as fast as before. And some market measures of inflationary expectations, such as the gap between inflation-indexed Treasury bonds and others, have fallen in recent weeks.

But headline inflation remains high—at 4% in the year to March. And price pressures are building at the wholesale level. Producer prices rose at an annual rate of 9% in the first quarter of the year, while prices of intermediate goods were up by 15%. If the dollar weakens further and commodity prices continue to soar, that pressure will rise. The central bankers' balance of risks is clearly shifting.

Spanish housing

Counting the costa

Apr 24th 2008
From The Economist print edition

Spain's property boom is unwinding too fast for some banks

IN THE midst of a very modern financial crisis, it is easy to be wistful for a good old-fashioned approach to banking. Thanks in large part to stringent regulation, Spanish banks are rightly being applauded for the way they steered clear of toxic credit derivatives and shadowy off-balance-sheet exposures. However, they are finding it much harder to avoid Spain's cramping housing market.

The numbers are increasingly bleak. Completed house sales in Spain dropped by 27% in January compared with a year earlier. The most recent data show building permits for housing falling even more sharply. Housing starts are also plunging.

The pain is already being felt. Two middle-sized banks, Bankinter and Banco Popular, noted in their first-quarter results in the past few days that profits were hit by rising provisions against bad loans and slowing loan growth. Banks are also having to pay more to win deposits because of frozen wholesale markets. Santander and BBVA Group, the biggest banks, will report earnings before the end of April.

Spanish officials like to draw flattering comparisons between their housing slowdown and America's subprime mess. Spanish lending policies were certainly more conservative. Loan-to-value ratios usually did not exceed 80%. Borrowers were even required to provide documentation proving things like income. Spanish banks have not had to shelve riskier product lines in the same way that American and British mortgage lenders have done.

Not every point of comparison is in Spain's favour, however. Housing investment accounted for 10% of Spanish GDP in 2007, compared with 6.5% in America before its housing market tanked. According to Standard & Poor's, a rating agency, the construction industry has created one in every five new jobs in Spain since 2000.

Economic growth estimates are being pared back as fast as you can say “beachfront apartment”. The central bank predicts growth of 2.4% this year, down from its previous forecast of 3.1%. That is still much cheerier than the IMF's prognosis of 1.8%. Further out, uncertainty rules: the latest estimates for 2009 from BBVA have an enormous range, from 0.8% to 2%. The Socialist government, which is much readier to acknowledge the scale of the problem now that last month's election is safely won, announced a €22 billion ($35 billion) fiscal-stimulus package earlier this month.

For most banks, the situation is still perfectly manageable. The absolute volumes of bad loans remain low. The central bank's insistence on higher provisions when times were good is muting the effect of higher delinquencies, for now. The maturity of banks' wholesale liabilities is nicely spread out. Accusations that the European Central Bank is keeping Spanish banks afloat by buying their mortgage securities are rebutted by the Bank of Spain. The central bank says that its banks are less reliant on ECB funding, relative to the size of the economy, than those of other euro-zone countries.

If there is a hard landing, however, Spain's savings banks are likely to be more vulnerable than their commercial counterparts, for two reasons. First, they are less geographically diversified. According to analysts at Citigroup, savings banks on the southern coastline have greatest cause for concern. The sunny regions of Andalucia and Murcia are at particular risk because their property markets have grown so fast. Andalucia accounted for one-fifth of all new mortgages in 2006, for example, but only 14% of total bank lending.

Second, savings banks have higher exposures to wobbling property developers. According to Antonio Ramirez of Keefe, Bruyette & Woods, an investment bank, savings banks have 20-25% of their loan portfolios tied up in construction and real estate, compared with roughly 15-18% for the middle-sized banks and just 8-10% for BBVA and Santander. A period of slower growth looms for most banks; some may face sterner tests.

Japanese finance

My bow is my bond

Apr 24th 2008 | TOKYO
From The Economist print edition

A wicked swindle exploits a soft spot in Japan's business culture

TRUST is the bedrock of business everywhere, but the sources from which it springs are different. In Japan, where reputation and relationships are considered precious, the informal cues are as important as the legalistic ones. Parties take their time discussing deals. Managers meet to exchange *meishi*—their all-important business cards (usually presented with two hands)—and bow respectfully. It helps to establish confidence.

So it was that when a handful of bankers from Lehman Brothers met executives of Marubeni, one of Japan's largest trading houses, at Marubeni's headquarters across from the Imperial Palace last autumn, they never suspected that they were actually being drawn into a massive fraud. The teams had met numerous times to discuss a bridge loan. Reams of paperwork were supplied. In a convoluted agreement, Lehman provided more than $350m in financing to a small firm with ties to Marubeni (and founded by a cousin of the empress of Japan); the trading house guaranteed repayment.

Or did it? When Lehman contacted Marubeni after a payment was missed, Marubeni said that it had no idea what the bank was talking about. Marubeni has claimed that contracts signed and stamped by a Marubeni director were found to be forgeries and the manager whom Lehman's bankers met in Marubeni's offices was an impostor. Marubeni says the two employees who negotiated the deal were fired. Marubeni refuses to repay the money, claiming it is a victim of fraud itself. On March 31st Lehman sued Marubeni for $350m. Since the fraud was uncovered, more alleged victims have surfaced, such as Och-Ziff, an American private-equity firm, which is owed around $80m.

The case pits a company's responsibility to supervise itself against the adequacy of the due diligence that investors must perform. The Japanese legal doctrine of “apparent authority” holds firms accountable for their employees' actions, provided those actions are carried out within the scope of their normal work. Meanwhile, Lehman's checks will come under scrutiny, not least by its own insurance company. Yet also on trial will be Japan's business culture—and what constitutes trust in the world of finance.

In the West, that culture is increasingly one of implicit mistrust. Deals require armies of lawyers and thick paper trails to give parties confidence, in spite of the time and money that such work entails. In Japan, by contrast, companies—some dating back centuries—regularly deal with long-standing partners; reputational concerns, rather than strictly legal ones, are paramount. Business disputes rarely go to trial. The number of corporate lawyers is extremely low compared with other financial centres, and frauds by one party against another are exceedingly rare.

So when Lehman met Marubeni employees at the trading house's offices, there was no reason to suspect anything was amiss. Many consider such a culture to be very beneficial to Japan. Yet the closer that Japan's financial practices are to global standards, the more the informal ties of trust will be replaced with formal legal ones. Something will be gained, but something will be lost as well.

Economics focus

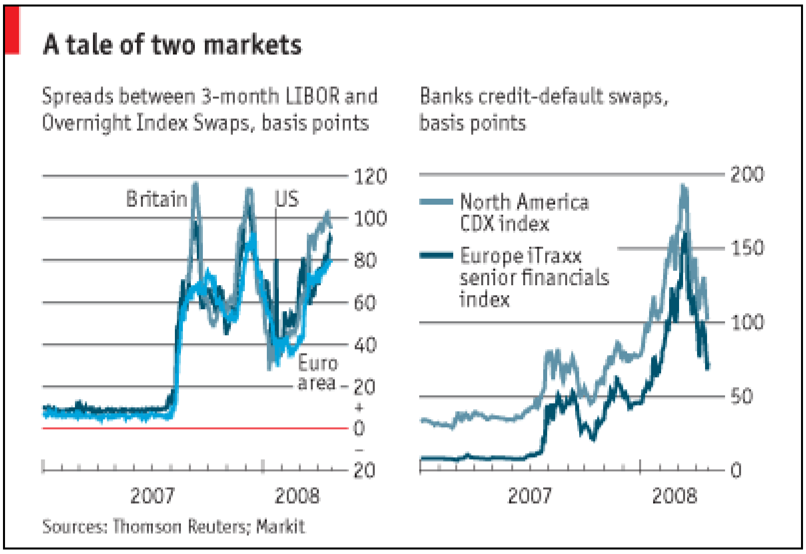
Bankers' trust

Apr 24th 2008
From The Economist print edition

Why have banks been paying so much in the interbank market?

SINCE last August, some of the world's most powerful central bankers have battled with growing resourcefulness to restore the law of gravity to the market that banks use for short-term borrowing. As the credit crisis has deepened, the central banks have made more money available against a broader range of collateral for longer periods to a wider group of financial firms. By throwing money at the situation, they have aimed to lower the London Interbank-Offered Rate (LIBOR) that banks charge each other for anything up to three-month loans (it helps determine borrowing rates for firms and households, too). But the rate remains stubbornly high; it has jumped again recently on reports that the British Bankers Association, which sources quotes each day from a panel of banks, is investigating whether banks have been reporting lower rates than they are actually paying in order to appear healthier than they are.

Before the crisis broke, typically banks would provide unsecured three-month loans to each other at rates that were barely higher than their cost of borrowing from the central bank. But last August, the gap between LIBOR and the overnight indexed swap (OIS) rate (a gauge of expected central-bank rates over the same period) widened sharply in Europe and America (see left-hand chart). At times, the gap was almost as wide as during the Y2K fears at the turn of the century. According to a recent paper* published by the Bank for International Settlements, the higher risk premium reflected in the rise of LIBOR over the OIS rate responds to several factors, particularly credit and liquidity risk. The first points to the bigger chance that a bank will go bust over a three-month period than overnight. As for liquidity, a three-month loan can less readily be exchanged for cash than an overnight one and lenders require a reward for that risk.



Disentangling the two is tricky, but the paper notes that the Y2K gap was driven more by liquidity concerns than by credit ones. Using the spread between secured and unsecured interbank rates as a gauge of credit risk, it believes that in the second half of 2007, credit concerns may have played a significantly larger role than in late 1999. The Bank of England, which has also sought to disaggregate the interbank spreads, said in February that most of the more recent pick-up appeared to be due to worries about credit risk.

In another recent paper† John Taylor of Stanford University and John Williams of the Federal Reserve Bank of San Francisco find support for this thesis—that the higher cost of interbank borrowing is due to banks' fears that their rivals will go bust, leaving any unsecured debt unpaid. They argue that the Federal

Reserve's Term Auction Facility, introduced in December to increase the supply of term (28-day) loans, has not helped much, because spreads are driven primarily by such fears.

Another way of looking at credit risk is by comparing the LIBOR spread with the premiums charged on banks' credit-default swaps (CDSs), which measure the risk of default. The latter have fallen recently (see right-hand chart), which appears to suggest that credit fears are easing in the banking industry. Why, then, do interbank rates remain so high?

Perhaps, argues Tim Bond, a market strategist at Barclays Capital, the falling cost of CDSs is a harbinger of things to come. He notes that interbank illiquidity reflects not so much banks' mistrust of one another as a loss of confidence in the banking market as a whole by those, such as money-market funds, which normally supply it with cash.

He finds that these funds have shunned banks' short-term offerings, fearing that their money might not be paid back. That has forced banks to scramble for extra cash in the interbank market. The banks' funding shortfall has been made more acute by the seizing-up of trading in asset-backed securities, closing off another vital cash-raising route.

Mr Bond reckons that in America, the combination of a rapid increase in commercial banks' assets and slow growth in customer deposits left a funding gap of more than $660 billion in the year to February. Although money-market funds had enough fresh investment to fill this gap, they chose to put most of their new money into safer government bills. Their risk aversion is not without foundation, as the funds suffered badly when they lent to bank-sponsored entities that invested in ropy mortgage securities. High LIBOR rates will persist, says Mr Bond, until money-market investors are lured back into lending to banks.

Disaster averted

That has not happened yet, but Mr Bond sees hopeful signs of improving confidence. The decline in CDS premia, he says, may reflect the commitments made by central banks, led by the Federal Reserve, to ensure that a solvent bank will not fail for the want of enough cash to meet its immediate needs.

That effort was bolstered on April 21st when the Bank of England unveiled its own ambitious plan to tackle the problem: the Special Liquidity Scheme. Under this measure banks can—for a market-determined fee—swap high-quality asset-backed securities for a smaller, but far more liquid, supply of nine-month treasury bills. The bank's governor, Mervyn King, said the scheme was designed to end once and for all the worry that a solvent bank might go under because it could not gain access to emergency lending.

At the very least, that should help reduce the illiquidity risk in the interbank spread and go some way to soothing solvency fears. But central banks can only do so much. Banks could also help solve the problem by revealing the full extent of their exposure to distressed mortgages, and by raising enough capital to offset those losses. Perhaps the CDS market is saying that they are already heading in the right direction.

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* “What Drives Interbank Rates? Evidence from the LIBOR Panel”, *BIS Quarterly Review*, March 2008.

† “A Black Swan in the Money Market”, NBER working paper no. 13943, March 2008.

Human evolution

Before the exodus

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Natonal Geographic

For two-thirds of its history, Homo sapiens lived exclusively in Africa. Only now are the details of that period becoming clear

MITOCHONDRIAL DNA is a remarkable thing. Itself the remnant of a strange evolutionary event (the merger of an ancient bacterium with the cell ancestral to all plant and animal life), it also carries the imprint of more recent evolution. In many species, humans included, it passes only from mother to child. No paternal genes get mixed into it. That makes it easy to see when particular genetic mutations happened, and thus to construct a human family tree.

The branches of that tree are now well studied. Humans started in Africa, spread to Asia around 60,000 years ago, thence to Australia 50,000 years ago, Europe 35,000 years ago and America 15,000 years ago. What have not been so well examined, though, are the tree's African roots. The genetic diversity of Africans probably exceeds that of the rest of the world put together. But the way that diversity evolved is unclear.

A study carried out under the auspices of the Genographic Project, based in Washington, DC, and just published in the *American Journal of Human Genetics*, goes some way towards correcting this oversight. The study's researchers, led by Doron Behar of the Rambam Medical Centre in Haifa and Spencer Wells of America's National Geographic Society, have used the mitochondrial DNA of more than 600 living Africans to show how genetic diversity has developed in Africa. In doing so, they have shed light on how modern man spread around his home continent long before he took the first, tentative steps into a bigger, wider world.

By the drought divided

The team paid particular attention to samples taken from the Khoi and San people of southern Africa. These people, known colloquially as bushmen, traditionally make their livings by hunting and gathering. Indeed, their way of life is thought by many anthropologists to resemble quite closely that of pre-agricultural people throughout the world.

Comparing Khoi and San DNA with that of other Africans shows that the first big split in *Homo sapiens* happened shortly after the species emerged, 200,000 years ago. Most people now alive are on one side of that split. Most bushmen are on the other. The consortium's analysis of which DNA “matrilines” are found where suggests that for much of its history the species was divided into two isolated populations, one in eastern Africa and one in the south of the continent, that were defined by this split. However, few other matrilineal splits from the first 100,000 years of the species's history have survived to the present day.

This suggests the early human population was tiny (so the opportunities for new matrilines to evolve in the first place were limited) and reinforces the idea that *Homo sapiens* may have come close to extinction (eliminating some matrilines that did previously exist). Indeed, there may, at one point, have been as few as 2,000 people left to carry humanity forward.

This shrinkage coincides with a period of prolonged drought in eastern Africa, and was probably caused by it. The end of the drought, however, was followed by the appearance of many new matrilines that survive to the present day. The researchers estimate that by 60,000-70,000 years ago, the period when the exodus that populated the rest of the world happened, as many as 40 such groups were flourishing in Africa—though that migration involved only two of these groups.

The African matrilines, however, seem to have remained isolated from each other for tens of millennia after the exodus. It was not until 40,000 years ago that they began to re-establish conjugal relations, possibly as a result of the technological revolution of the Late Stone Age, which yielded new and more finely crafted tools. Only the bushmen seem to have missed out on this panmictic party. They were left alone until a few hundred years ago, when their homelands were invaded from the north by other Africans and from the south by Europeans. Panmixis thus came full circle. And that particular party was certainly not a happy one.

Human reproduction

Sugar and spice...

Apr 24th 2008
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Skip breakfast for a daughter, eat up your cereals for a son

THERE are numerous old wives' tales about how a couple can increase their chances of having a boy or a girl. For a son, make love only on odd days of the month, eat plenty of meat and be sure the father keeps his genitals cool by wearing boxer shorts and loose-fitting trousers; for a daughter, put a wooden spoon under the bed and eat plenty of yogurt.

Although a child's sex is genetically determined by the father, mothers can influence the development of one sex rather than another. Studies in animals and humans suggest that there are links between the sex of a child and the mother's diet and her levels of stress. Although the mechanisms are not well understood, this appears to have evolutionary roots which favour greater reproductive success. Hence in hard times when food might be scarce, daughters were more valuable because their chances of providing offspring would have been greater than sons, who might get killed or fail to find a mate. But in good times sons were a better bet because they could father more children.

Those same evolutionary influences persist in modern life. New research shows a clear link between higher energy intake around the time of conception and the birth of sons—especially by mothers who eat cereals for breakfast.

The study, by a team of researchers from the Universities of Exeter and Oxford, looked at the eating habits of 740 British mothers expecting their first child. The overall sex ratio of their children was close to 50:50. But when split into three groups according to the number of calories the mothers consumed around the time of conception, the picture changed. Of those with the highest energy intake, 56% had sons, against 45% in the group with the lowest calorie intake. Moreover, besides consuming more calories the women with sons were more likely to have eaten a higher quantity and range of nutrients, especially breakfast cereals.

This could help to explain why there has been a small but consistent decline over the past 40 years in the proportion of boys being born in relatively well-off industrialised countries, says Fiona Mathews of the University of Exeter, the lead author of the group's paper, which was published this week in the *Proceedings of the Royal Society B: Biological Sciences*.

Big dietary changes have taken place in developed countries. Yet despite rising levels of obesity and a decline in physical activity, the group could find no evidence of a link between the body-mass index of a mother and the sex of her child. But worries about weight have led many women to eat low-calorie diets. Moreover, says Dr Mathews, skipping breakfast has become far more common.

So what could be happening? It is known from in vitro fertilisation research that high levels of glucose can enhance the growth and development of male embryos but inhibit female ones. Skipping breakfast extends the normal period of nocturnal fasting and depresses glucose levels, which the group thinks could be interpreted by the body as indicative of hard times. So, prospective parents now know what to do first thing in the morning.

Learning and longevity

Critical thinking

Apr 24th 2008
From The Economist print edition

Learned flies die young

YOU do not usually get something for nothing. Now a new study reveals that the evolution of an improved learning ability could come at a particularly high price: an earlier death.

Past experiments have demonstrated that it is relatively easy through selective breeding to make rats, honey bees and—that great favourite of researchers—fruit flies a lot better at learning. Animals that are better learners should be more competitive and thus over time come to dominate a population by natural selection. But improved learning ability does not get selected amongst these animals in the wild. No one really understands why.

Tadeusz Kawecki and his colleagues at the University of Fribourg in Switzerland have measured the effects of improved learning on the lives of fruit flies. The flies were given two different fruits as egg laying sites. One of these was laced with a bitter additive that could be detected only on contact. The flies were then given the same fruit but without an additive. Flies that avoided the fruit which had been bitter were deemed to have learned from their experience. Their offspring were reared and the experiment was run again.

After repeating the experiment for 30 generations, the offspring of the learned flies were compared with normal flies. The researchers report in a forthcoming edition of *Evolution* that although learning ability could be bred into a population of fruit flies, it shortened their lives by 15%. When the researchers compared their learned flies to colonies selectively bred to live long lives, they found even greater differences. Whereas learned flies had reduced life spans, the long-lived flies learned less well than even average flies.

The authors suggest that evolving an improved learning ability may require a greater investment in the nervous system which diverts resources away from processes that stave off ageing. However, Dr Kawecki thinks the effect could also be a by-product of greater brain activity increasing the production of reactive oxygen particles, which can increase oxidation in the body and damage health.

No one knows whether the phenomenon holds true for other animals. So biologists, at least, still have a lot to learn.

Thunder and lightning

Out of the clouds

Apr 24th 2008
From The Economist print edition

Summoning lightning bolts with a laser

THROUGHOUT most of history, lightning was as much a mystery as it was a terror. Nobody understood what it was and buildings were perpetually damaged. Then in 1752 one of the few enlightened individuals who suspected that it was a form of naturally occurring electricity decided to run an experiment by flying a kite in a thunderstorm with a key attached. It would become the stuff of legend.

Not only did Benjamin Franklin's research herald a new age of electrical understanding, but it also brought an end to a lot of destruction with the invaluable lightning rod. In the same spirit, researchers are now understanding more about the behaviour of lightning and how to create it. A group led by Jérôme Kasparian, of the University of Lyon in France, went to the top of South Baldy Peak in New Mexico during two passing thunderstorms to use high-power pulses of laser light to trigger electrical activity in the clouds.

Researchers believe storms become electrically charged when swirling wind, water and ice separate charged particles from one another, creating regions of cloud that are strongly charged. As clouds become more negatively or positively charged, their electrical potential builds up. When the charge is great enough to jump to an area that has particles of the opposite charge—usually another cloud but sometimes the ground—a bolt of lightning forms. As Franklin demonstrated, lightning bolts follow the path of least resistance and will readily travel down materials like metal and wet string.

The researchers used their laser pulses to rip away negatively charged electrons attached to molecules in the air around thunderstorms. These freed electrons behaved like conducting wires. The team reports in *Optics Express* that while full bolts of cloud-to-ground lightning were not formed, the lasers did create increased electrical activity in which charged particles followed the laser-generated path for a short distance. The result looked like corona discharges, known to mariners as St Elmo's fire—ominous flickering lights sometimes seen above the masts of a ship about to be hit by lightning.

Dr Kasparian thinks that more powerful lasers will be able to draw lightning to the ground. But why do that? Apart from helping to understand more about how lightning forms it could also help engineers test devices designed to protect structures such as aircraft, tall buildings and power lines from lightning. Franklin would doubtless have been impressed.

The brain

Early warning system

Apr 24th 2008
From The Economist print edition

It is possible to predict human errors from brain activity

ANYONE undertaking a repetitive or routine task knows the problem: suddenly something they have done dozens or hundreds of times before goes wrong. In a factory it might mean that a component has to be thrown into the scrap bin. But in some occupations, like operating a giant crane or piloting an aircraft, the consequences can be devastating.

Human errors are often put down to a momentary loss of concentration. But it now appears that sometimes a localised change in brain activity can be involved. Not only does that change contribute towards making a mistake, but also the type of brain activity is detectable before the mistake is made. That means it could be used to help predict, and so possibly prevent, some human errors.

The human brain is a complex organ, but it is becoming better understood with the use of functional magnetic-resonance imaging. This uses a large scanner to detect changes in the blood flow in parts of the brain that correspond to increases or decreases in mental activity.

A team of researchers from laboratories in America, Britain, Germany and Norway used an imaging machine to scan the brains of a group of volunteers who were set a “flanker” test. This measures performance in the presence of distracting information: they were asked to respond as quickly as possible to the direction of an arrow flanked by other arrows that point in the same or opposite direction. Although the task is simple and repetitive, to keep providing the right answer demands a fair bit of brain power: people make a mistake about 10% of the time.

When performing correctly the volunteers' brains showed increased levels of activity in those parts associated with cognitive effort, as would be expected. However, these areas gradually became less active before errors were made. At the same time another set of regions in the brain became more active. These regions are part of a so-called “default mode network” and show increased used when people are resting or asleep.

This is not to say that people are falling asleep on the job. Exactly what this network does is not fully understood, but it seems to be related to how much effort or resources the brain is prepared to put into performing a task. In one sense, the brain could be trying to economise during a repetitive task by shifting resources to the default mode. Once a mistake has been made and detected, people quickly snap out of the default mode.

What this means is that brain activity can be used to predict the likelihood of someone making an error about six seconds in advance, with gradual changes starting as much as 30 seconds ahead of time, the group reports this week in the *Proceedings of the National Academy of Sciences*. This, the authors add, implies it is unlikely that errors made during repetitive or monotonous tasks arise solely from a sudden moment of lost concentration.

Imaging machines are far too big and complex to be used in workplaces to monitor the brain activity of people engaged in important tasks. But Tom Eichele, of the University of Bergen, Norway, the lead author, says the team hopes to study another way of detecting the observed activity pattern, by correlating it to changes in electrical activity in the brain. These can be measured by electroencephalography (EEG), using electrodes placed on the scalp.

Small, portable EEG monitors are already available. Indeed, they have even been incorporated into baseball caps. A lightweight head device is also being developed for people to interact mentally with computer games. So, if EEG features can be found that correspond to the change in brain activity which the researchers have observed, then a hat that gives warning of an imminent mistake might one day become reality.

Correction: Financial endocrinology

Apr 24th 2008
From The Economist print edition

In “Bulls at work” in last week's issue, we referred to ten-year bond-futures contracts. In fact the research in question involved the prices of options on such contracts. Sorry. This error has been corrected online.

Israeli documentary cinema

Belonging in Israel

Apr 24th 2008 | TEL AVIV
From The Economist print edition

Jonatan Ben Efrat

What does it mean to be an outsider in the Holy Land? A new generation of Israeli documentary-makers examines a thorny question

IT IS no surprise that in Israel, a country constructed around the notion of belonging, many film-makers should choose to focus on what it is like not to belong. A selection of new documentaries screened this month at the Israeli Cinema Showcase in London and at Tel Aviv's annual documentary-film festival, DocAviv, showed that stories about being an outsider in Israel are an interesting way to explore the country's subtleties and contradictions.

The ultimate outsiders are, of course, the Palestinians. Until the second *intifada* Palestinians could still move relatively freely and many had jobs in Israel. Most are now excluded. As a result, those who do get in are more vulnerable.

“Six Floors to Hell” by Jonathan Ben Efrat follows the lives of a group of Palestinian labourers who have slipped in from the West Bank, as they jockey for odd jobs by day and sleep in the foundations of a mall at the busy Geha Junction in central Israel by night. Contractors happily take advantage of their illegal status to hire them on the cheap, while the police seem content to round them up occasionally and burn their mattresses and other meagre possessions before setting them free again. As they take an evening stroll through a park, one of them wonders at the crowds of Filipino and African guest workers who have been granted visas while they, whose families used to own land there, can get in only by sneaking around checkpoints.

In Ibtisam Mara'ana's “Three Times Divorced”, Khitam, a mother of six from Gaza who has fled the home of her abusive husband, an Israeli-Arab, battles for custody of her children. In Israel issues of marriage are in the purview of religious not civil authorities; as Khitam and her husband are Muslims their case comes before a *sharia* court, which, as the film shows, is biased in his favour. Khitam is Palestinian, so her marriage has won her only a visitor's permit in Israel, not residency or citizenship. She cannot turn to the state for legal aid or asylum in a women's shelter. “She has no status in this country,” a social worker explains.

Fragmented selves

A more complex issue is the subtle hierarchies within both Palestinian and Jewish-Israeli society, both of them communities that purport to value unity and common identity. The gaps between Palestinians in the occupied territories and those with Israeli citizenship, which emerge in "Three Times Divorced", are also evident in Rokaya Sabbah's "On Hold". She and her friends from Haifa call themselves Palestinians. They face the job discrimination and racial prejudice that second-class citizens suffer everywhere, but they speak an Arabic heavily laced with Hebrew and their mores and mannerisms are in many ways distinctly Israeli.

This has a fragmenting effect. "In the Arab countries you feel like an Israeli, and here in Israel you feel like an Arab," Ms Sabbah comments in the film. When one of her friends starts a job at an East Jerusalem art gallery, the Palestinians there, who have Israeli residency but not citizenship, treat her with suspicion too. "I don't feel I belong anywhere," she says. Ms Sabbah and her partner are torn between moving to Spain to seek work and staying in Israel; between losing their identity in a foreign melting-pot and having it thrown in their face every day at home.

Meanwhile, torn loyalties dog the protagonists of two films about Jewish-Israelis whose lives span cultural borders. "Yideshe Mama" by Fima Shlick and Genadi Kuchuck follows a Russian who wants to marry his Ethiopian girlfriend. Her parents seem fine with it, but his mother complains that he is bringing "the lowest possible people" into the family. And the almost surreal "King Lati the First" portrays a boy born in Israel to a Senegalese father, Aziz, who obtained Israeli citizenship as a refugee, and a Belarusian mother, Irena, who, being Jewish, got it by the more conventional method.

Lati, who is technically no less Jewish or Israeli than any of his classmates, endures taunts of "nigger" from them. Aziz, who is of royal blood in his tribe, takes Lati on a trip to Senegal to stake the boy's claim to the vacant tribal throne. Whether this is more for the boy's sake or the father's remains unclear; at one point in the film Aziz is asked whether it is fair to load his ambitions on his son, and does not answer. But the director, Uri Bar-On, says that since the making of the film, Lati seems to have gained pride in his origins and self-confidence against his tormentors.

In both these films, Jewishness and Israeliness take a back seat to the conflicts of ethnic identity, but gentle reminders float in the background that Russian and African Jews, though not as low in the pecking order as Arabs, are still not fully accepted as Israelis. "Half of my family was killed in the Holocaust," says Irena at one point, "but in Israel I'll always be a Russian."

Between the cracks

Two other films examine the status of Israelis who, being neither Palestinian nor Jewish, fall between the cracks of identity, with Kafkaesque results. Ohad Ofaz's "The Boys from Lebanon" looks at the small community of Lebanese Christians who fought on the side of the Israeli army during its 18-year-long occupation of south Lebanon, and who were given asylum with their families in Israel when it pulled out almost overnight in 2000. Barred from their homes just a few kilometres over the border, but stigmatised in Israel where the Jews look down on them as Arabs and the Arabs despise them as traitors, their horizons and ambitions are shrunken.

Pierre, a teenager when he arrived in Israel, wants to be a musician, but the only place he can get an audience is the small town where most of his fellow Lebanese live. His younger brother Massoud starts a basketball team, but sometimes cannot even get a hall to train in because of the hostility from locals.

"The Prodigal Son" is a rare inside glimpse of the African Hebrew Israelites, a group of black Americans who claim descent from one of the lost tribes of Israel. Though not recognised by the rabbinate as Jews, they have managed over four decades to establish a thriving but tight-knit, deeply traditional, teetotal and vegan community in southern Israel. A few years ago they were given permanent residency, and full citizenship is now probably only a matter of time.

One of them, Ben Halahliel Mercer, a film student, took up a camera to record his elder brother, Kathriel, who decamped to Tel Aviv for a life of freedom, girls and booze. Kathriel's dilemma is not unlike that of Ms Sabbah: to escape the strictures of his community he has to surrender his identity in a foreign society. But in his case it is one that will always treat him, a black non-Jew, as a lower-class alien.

One thing all these films show is that for all their clannishness, Israeli society's various subgroups are also remarkably open to well-meaning interlopers. Mr Mercer's community is probably the only one to which an outsider would have real trouble getting close. Mr Ben Efrat is a Jew and Ms Mara'ana is a Palestinian-Israeli, but he seems to have gained just as much trust and access to his Palestinian subjects' private thoughts as she has. What distinguishes the films in this crop made by outsiders to the community from those made by insiders, if anything, is that being more detached, they are more keenly observed.

A light-hearted respite from all this cultural anguish comes in “Circumcise Me” by David Blumenfeld and Matthew Kalman, a film now just starting the festival circuit. Its subject is Yisrael (formerly Chris) Campbell, an ultra-Orthodox Jew born a Catholic Irish-American. Mr Campbell has turned his experiences of conversion—he had to undergo the process, including a symbolic circumcision, three times before being certified fully kosher—into a stand-up comedy show. His show, which is the main content of the film, manages to be both hilarious and moving, as when he describes how, planning his wedding at a Jerusalem hotel at the height of the *intifada*, he had to haggle over the number of armed security guards the hotel would provide, and simultaneously realised that he had now thrown his lot in with the Jewish people “more deeply than I had ever thought possible.”

His story is a bittersweet contrast to the others, for it shows that it can be easier for an American convert to Judaism to feel fully Israeli than for a Jewish-born Russian or Ethiopian, let alone a Palestinian who can trace her family history on the land back for generations. If Israel were a true melting-pot those divisions would melt away. But it would also be a far less interesting place.

The global ruling class

Billion-dollar babies

Apr 24th 2008
From The Economist print edition

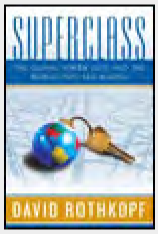
WHO rules the world? The most familiar answers to this question are so poisoned by paranoia that it is tempting to dismiss the question itself. If the Jews are so powerful, then why have they had such a dreadful time of things? If the men and women of Davos are so mighty, then why do they keep messing everything up?

Yet the fact that so many people give foolish answers to a question does not discredit the question. The rise of nation states produced national ruling classes. It would be odd if the current integration of the world economy did not produce new global elites—business people and financiers who run global companies and global politicians who steer supra-national organisations such as the European Union (EU) and the International Monetary Fund.

Reuters

John Paulson, power personified

Superclass: The Global Power Elite and the World They Are Making
By David Rothkopf



Farrar, Straus and Giroux; 400 pages; $26. Little, Brown; £20

Buy it at
Amazon.com
Amazon.co.uk

David Rothkopf, a visiting scholar at the Carnegie Endowment for International Peace, argues that these elites constitute nothing less than a new global “superclass”. They have all the clubby characteristics of the old national ruling classes, but with the vital difference that they operate on the global stage, far from mere national electorates.

They attend the same universities (Mr Rothkopf calculates that Harvard, Stanford and the University of Chicago are now the world's top three superclass producers). They are groomed in a handful of world-spanning institutions such as Goldman Sachs. They belong to the same clubs—the Council on Foreign Relations in New York is a particular favourite—and sit on each other's boards of directors. Many of them shuttle between the public and private sectors. They meet at global events such as the World Economic Forum at Davos and the Trilateral Commission or—for the *crème de la crème*—the Bilderberg meetings or the Bohemian Grove seminars that take place every July in California.

Mr Rothkopf makes a fascinating tour of the world of the superclass. He opens the door to the office of the head of Goldman Sachs, Lloyd Blankfein, on the top floor of Goldman's tower on New York's Broad Street. He visits the factory that customises Gulfstream jets (every year nearly 10% of Gulfstream's clients attend Davos). He calls on the Carlyle Group where financiers and former presidents get together to make each other richer. And he offers a tour of the weird proceedings of the Bohemian Grove meetings, which Richard Nixon described as “the most faggy goddamned thing you could ever imagine.”

“Superclass” is such a wide-ranging book that it inevitably also raises quibbles. Mr Rothkopf never quite defines the boundaries of his subject. Is he talking about the super-rich? Or about the super-influential? Do the people he talks about really constitute a “class”? Or are they an agglomeration of competing elites with different agendas? Mr Rothkopf adds to the confusion by chasing all manner of hares, including the rise of internet-enabled jihadists.

Mr Rothkopf, whose CV includes a spell working for Kissinger Associates and a period as the deputy under-secretary of commerce for international trade, is much better informed about America than he is about the rest of the world. He is fascinating on the revolving door between the Pentagon and the arms industry, for example, but he says next to nothing about the rise of the EU, one of the great building blocks of the trans-national world. His exposition of the wonders of Davos is more breathless than illuminating.

Still, none of this should put off potential readers: “Superclass” is a pioneering study of a subject that has often been the preserve of conspiracy theorists. Mr Rothkopf is anything but a crank, and he is right when he says that, these days, the most influential people around the world are also the most global people.

He is also admirably ambivalent about his subject. He worries about surging inequality—the richest 1% of humans own 40% of the planet's wealth—and about the rumbling backlash against so much unaccountable power. But he points out that, in a world where most global institutions are lumbering and antiquated, members of the superclass have repeatedly stepped in to put the global system to rights. Let us hope that they have not lost their touch.

Superclass: The Global Power Elite and the World They Are Making.
By David Rothkopf.
Farrar, Straus and Giroux; 400 pages; $26. Little, Brown; £20

American history

Big bite

Apr 24th 2008
From The Economist print edition

THIS entertaining and informative book, which traces the burger's evolution from working man's snack during the Depression to symbol of American corporatism, is nothing less than a brief history of America in the 20th century.

The Hamburger: A History
By Josh Ozersky

Yale University Press; 160 pages; $22 and £14.99

Like many stories, this one starts long, long ago, with a castle. This castle had five-cent hamburgers instead of princesses, and rather than being in an enchanted forest, it was in Wichita, Kansas.

An ambitious fry-cook named Walter Anderson opened White Castle in 1921. He did not invent the hamburger (this book wisely steers around that controversy); he merely standardised its production, cooking dozens of pre-weighed, pre-shaped burgers at once on a dedicated griddle, and serving them on specially designed buns. The friendly grillman in a white paper hat, amicably chatting with the customers as he formed meat into a patty and slapped it onto the grill next to cheese sandwiches and omelettes, gave way to the kitchen as assembly line, and the cook as infinitely replaceable technician.

When a businessman named Ray Kroc bought a “drive-in burger bar” in San Bernardino, California, run by Richard and Maurice McDonald, he built on White Castle's practice of culinary standardisation: a McDonald's hamburger weighs 1.6 ounces (45.4 grams) and spans 3 and 5/8 inches (9.2cm); it is garnished with a quarter of an ounce of chopped onion, a teaspoon of mustard, a tablespoon of ketchup and a pickle slice one inch in diameter.

Burgers are cooked 12 at a time, laid double-file on the grills; the third row, closest to the heat, is flipped first, followed by the fourth, fifth and sixth rows, then the left two last. All managers must complete a rigorous training course at Hamburger University, McDonald's training centre in Illinois.

But Kroc—a businessman of such drive and rage he once fired a man for wearing a woolly hat on a freezing day and said of rivals, “If they were drowning I'd put a hose in their mouth”—added a crucial twist to his business model: franchising. Most restaurants are independently owned, making McDonald's less a single corporate behemoth than a “confederation of entrepreneurs, small businesspeople operating according to standards devised by a central organising authority.”

The real trick behind McDonald's success had to do with property: Harry Sonneborn, the company's first chief financial officer, decided to buy or let sites, then sublet them to franchise managers at a hefty mark-up, and the rate rose concomitantly with burger sales. Sonneborn used to tell investors that McDonald's was less a hamburger company than a property business. The charming Kroc crowed, “Now we will have a club over [franchise managers], and by God there will be no more pampering or fiddling with them”.

This is why McDonald's is a worldwide icon with a market capitalisation of $67.2 billion and White Castle remains a modest but stable burger chain (even if its soft, square little burgers, eaten by the sack and topped with grilled rather than raw onions, are immeasurably superior to those of any other fast-food chain).

All of this, of course, is a long way from meat on a bun, but then a hamburger isn't just a hamburger. José Bové's supporters, after all, didn't smash up a McDonald's because they wanted extra pickles.

The Hamburger: A History.
By Josh Ozersky.
Yale University Press; 160 pages; $22 and £14.99

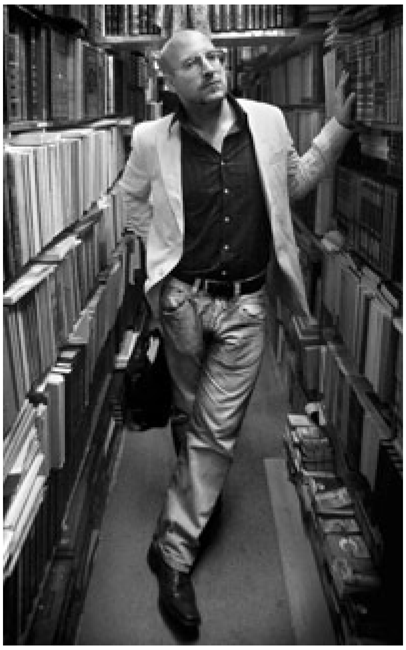
Egyptian life

An unorthodox insight

Apr 24th 2008
From The Economist print edition

THIS account of life in Cairo is sex and the city with a difference. Young Cairene women are as elegant and as sex-obsessed as their New York counterparts but their every action is monitored by bullying, protective brothers and nosy doormen. A circle of sisters, friends and neighbours meet each evening at Roda's apartment to play *tarneeb* (a simplified form of bridge) and to chew over their frustrations with love, work and families. When tiresome menfolk call them on their mobiles, the lies come tripping.

Little Brown



Miles away

Hugh Miles, a British freelance journalist, meets Roda at a party and is smitten by her Nefertiti grace. A doctor and fortunately brotherless, Roda is freer than most of her friends. But she still cannot easily date in public, let alone visit Hugh at his apartment. So he too, a lone male, is drawn into the *tarneeb* sessions.

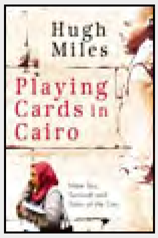
Hugh quickly gets to understand the prevailing angst. Yosra, hooked on prescription drugs, is desperate at 33 to find a husband. Amira, secretly married, is frustrated in her marketing career by an Islamist boss. Nadia has an abusive husband. Reem, disfigured by cosmetic surgery gone wrong, is unable to marry her boyfriend because he is a Copt. Hugh himself, if he is to marry his Roda, will have to convert to Islam, a process that is daunting for an Egyptian Copt but which, for a foreign Christian, turns out to be as easy as buying a bus ticket.

Mr Miles opens windows to a little- known side of Cairo in a way that carries a faint whiff of Waguih Ghali's wonderful 1964 book “Beer in the Snooker Club”. His anecdotes are enlightening (the girls exclaim with envy when told of an unmarried friend with an “elastic hymen” that seemingly never breaks) and, along the way, he conveys the sense and smell of Cairo, its hustle and humour, its near permanent state of traffic gridlock. He has a nice turn with words: at a women's gym he observes how “a matron with a face like an aubergine stuffed with rice sat on guard at the door.”

Perhaps for balance, Mr Miles supplies worthy little lectures on the much bleaker side of the city and its regime; these sometimes seem a mite forced. He is better when he sticks to his girls, particularly poor Yosra, battered by hopeless love affairs, the soul-destroying job she sleeps through and the pills she munches. All these misfortunes are made clear when a sheikh explains that a malignant *jinn* is making love to her at night. She believes him and, to evict the *jinn*, she lies flat on the floor for hours with the Koran playing into her ears. The reader longs for a happy ending for Yosra but Mr Miles, as he coolly observes his women, is not writing fairy tales.

Playing Cards in Cairo: Mint Tea, Tarneeb and Tales of the City.
By Hugh Miles.
Abacus; 288 pages; £10.99

Playing Cards in Cairo: Mint Tea, Tarneeb and Tales of the City
By Hugh Miles



Abacus; 288 pages; £10.99

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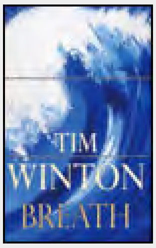
New fiction 1

Waves of pleasure

Apr 24th 2008
From The Economist print edition

RICHLY Australian, “Breath” is a classic coming-of-age novel, which is not to pigeonhole the work as small or pat. Thomas Wolfe and James Joyce among many other literary greats have employed the form. Readers who are, like the narrator, adolescent might well enjoy Tim Winton's surf-and-turf tale. But this is also a book for grown-ups.

Breath
By Tim Winton



Picador; 320 pages; £14.99. To be published in America by Farrar, Straus and Giroux in June

Buy it at
Amazon.co.uk

In a small coastal sawmill town in the 1970s, Bruce Pike, or “Pikelet”, forms a friendship with Loonie, an enviably fearless peer with whom Pikelet defies his meek parents' prohibition against surfing. Soon the two fall in thrall to an older surfer, Sando, who calls the boys to ever-riskier battles with water. When Sando begins to prefer the more daring Loonie, the boys' friendship founders. Pikelet is drawn to a danger greater than 20-footers: the dubious charms of Sando's wife, Eva, a former daredevil skier embittered by a knee injury that has terminated her own exhilaration on the slopes. From here the novel grows darker, and unnervingly more adult.

Regarded as a national treasure in Australia, Mr Winton is skilful at conveying not only the thrill of surfing, but also its terrors. For Mr Winton no two waves are alike (one is “as ugly as a civic monument”). Descriptions of man-meets-ocean are vivid, intoxicating and beautifully written. Given that Mr Winton is now 47, he is remarkably in touch with the currents of a 15-year-old's emotional life, and towards the end of the novel does a marvellous job of fast-forwarding into the damaged adult that Pikelet will become. “Breath” adeptly portrays the complex symbiotic relationship between the older mentor and his worshipful acolytes. Which party is more grateful for the other? Of Eva, “there was something careless about her that I mistook for courage in the same way I misread Sando's vanity as wisdom.”

Yet what may most distinguish this coming-of-age fiction is its perfect balance of teenage romanticism and disillusion. The hippy couple the boys idolise is bound to disappoint. But to the very end, Mr Winton celebrates the immediacy and animation of “something completely pointless and beautiful”. Surfing, disappoint? Never.

Breath.
By Tim Winton.
Picador; 320 pages; £14.99. To be published in America by Farrar, Straus and Giroux in June

Economist.com BOOKS & ARTS

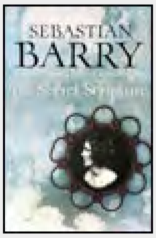
New fiction 2

The unremembered

Apr 24th 2008
From The Economist print edition

THE self-enclosed world of the dramatic monologue is one of the greatest fictional devices. Think of Hamlet. Think of Macbeth. Or of Robert Browning's murderously brilliant poem, “My Last Duchess”. Its forcefulness is evident in novels too—in Molly Bloom's conclusion to James Joyce's “Ulysses”, for example, and now in the latest novel by Sebastian Barry, another Irish writer, which largely consists of intertwined lives whose narrators and narrations seem partially in collision with each other. One is the tale of an elderly female patient incarcerated in the Roscommon Regional Mental Hospital; the other is that of her (male) psychiatrist of long standing.

The Secret Scripture
By Sebastian Barry



Faber and Faber; 320 pages; £16.99. To be published in America by Viking in June

Buy it at
Amazon.co.uk

When the omniscient narrator is absent, each character speaks on behalf of his or her own private self. There is no bland truth-teller to lead the reader by the hand. In this book, the worlds each character builds are significantly, tantalisingly estranged from each other. Is this an issue of truthfulness? Nothing so simple. It is to do with the nature and importance of memory—those fragmented “gleams of half-extinguished thought”, in the words of William Wordsworth.

Roseanne McNulty describes the world of her girlhood in rural Ireland from soon after the turn of the 20th century. This reconstituted reality is, in spite of the murderous goings-on of the different political factions, of an almost visionary playfulness and fancy. Its embroidery conceals as much as it reveals. She uses words with a delightful fastidiousness, rather in the manner of her beloved father who, she would have the reader believe, “filleted” his talk out of the wonderful words of his favourite 16th- and 17th-century authors, John Donne and Sir Thomas Browne.

The countering world of Dr Grene, the psychiatrist, is robustly matter-of-fact by comparison. The novel's delight lies in the way in which the two tales—and, eventually, the two lives—begin to coalesce, to the utter surprise of both the characters and the reader.

The Secret Scripture.
By Sebastian Barry.
Faber and Faber; 320 pages; £16.99. To be published in America by Viking in June

Correction: Babylon

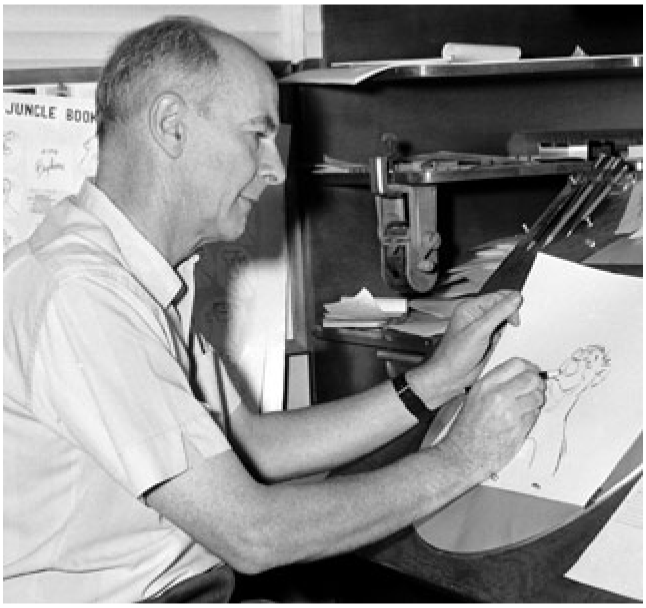
Apr 24th 2008
From The Economist print edition

In our report on the Babylon exhibition in Paris ("Ere Babylon was dust", April 12th) we mistakenly attributed the building of the Tower of Babel to the Jews exiled to Babylon in 586BC. This is incorrect. The tower was built between 3500BC and 2400BC by the people "of one language and of one speech" (Genesis 11:1-9) who inhabited the land of Shinar, in the kindom of Nimrod. Sorry.

Ollie Johnston

Apr 24th 2008
From The Economist print edition

Reuters



Ollie Johnston, last of Disney's elite animators, died on April 14th, aged 95

IF YOU interviewed Ollie Johnston in the last years of his life, sooner or later he would start to change. The trim body, lean as a whippet's, would begin to prowl and strut, then round on you with an accusing, pointing arm, just like the evil prosecutor in “Toad of Toad Hall”. Or he would cock his head, gyrate it, fidget and twitch, for all the world like the rabbit Thumper as he explains to Bambi why he doesn't like clover greens. He would skip and stumble to play little Penny carrying a slithering cat in “The Rescuers”, or tilt stiffly from side to side like a waiter-penguin from “Mary Poppins”.

All these vignettes, performed in his 80s with a young man's grace, had come from decades of observation. For the plump, elderly Good Fairies in “Sleeping Beauty” (1959) Mr Johnston and Frank Thomas, his lifelong friend and fellow animator, would lurk behind little old ladies in the supermarket, noting how they bounced as they walked and how they pinned up their hair. For “101 Dalmatians” (1961), in which he drew the parent-dogs Pongo and Perdita, he studied every nuance of ears, noses, flanks and tails. Dog-nous had helped him too in his first job as an assistant animator, “Snow White and the Seven Dwarfs” (1937), in which Dopey's paw-flapping stupidity was based on hound behaviour.

Of the elite animators Walt Disney gathered round him in the 1930s, the “Nine Old Men” as he called them, it was generally agreed that there was none like Mr Johnston. His background was suitable enough for the work: middle-class Californian, Stanford University art department, Chouinard art school in Los Angeles, until in 1935 he was hired, at $17 a week, by the studios in Burbank. But his approach was different. Where his colleagues focused on the “extremes”, the beginning or end of an action, he worked like an “in-betweener”, filling in with his quick, clear lines the smallest progressions of movement in a cheek, a hand or a leg, finding and sustaining the inner rhythm of the character.

The trouble with noses

What mattered for him was not movement, but the emotions behind it. “What is the character thinking, and why does he feel that way?” was the question he asked himself as he sat down to draw. As a student he had dreamed of being a magazine illustrator, producing portraits so alluring that buyers would feel they had to read the stories. Here his portraits could actually move and breathe. They could touch hands. He wanted to know the whole track of their lives to that moment, so that the way Sneezy blew his nose, or the delight of first-mate Smee as he sucked the liquor from his thumb in “Peter Pan” (1953), or the shambling dance of the bear Baloo in “The Jungle Book” (1967) would be informed by a universe of experience.

Some characters were harder than others. Mr Johnston could never find the spark in Lewis Carroll's Alice, with her prim hairband and her white apron, and thought the film a failure. In “Bambi”, where he excelled himself with the pathos of the fawn discovering his mother dead in the snow, or acknowledging with a slight, shy droop of the head the magnificence of his father, or stumbling through the forest on legs as thin as the grass, he found the face too bland, and the nose too short, to register as much as he wanted. He had more nose to work with in “Pinocchio” in 1940; but there, typically, he drew just the beginning of the transformation, as the puppet-boy, “who doesn't know a darn thing”, was suddenly, astonishingly confronted by the Blue Fairy and his own lies. The six-foot-long nose, with a bird's nest swaying at the end of it, was somebody else's thought.

The work of a Disney animator, as the studios roared from strength to strength, could be as numbing as the daily grind on any other production line. The constant perusal of the storyboards pinned along the wall; the mute challenge of the pile of medium-grade bond paper and the pencil-sharpener full of shavings; the exposure-sheet tacked to the drawing-board, giving the exact times allotted to the scene and the dialogue; the knowledge that 30 feet of drawings, at 16 drawings a foot, would have a running time of merely 20 seconds. But Mr Johnston made light of it, adoring the work and passing on his expertise enthusiastically to others. The only thing he possibly loved more was the inch-scale hand-built railway that ran round his garden, which with huffing and panting and articulated pistons moved much like an ideal cartoon character: everything functional, everything with a purpose.

Those who came to see him in the studios might find him acting, rather than drawing. Disney routinely brought in actors to help the animators, but their bodies and faces seldom matched up to the ones Mr Johnston had in his mind, with their flowing capacity to squash, stretch and rebound. He could sometimes give the idea better himself, by getting up and doing. When his characters had to speak he would draw with a mirror beside him, giving them the lines of his own mouth making letters and his own eyebrows rising and falling. “You get an idea, your eyes begin to widen,” he noted. “Your cheeks start to come up; your whole face moves...The entire pose should express the thought.” Small wonder that so much of his own life got into his drawings, and so much of their life into him.

Overview

Apr 24th 2008
From The Economist print edition

The Bank of **Canada** lowered its benchmark interest rate from 3.5% to 3% at its meeting on April 22nd, the third time it has cut rates this year. The central bank said it expected a “deeper and more protracted slowdown” in America to hurt Canadian exports and tighter credit conditions to damp spending at home. Canada's inflation is below 1.5% and the bank reckons “some further monetary stimulus” will be necessary to meet the 1-3% target over the medium term.

By contrast, **Norway's** central bank raised its key interest rate by 0.25 percentage points to 5.5%. The bank said that in reaching its decision, the prospect of higher inflation outweighed concerns about a slowdown in the global economy.

Manufacturing firms in the **euro area** were far less busy in April than March, according to the initial results of a survey of purchasing managers. The activity index fell from 52.0 to 50.8, its lowest level since August 2005. Some firms said the strong exchange rate had hurt their export orders. The euro, which had climbed briefly to a new high above $1.60 this week, fell on the news.

Consumer prices in **Australia** rose by 4.2% in the year to the first quarter, well above the target of 2-3%. Expectations of a further interest-rate rise sent the Aussie dollar above $0.95 for the first time since 1984.

Sales of existing homes in **America** fell by 2% in March, but were still slightly above the recent low reached in January.

Output, prices and jobs

Apr 24th 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	+1.6 Mar	+4.0 Mar	+2.8	+3.3	5.1 Mar
Japan	+2.0 Q4	+3.5	+1.3	+1.5	+5.1 Feb	+1.0 Feb	–0.2	+0.7	3.9 Feb
China	+10.6 Q1	na	+9.6	+9.0	+17.8 Mar	+8.3 Mar	+3.3	+5.0	9.5 2007
Britain	+2.8 Q4	+2.5	+1.8	+1.8	+1.3 Feb	+2.5 Mar§	+3.1	+2.6	5.2 Feb††
Canada	+2.9 Q4	+0.8	+1.5	+2.1	–1.0 Jan	+1.4 Mar	+2.3	+1.7	6.0 Mar
Euro area	+2.2 Q4	+1.6	+1.6	+1.6	+3.1 Feb	+3.6 Mar	+1.9	+2.7	7.1 Feb
Austria	+3.0 Q4	+2.3	+2.6	+2.3	+4.7 Feb	+3.5 Mar	+1.8	+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	+1.9 Feb	+3.2 Mar	+1.2	+2.4	7.5 Q4§§
Germany	+1.8 Q4	+1.1	+1.7	+1.7	+5.9 Feb	+3.1 Mar	+2.0	+2.3	7.8 Mar
Greece	+3.6 Q4	+2.8	+2.8	+3.3	–4.2 Feb	+4.4 Mar	+2.6	+3.9	8.0 Jan
Italy	+1.9 Q3	+1.7	+0.8	+1.1	–0.8 Feb	+3.3 Mar	+1.7	+2.6	6.0 Q4
Netherlands	+4.5 Q4	+4.8	+2.5	+1.9	+0.7 Feb	+2.2 Mar	+1.8	+2.0	4.0 Mar††
Spain	+3.5 Q4	+3.2	+2.4	+2.1	+3.9 Feb	+4.5 Mar	+2.5	+3.6	9.0 Feb
Czech Republic	+6.6 Q4	+7.0	+4.7	+5.4	+11.3 Feb	+7.1 Mar	+1.9	+6.5	5.6 Mar
Denmark	+1.9 Q4	+1.2	+1.5	+1.6	+1.9 Feb	+3.1 Mar	+2.0	+2.4	2.0 Feb
Hungary	+0.8 Q4	+0.5	+2.4	+3.6	+9.8 Feb	+6.7 Mar	+9.0	+5.9	8.0 Feb††
Norway	+4.7 Q4	+5.2	+2.9	+2.5	+0.3 Feb	+3.2 Mar	+1.1	+3.6	2.3 Jan††
Poland	+6.1 Q4	na	+5.1	+4.3	+0.9 Mar	+4.1 Mar	+2.5	+4.0	11.1 Mar‡‡
Russia	+8.0 Q1	na	+7.1	+6.2	+6.5 Mar	+13.3 Mar	+7.4	+12.5	6.6 Feb‡‡
Sweden	+2.8 Q4	+3.1	+2.4	+2.3	+1.9 Feb	+3.4 Mar	+1.9	+2.8	6.1 Feb‡‡
Switzerland	+3.6 Q4	+4.2	+2.1	+1.7	+9.1 Q4	+2.6 Mar	+0.2	+1.8	2.5 Mar
Turkey	+3.4 Q4	na	+4.1	+5.2	+7.5 Feb	+9.2 Mar	+10.9	+9.0	10.1 Q4‡‡
Australia	+3.9 Q4	+2.4	+3.0	+3.0	+0.1 Q4	+4.2 Q1	+2.4	+3.3	4.1 Mar
Hong Kong	+6.7 Q4	+6.6	+4.9	+5.6	–0.3 Q4	+4.2 Mar	+2.4	+4.3	3.4 Mar††
India	+8.4 Q4	na	+7.8	+7.2	+8.6 Feb	+5.5 Feb	+7.6	+5.8	7.2 2007
Indonesia	+6.3 Q4	na	+5.9	+6.3	+7.5 Feb	+8.2 Mar	+6.5	+6.8	9.8 Feb
Malaysia	+7.3 Q4	na	+5.8	+5.9	+6.6 Feb	+2.8 Mar	+1.5	+2.8	3.0 Q4
Pakistan	+7.0 2007**	na	+5.0	+5.3	+8.7 Jan	+14.1 Mar	+7.7	+9.4	6.2 2006
Singapore	+7.2 Q1	+16.9	+4.4	+4.7	+10.0 Feb	+6.5 Feb	+0.6	+4.3	1.6 Q4
South Korea	+5.7 Q4	+6.4	+4.5	+4.4	+10.1 Feb	+3.9 Mar	+2.2	+2.9	3.1 Mar
Taiwan	+6.4 Q4	na	+4.3	+4.3	+15.2 Feb	+4.0 Mar	+0.9	+2.6	3.9 Mar
Thailand	+5.7 Q4	+7.3	+4.7	+4.3	+14.7 Feb	+5.3 Mar	+2.0	+5.0	0.8 Dec
Argentina	+9.1 Q4	+8.0	+6.2	+4.5	+5.2 Mar	+8.8 Mar	+9.1	+10.3	7.5 Q4‡‡
Brazil	+6.2 Q4	+6.4	+4.3	+4.1	+9.7 Feb	+4.7 Mar	+3.0	+4.7	8.7 Feb‡‡
Chile	+4.0 Q4	+3.7	+4.0	+4.6	+5.7 Feb	+8.5 Mar	+2.6	+5.9	7.3 Feb††‡‡
Colombia	+8.1 Q4	+6.8	+5.0	+4.3	+8.8 Feb	+5.9 Mar	+5.8	+5.7	12.0 Feb‡‡
Mexico	+3.8 Q4	+3.0	+1.9	+2.8	+5.4 Feb	+4.3 Mar	+4.2	+3.9	3.8 Mar‡‡
Venezuela	+8.5 Q4	na	+6.0	+4.5	+2.5 Jan	+29.1 Mar	+18.5	+28.2	6.7 Q4‡‡
Egypt	+8.1 Q4	na	+7.0	+6.8	+7.5 2007**	+14.4 Mar	+12.8	+10.9	9.0 Q4‡‡
Israel	+6.8 Q4	+6.4	+3.6	+3.9	+3.8 Feb	+3.7 Mar	–0.9	+3.4	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	+3.5 Feb	+10.6 Mar	+6.1	+7.2	23.0 Sep‡‡
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	+10.9 Mar	+5.7	+9.0	5.6 Jan
Finland	+3.7 Q4	+3.8	+3.0	+3.0	+4.4 Feb	+3.9 Mar	+2.6	+3.0	6.2 Mar
Iceland	+4.6 Q4	+1.4	+1.4	+2.6	+0.4 2007	+8.7 Mar	+5.9	+7.5	1.0 Mar‡‡
Ireland	+3.5 Q4	–3.3	+2.4	+2.4	+1.0 Feb	+5.0 Mar	+5.1	+3.0	5.5 Mar
Latvia	+8.0 Q4	na	+4.0	+4.2	–4.7 Feb	+16.8 Mar	+8.5	+13.2	4.9 Mar
Lithuania	+7.9 Q4	–4.3	+7.2	+6.4	na	+11.3 Mar	+4.6	+8.8	4.7 Feb‡‡
Luxembourg	+5.6 Q3	+2.8	+4.9	+4.8	+4.9 Feb	+3.1 Feb	+2.0	+3.1	4.6 Feb‡‡
New Zealand	+2.8 Q4	+3.1	+1.9	+2.5	+4.2 Q4	+3.4 Q1	+2.5	+2.9	3.4 Q4
Peru	+11.9 Feb	na	+6.9	+6.6	+13.4 Feb	+5.5 Mar	+0.2	+4.2	10.5 Feb‡‡
Philippines	+7.3 Q4	+7.4	+5.4	+5.5	+0.5 Jan	+6.4 Mar	+2.2	+5.1	7.4 Q1‡‡
Portugal	+2.0 Q4	+3.0	+1.7	+1.9	+1.0 Feb	+3.1 Mar	+2.3	+2.4	7.8 Q4‡‡
Slovakia	+14.3 Q4	na	+7.5	+5.7	+11.5 Feb	+4.2 Mar	+2.7	+3.3	7.6 Mar††
Slovenia	+4.7 Q4	na	+4.6	+4.0	+7.3 Feb	+6.9 Mar	+2.3	+4.4	7.1 Feb‡‡

*% change on previous quarter, annual rate. †*The Economist* poll or Economist Intelligence Unit estimate/forecast. ‡National definitions. §RPI inflation rate 3.8% in Mar. **Year ending June. ††Latest three months. ‡‡Not seasonally adjusted. §§New series. ***Centred 3-month average

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

The Economist commodity-price index

Apr 24th 2008
From The Economist print edition

The Economist commodity-price index

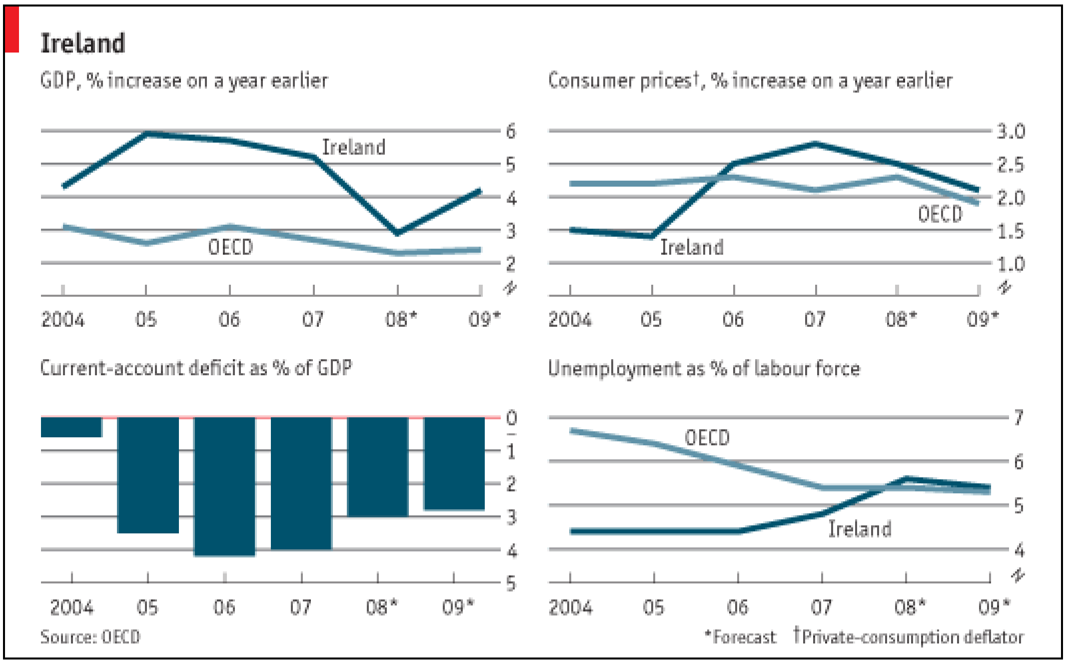
2000=100

	Apr 15th	Apr 22nd*	% change on one month	% change on one year
Dollar index				
All items	262.6	264.1	+3.7	+31.0
Food	261.1	263.8	+4.2	+69.0
Industrials				
All	264.5	264.6	+3.1	+1.6
Nfa†	193.9	191.8	+1.0	+21.6
Metals	303.2	304.4	+3.8	-3.8
Sterling index				
All items	202.9	200.8	+4.0	+31.6
Euro index				
All items	153.7	152.9	+1.2	+11.7
Gold				
$ per oz	927.80	918.90	-0.5	+34.0
West Texas Intermediate				
$ per barrel	113.80	119.05	+17.2	+84.4

*Provisional †Non-food agriculturals.

Ireland

Apr 24th 2008
From The Economist print edition



Trade, exchange rates, budget balances and interest rates

Apr 24th 2008
From The Economist print edition

Trade, exchange rates, budget balances and interest rates

	Trade balance*	Current-account balance		Currency units, per $		Budget balance	Interest rates, %	
	latest 12 months, $bn	latest 12 months, $bn	% of GDP 2008†	Apr 23rd	year ago	% of GDP 2008†	3-month latest	10-year gov't bonds, latest
United States	−827.0 Feb	−738.6 Q4	−4.7	–	–	−2.4	1.97	3.73
Japan	+105.4 Feb	+216.0 Feb	+4.7	104	118	−2.9	0.75	1.45
China	+256.6 Mar	+249.9 2006	+10.6	6.98	7.72	0.5	4.49	4.36
Britain	−178.9 Feb	−115.4 Q4	−4.2	0.50	0.50	−3.3	5.86	4.66
Canada	+45.5 Feb	+12.5 Q4	nil	1.02	1.12	0.3	2.51	3.78
Euro area	+27.3 Feb	+25.3 Feb	+0.1	0.63	0.73	−0.9	4.83	4.14
Austria	+0.9 Jan	+12.2 Q4	+2.7	0.63	0.73	−0.4	4.83	4.32
Belgium	+15.4 Jan	+2.7 Dec	+1.8	0.63	0.73	−0.5	4.90	4.46
France	−56.3 Feb	−32.7 Feb	−1.6	0.63	0.73	−2.9	4.83	4.30
Germany	+271.5 Feb	+264.1 Feb	+6.2	0.63	0.73	1.0	4.83	4.14
Greece	−57.1 Dec	−43.8 Feb	−12.5	0.63	0.73	−2.7	4.83	4.65
Italy	−12.1 Feb	−53.4 Feb	−2.5	0.63	0.73	−2.6	4.83	4.62
Netherlands	+58.2 Feb	+50.7 Q4	+7.2	0.63	0.73	0.6	4.83	4.34
Spain	−139.6 Jan	−152.4 Jan	−9.2	0.63	0.73	nil	4.83	4.43
Czech Republic	+4.6 Feb	−3.9 Feb	−3.0	15.8	20.6	−2.6	4.10	4.61
Denmark	+4.1 Feb	+4.4 Feb	+1.2	4.70	5.45	3.6	5.25	4.39
Hungary	+0.1 Feb	−6.9 Q4	−5.9	158	180	−4.1	8.28	8.50
Norway	+66.1 Mar	+64.1 Q4	+17.2	5.01	5.96	17.5	6.34	4.60
Poland	−13.5 Feb	−17.2 Feb	−4.0	2.15	2.76	−2.0	6.32	5.98
Russia	+146.3 Feb	+92.4 Q1	+5.1	23.4	25.7	2.5	10.25	6.48
Sweden	+19.1 Feb	+38.1 Q4	+6.9	5.88	6.72	2.0	4.03	4.15
Switzerland	+12.5 Mar	+71.1 Q4	+15.1	1.02	1.20	0.9	2.86	3.11
Turkey	−65.7 Feb	−39.0 Feb	−6.1	1.29	1.33	−2.0	16.76	6.47‡
Australia	−21.8 Feb	−56.4 Q4	−6.1	1.05	1.20	1.5	7.81	6.25
Hong Kong	−24.9 Feb	+27.4 Q4	+9.5	7.79	7.82	3.0	2.08	2.51
India	−75.0 Feb	−12.8 Q4	−2.4	40.1	40.9	−3.1	7.21	8.57
Indonesia	+39.2 Feb	+11.0 Q4	+2.1	9,210	9,082	−1.8	8.19	6.96‡
Malaysia	+31.0 Feb	+28.9 Q4	+13.8	3.13	3.42	−3.2	3.62	3.87‡
Pakistan	−17.8 Mar	−8.4 Q4	−8.2	64.6	60.7	−5.2	8.50	9.30‡
Singapore	+32.0 Mar	+39.1 Q4	+24.3	1.35	1.51	1.0	1.25	2.29
South Korea	+6.5 Mar	+0.9 Feb	+0.5	991	927	0.2	5.35	5.09
Taiwan	+13.5 Mar	+31.7 Q4	+5.3	30.3	33.2	−1.8	2.70	2.34
Thailand	+10.5 Feb	+14.3 Feb	+2.1	31.5	34.8	−3.0	3.26	4.23
Argentina	+12.1 Feb	+7.3 Q4	+2.8	3.18	3.08	1.1	10.69	na
Brazil	+34.1 Mar	−4.9 Feb	−0.4	1.66	2.03	−1.8	11.64	6.16‡
Chile	+22.5 Mar	+7.2 Q4	+3.8	445	527	5.4	6.48	4.31‡
Colombia	+1.2 Jan	−5.9 Q4	−4.0	1,764	2,113	−1.6	9.61	5.53‡
Mexico	−12.2 Mar	−7.4 Q4	−1.4	10.5	10.9	nil	7.44	7.74
Venezuela	+23.7 Q4	+20.0 Q4	+7.0	3.33	4.23§	nil	14.14	6.55‡
Egypt	−20.5 Q4	+0.5 Q4	+0.3	5.37	5.69	−7.2	6.72	4.84‡
Israel	−11.9 Mar	+5.0 Q4	+1.5	3.44	4.03	−1.4	2.91	5.27
Saudi Arabia	+146.4 2007	+98.9 2006	+30.8	3.75	3.75	19.1	2.31	na
South Africa	−10.3 Feb	−20.6 Q4	−7.8	7.65	6.98	−1.2	11.85	9.39
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*								
Estonia	−4.4 Jan	−3.5 Feb	−13.1	9.85	11.5	0.6	6.32	na
Finland	+12.6 Feb	+12.4 Feb	+3.8	0.63	0.73	4.6	4.69	4.30
Iceland	−1.7 Mar	−3.2 Q4	−12.0	73.7	64.1	1.4	15.67	na
Ireland	+36.3 Jan	−12.7 Q4	−4.3	0.63	0.73	−0.8	4.83	4.48
Latvia	−7.3 Feb	−6.3 Feb	−14.5	0.44	0.51	nil	5.39	na
Lithuania	−7.3 Feb	−5.4 Feb	−12.0	2.17	2.53	−0.6	5.04	na
Luxembourg	−6.2 Jan	+3.9 Q4	na	0.63	0.73	0.9	4.83	na
New Zealand	−3.3 Feb	−10.2 Q4	−7.6	1.25	1.34	3.1	7.35	6.48
Peru	+8.3 Feb	+1.5 Q4	+0.7	2.79	3.18	1.8	5.50	na
Philippines	−6.1 Jan	+6.4 Dec	+4.2	41.9	47.5	−0.2	6.31	na
Portugal	−27.4 Jan	−23.4 Feb	−8.8	0.63	0.73	−2.6	4.83	4.51
Slovakia	−0.5 Feb	−4.1 Dec	−3.3	20.4	24.6	−2.1	3.80	4.52
Slovenia	−3.2 Feb	−2.6 Jan	−2.8	0.63	0.73	−0.2	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 24th 2008
From The Economist print edition

Markets

	Index Apr 23rd	% change on one week	Dec 31st 2007 in local currency	Dec 31st 2007 in $ terms
United States (DJIA)	12,763.2	+1.1	-3.8	-3.8
United States (S&P 500)	1,379.9	+1.1	-6.0	-6.0
United States (NAScomp)	2,405.2	+2.3	-9.3	-9.3
Japan (Nikkei 225)	13,579.2	+3.3	-11.3	-4.4
Japan (Topix)	1,314.4	+3.3	-10.9	-4.0
China (SSEA)	3,439.8	-0.4	-37.7	-34.8
China (SSEB, $ terms)	234.1	+0.1	-38.8	-36.0
Britain (FTSE 100)	6,083.6	+0.6	-5.8	-6.3
Canada (S&P TSX)	14,069.8	-0.2	+1.7	-1.5
Euro area (FTSE Euro 100)	1,187.2	+0.5	-13.7	-6.2
Euro area (DJ STOXX 50)	3,763.6	+0.4	-14.5	-7.1
Austria (ATX)	4,048.9	+1.7	-10.3	-2.6
Belgium (Bel 20)	3,879.2	+0.4	-6.0	+2.1
France (CAC 40)	4,944.7	+1.8	-11.9	-4.4
Germany (DAX)*	6,795.0	+1.4	-15.8	-8.5
Greece (Athex Comp)	4,055.1	+2.8	-21.7	-15.0
Italy (S&P/MIB)	33,427.0	+0.5	-13.3	-5.8
Netherlands (AEX)	471.2	+1.7	-8.6	-0.8
Spain (Madrid SE)	1,470.4	+0.2	-10.5	-2.8
Czech Republic (PX)	1,555.1	+1.1	-14.3	-1.3
Denmark (OMXCB)	399.5	-1.7	-11.0	-3.4
Hungary (BUX)	22,141.6	+1.2	-15.6	-7.6
Norway (OSEAX)	528.5	+3.6	-7.3	+0.5
Poland (WIG)	45,394.0	-3.7	-18.4	-6.6
Russia (RTS, $ terms)	2,159.0	-0.1	-10.1	-5.7
Sweden (Aff.Gen)	307.0	-0.1	-9.8	-0.9
Switzerland (SMI)	7,324.5	+1.0	-13.7	-3.8
Turkey (ISE)	42,827.7	+3.1	-22.9	-30.0
Australia (All Ord.)	5,711.4	+3.2	-11.1	-3.7
Hong Kong (Hang Seng)	25,289.2	+5.9	-9.1	-9.0
India (BSE)	16,698.0	+2.8	-17.7	-19.0
Indonesia (JSX)	2,314.3	-1.0	-15.7	-14.0
Malaysia (KLSE)	1,288.2	+2.8	-10.9	-5.9
Pakistan (KSE)	15,470.1	-0.5	+9.9	+4.8
Singapore (STI)	3,193.8	+3.4	-7.8	-1.9
South Korea (KOSPI)	1,800.8	+2.4	-5.1	-10.3
Taiwan (TWI)	9,008.5	-0.6	+5.9	+13.4
Thailand (SET)	837.7	+0.5	-2.4	+4.4
Argentina (MERV)	2,140.4	-1.0	-0.5	-1.6
Brazil (BVSP)	64,947.0	+1.2	+1.7	+9.2
Chile (IGPA)	14,045.2	-0.1	-0.2	+11.7
Colombia (IGBC)	9,567.2	+1.3	-10.5	+2.3
Mexico (IPC)	31,848.0	-0.2	+7.8	+12.2
Venezuela (IBC)	37,767.1	-6.7	-0.4	-35.7
Egypt (Case 30)	11,680.2	+3.2	+11.6	+14.6
Israel (TA-100)	1,014.2	+1.2	-12.2	-1.6
Saudi Arabia (Tadawul)	9,754.1	+1.3	+23.0	+22.9
South Africa (JSE AS)	31,740.8	-0.4	+9.6	-2.1
Europe (FTSEurofirst 300)	1,313.2	+0.8	-12.8	-5.3
World, dev'd (MSCI)	1,504.5	+0.9	-5.3	-5.3
Emerging markets (MSCI)	1,192.1	+2.3	-4.3	-4.3
World, all (MSCI)	382.3	+1.0	-5.2	-5.2
World bonds (Citigroup)	783.6	-1.3	+7.3	+7.3
EMBI+ (JPMorgan)	440.1	-0.6	+1.5	+1.5
Hedge funds (HFRX)	1,312.7	+0.3	-1.3	-1.3
Volatility, US (VIX)	22.5	21.6	22.5	(levels)
CDSs, Eur (iTRAXX)†	77.0	-14.2	+52.1	+65.2
CDSs, N Am (CDX)†	111.0	-7.2	+26.7	+26.7
Carbon trading (EU ETS) €	25.0	+0.7	+12.3	+22.0

*Total return index. †Credit-default swap spreads, basis points.
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; JPMorgan Chase; Bank Leumi le-Israel; CBOE; CMIE; Danske Bank; EEX; HKMA; Markit; Standard Bank Group; UBS; Westpac.

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MARKETS & DATA

WEEKLY INDICATORS

Top exporters

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The volume of global merchandise trade grew by 5.5% in 2007, according to a preliminary assessment of trade figures from the World Trade Organisation (WTO). Germany topped the WTO's ranking of leading exporters, with 9.5% of global sales last year. China and America were close behind. Together, these three accounted for more than a quarter of world exports. Outside the top three, only Japan has an export share above 5%. America was by some distance the world's biggest importer in 2007, sucking in a staggering $2 trillion of merchandise from abroad. Its share of global imports, 14.2%, was almost twice that of the next largest importer, Germany. China was ranked third among importers, with 6.7%.