



Albania	ALL60	Croatia	HRK18	France	€5.50	Ireland	€5.50	Latvia	€5.50	Lithuania	€5.50	Nigeria	€5.50	Romania	RON25	South Africa	€40.00
Austria	€5.50	Cyprus	€5.50	Cuba	€5.50	Denmark	DKK5	Egypt	€5.50	Finland	€5.50	Greece	€5.50	Hungary	HUF1	India	€5.50
Belgium	€5.50	Bulgaria	BGN13	Canada	€5.50	China	€5.50	Colombia	€5.50	Czech Rep	CZK150	Estonia	€5.50	Germany	€5.50	Indonesia	€5.50
Denmark	DKK5	Egypt	€5.50	Finland	€5.50	France	€5.50	Greece	€5.50	Hongary	HUF1	Ireland	€5.50	Italy	€5.50	Japan	€5.50
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Greece	€5.50	Hongary	HUF1	India	€5.50	Indonesia	€5.50	Israel	€5.50	Italy	€5.50	Japan	€5.50	Korea	€5.50	Malaysia	€5.50
Hongary	HUF1	India	€5.50	Indonesia	€5.50	Israel	€5.50	Italy	€5.50	Japan	€5.50	Korea	€5.50	Malaysia	€5.50	Mexico	€5.50
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Norway	€5.50	Poland	€5.50	Portugal	€5.50	Russia	€5.50	Saudi Arabia	€5.50	South Africa	€40.00	Spain	€5.50	Sweden	€5.50	Switzerland	€5.50
Poland	€5.50	Portugal	€5.50	Russia	€5.50	Saudi Arabia	€5.50	South Africa	€40.00	Spain	€5.50	Sweden	€5.50	Switzerland	€5.50	Taiwan	€5.50
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Crunch time

The Economist

AUGUST 1ST-7TH 2009

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Spies, torture and terrorism

President Tony Blair: Brussels shudders

The commercial-property bust

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The Economist

Volume 392 Number 8642

First published in September 1843 to take part in "a severe contest between intelligence, which presses forward, and an unworthy, timid ignorance obstructing our progress."

Editorial offices in London and also: Bangkok, Beijing, Berlin, Brussels, Cairo, Chicago, Delhi, Frankfurt, Hong Kong, Jerusalem, Johannesburg, Los Angeles, Mexico City, Moscow, New York, Paris, San Francisco, São Paulo, Tokyo, Washington

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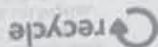
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The world this week

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Sweden's government asked Venezuela to explain how anti-tank rocket launchers sold to the Venezuelan army had come into the hands of Colombia's FARC guerrillas. The Colombian army found the weapons in a FARC camp. Chávez, said there was no evidence to link the weapons to Venezuela, and recalled his ambassador from Colombia — not for the first time.

At least 15 people were drowned and some 70 more were missing after an overloaded sailing boat carrying Haitian migrants capsized off the Turks and Caicos Islands in the Caribbean. More than 100 people were rescued.

The vice-president of China's supreme court said the country would reduce death-penalty executions "to an extremely small number". In 2008 China executed more than 1,700 people, or 72% of the world's total.

At talks in Washington, D.C., America and China promised to resist protectionism and to work together to slow climate change. But they failed to produce any detailed new agreements.



Marching for Manuel

Iran's beleaguered president, Mahmoud Ahmadinejad, came under fire from his hit-erto stalwart conservative allies in the ruling establishment, when they prevented him from making his son's father-in-law the country's vice-president. But he made him his chief of staff instead, and fired the head of intelligence for criticising the initial appointment.

At least seven Iranian members of the People's Mujahideen of Iran, a dissident group that took refuge in Iraq under the auspices of Saddam Hussein, who gave them their own camp north of Baghdad, were killed in a raid by Iraqi security forces. The Iraqi government wants to close Camp Ashraf, whose occupants are afraid they may be sent back to Iran.

In a presidential and general election in Iraq's autonomous Kurdish region, a new party



called Change shook the ruling duopoly of the Kurdish Democratic Party, run by the Barzani clan, and the Patriotic Union of Kurdistan, run by the Talabani. The new party won about a third of the seats.

More worries were voiced about the struggling Baltic economies as data showed Lithuania's GDP had shrunk by 22% year on year in the second quarter. After frantic negotiations, the parties in Latvia's ruling coalition agreed to a package of austerity measures to secure IMF aid.

The European Union asked for a formal assessment of Iceland's application to join the 27-nation block, putting the Nordic country on a fast-track to membership, possibly within three years' time. Iceland reversed its cool attitude towards the EU last year, when its banking system collapsed.

A smattering of Labour MPs blamed Gordon Brown for the party's defeat in a by-election for a seat in Norwich, which was won handily by the Conservatives. But no one

Mr Obama's comments on the arrest of Henry Louis Gates, a professor of black studies at Harvard University, sparked a row. Mr Obama had said that although he didn't know the facts about the arrest of Mr Gates for disorderly conduct at his home, the police had "acted stupidly". After the Cambridge police association stoutly defended the arresting officer (above left), Mr Obama admitted his comments had made the controversy worse, and invited both Mr Gates and the sergeant to the White House for a beer.



Lawmakers in California approved the budget deal thashed out between Arnold Schwarzenegger, the governor, and legislative leaders. The package plugs the state's budget deficit gap, though last-minute negotiations removed some items that had been earlier agreed on, such as the first lease for 40 years to allow oil drilling off Santa Barbara. The Senate Judiciary Committee endorsed Sonia Sotomayor's appointment to the Supreme Court; she picked up the support of one Republican senator. A few other Republicans have said they will vote for her when the full Senate deliberates.

Toil and trouble Amid increasing rancour among the various committees in Congress that have responsibility for health-care reform, Barack Obama went out to stump for his plan. But many Democrats said the president needed to offer clearer leadership.

Leadership challenge to the prime minister. openly ventured to push for a

Business

After months of speculation and a failed merger effort, **Microsoft and Yahoo!** announced an agreement to integrate their internet-search and advertising businesses. Under the deal, Microsoft will incorporate Yahoo!'s search technologies into its existing web-search platforms while its Bing search engine will operate on Yahoo!'s websites. Microsoft will enter a revenue-sharing partnership with Yahoo!. Between them, the two account for 28% of internet searches in America, compared with Google's 65%.

There was more evidence that **housing markets** may be turning a corner. Sales of new homes in America jumped by 11% in June compared with May, the biggest increase in nearly nine years. And the S&P/Case-Shiller home-price index for May rose by 0.5%, its first gain since mid-2006. The Land Registry's survey of house prices in England and Wales recorded its first advance, 0.1%, in 17 months.

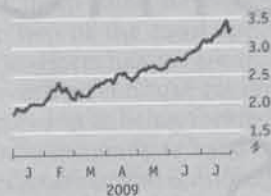
The head of the Obama administration's task-force on the car industry assured a congressional panel that the reconstructed management boards at **Chrysler and General Motors** were in complete commercial control of their companies and that "there is no checking with the government". Ron Bloom also warned lawmakers not to pass a measure reversing the cuts in car dealerships made by the companies because it would shake market confidence.

The freight depression
TUI, a German tourism group, agreed to provide the bulk of short-term financing requested by **Hapag-Lloyd**, which the container-shipping line needs to stay afloat. TUI has sold 57% of its stake in Hapag with a view to leaving the **shipping industry**. Meanwhile, Japan's three biggest shipping companies all reported quarterly losses, which they blamed on the global slowdown.

It emerged that a provisional report prepared for France's financial-market regulator into alleged insider share dealing at **EADS** had recommended fines for former and current executives at the aerospace company. Two of its biggest shareholders, Lagardère, a French media group, and Germany's Daimler, were cleared of wrongdoing.

China's stockmarket

Shanghai Composite
December 19th 1990=100, '000



Source: Thomson Datastream

Two giant public offerings in **China**, including that of China State Construction Engineering, whose IPO was the world's biggest so far this year, helped to propel the country's stockmarkets upwards. The exuberance was halted by rumours that China's biggest banks may curb lending.

Singapore's state investment company, **Temasek**, said the value of its assets had fallen by a fifth, or S\$40 billion (\$28 billion), for the year to March

31st, and raised the possibility of allowing the public to "co-invest" in its operations. A recent report from Deutsche Bank drastically cut forecasts for growth at sovereign-wealth funds worldwide.

Rearranging the chairs
Lloyds Banking Group appointed Sir Win Bischoff as its new chairman. He replaces Sir Victor Blank, a leading proponent of Lloyds TSB's acquisition of HBOS last year, which many shareholders consider a mistake. Sir Win stepped down as chairman of Citigroup in February.

Deutsche Bank reported a sizeable increase in net profit for the second quarter, to €1.1 billion (\$1.5 billion). However, investors took fright at the German bank's provisions for bad loans, which swelled to €1 billion. Meanwhile, Deutsche said that its management and supervisory boards had not authorised the investigation of managers and a major shareholder in Germany's latest corporate-spying allegations. State prosecutors are reviewing the evidence.

The average daily volume in Britain's **foreign-exchange market**, the world's largest, fell to \$1.36 trillion in April, a fifth

lower than last October, as transactions slowed between banks and other financial companies. America's foreign-exchange market shrank by 31% in the same period.

Verizon, America's second-biggest telecoms company, announced a further 8,000 job cuts at its landline division.

The quarterly earnings season got under way for big **oil companies**, in which most are expected to report much reduced profits because of falling oil prices and weaker demand. Royal Dutch Shell's net profit dropped by 67%, to \$3.8 billion. ConocoPhillips's profit fell by 76%, and BP's by 53%.

To boldly go
Abu Dhabi's Aabar Investments said it would pay \$280m for a 32% stake in **Virgin Galactic**, Sir Richard Branson's space-tourism venture. Aabar plans to build facilities for a regional "spaceport" in the emirate, which it hopes will attract scientific research. Virgin Galactic is offering flights to space for \$200,000 from a spaceport in California's Mojave desert, starting in 2011.

Other economic data and news can be found on Pages 77-78



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Leaders

Crunch time

The next few weeks could determine the fate of Barack Obama's presidency



IF THE opinion polls are to be believed, Barack Obama is now, six months into his presidency, no more popular than George Bush or Richard Nixon were at the same stage in theirs. His ratings are sagging particularly badly with electorally vital independent voters: two-thirds of them think he wants to spend too much of their money. Two of the most specific pledges he made to the electorate—to reform health care and to produce a cap-and-trade system to curb greenhouse-gas emissions—are in trouble. And an impression is being formed in Washington of a presidency that is far too ready to hand over the direction of domestic policy to Congress; that is drifting either deliberately or lethargically leftwards; and that is more comfortable with lofty visions than details. On the campaign trail Mr Obama showed an impressive ability to change gears. He needs to do so again this summer.

His cause is by no means hopeless. Just as his initial Messianic polling numbers were misleadingly optimistic, his problems should now be put into context. Most obviously, nearly 200 days into office, he has avoided making any horrific mistakes, especially in the fraught business of economic policy. On the hardly insignificant matter of restoring America's reputation in the world he has delivered a degree of what he promised (though even there the tough times are still ahead of him, as our next leader makes clear). He has had to cope with the worst recession for half a century. He has been curiously ill-served by a press short of useful criticism, with liberal America prepared only to debate what sort of water he walks on best, while conservative radio hosts argue over when exactly he became a communist. And of course, government is darned hard: even when you make the right decision—to close Guantánamo, for instance—it can take years to put into effect.

So Mr Obama's underperformance is relative and partial; but it is serious, especially in domestic policy. And if his schemes at home come to naught, then his credibility abroad will wither. That is why the next few weeks are crucial.

Taking too much care of Hillarycare

In foreign policy an American president enjoys the most freedom of operation. At home the man in the Oval Office is mightily constrained by Congress. It is the artful combination of arm-twisting, compromise, rhetoric and gritty attention to detail that make the difference between an FDR and a Jimmy Carter. Back in his honeymoon days Mr Obama was constantly compared to Roosevelt. No longer.

The suspicion is that the president has taken the experience of Bill Clinton too much to heart. The previous Democratic presidency got off to a rocky start for many reasons, but his failed attempt to impose health-care reform on Congress in 1993-94 bulks largest. Putting Hillary Clinton in charge of an unwieldy, secretive task-force that attempted to present powerful senators with a masterplan backfired. Congress promptly shot it down—and Mr Clinton lost both the House

and the Senate to the Republicans in 1994.

A president plainly should not ignore Congress. But Mr Obama has veered to the opposite extreme. Although he has a White House stuffed full of first-rate policy wonks, he has repeatedly subcontracted the big decisions—the \$787 billion stimulus bill, cap-and-trade, health reform—to the Democratic leadership in Congress. At times Mr Obama's role has seemed limited to deploying his teleprompter-driven oratory to sell whatever Congress proposes to the public, even before it is clear what exactly those proposals amount to.

Nobody voted for President Pelosi

Worse, the plans have usually ended up running away from tough decisions. With the stimulus bill the flaws were forgivable: there was an urgent need to give the economy a boost. But the House of Representatives has produced a cap-and-trade bill that is protectionist, riddled with exemptions and which gives away the permits that are supposed to force carbon-emitters to change their ways. There is a growing danger that this bill will not be passed through the Senate and reconciled with the House version in time for the Copenhagen summit on climate change in December.

With health care, Mr Obama's preference for vague statements of principle rather than detailed specification has led to a House proposal that loads taxes onto the rich, sets up a state-run insurance scheme that many fear will put private-sector providers out of business and fails to contain, let alone reverse, the escalating costs of treatment while adding an expensive requirement that everyone have health insurance, with large subsidies where needed (see page 35). Barely any Republicans could support this proposal as it stands. Frantic efforts to save the reform effort are under way in the Senate, but it is distinctly odd to note that the president's signature policy is now being devised for him by a gang of six senators. Financial regulation is also stuck (see page 58).

A policy of ramming bills through Congress on a party-line basis might suit Nancy Pelosi, the Democrats' leftish leader in the House. But, from Mr Obama's point of view, it is bad politics in two different ways. It is shifting the presidency to the left, annoying centrist voters who worry about the swelling government debt. And it may not even get the bills through. Conservative Democrats, many of whom represent right-leaning states and districts recently captured from the Republicans (see page 37), are nervous about backing bills without bipartisan support. Over 40 of them broke ranks in the House over the climate-change bill. Now there is the likelihood that health reform, like the climate-change bill, will be deferred until the autumn, when fears about the deficit will have grown and the two expensive bills could combine to spook voters.

What should Mr Obama do? He must come down from his cloud and start leading. The House Democrats could be usefully reminded that their present 78-seat margin owes everything to the president's coat-tails; they are endangering his popularity. Mr Obama should also court centrist Republicans. That means getting into the nitty-gritty: Republicans can hardly be expected to save Mr Obama's presidency unless they get

None of this is impossible. As *The Economist* went to press, hopes were rising that the Senate finance committee might soon produce a bipartisan version of the health bill. But then the final version of that bill will have to be reconciled with the much-worse House version. If the result is another lazy deficit-boosting, hard-decision-avoiding scheme (like George Bush's rotten Medicare bill), what president would want to be remembered for that? Mr Obama remains an inspiring figure. But he needs to get his hands dirty this summer if he is to rescue a presidency that has started to slip. ■

Get stuck in, Mr President

America, Israel and Palestine

something solid in return. For instance, one way to pay for bringing the uninsured into the health-care system (a noble Democratic priority) is to scrap a distorting tax-deduction that veils the true cost of health insurance, a policy espoused by John McCain last year. A real "post-partisan" president would be trying to bully through this compromise, not talking dreamily about wanting health care for all at no cost to anybody but the rich. And on the subject of detail, precise talk from the president about how he intends to grapple with government debt would reassure a lot of centrist waverers.

After making a good start in the Middle East, Barack Obama must now get directly involved



THINK HE HAS ENOUGH ON HIS plate without worrying about the dog's dinner simmering away in the corner: the sickly Middle East peace process, with its often nauseous ingredients. This week he has sent an array of colleagues to stir the pot, including his envoy, George Mitchell, who has been in and out of the region; Robert Gates, his secretary of defence; and Jim Jones, his security adviser, who knows the Palestinians from the past. But Mr Obama is the indispensable head chef. However preoccupied, it is he who must decide what to serve up—and when.

He has made an excellent start. His speech in Cairo to the Muslim world was masterly. He persuaded many Arabs and quite a few Palestinians that he was determined to be even-handed. And he squeezed Israel's new prime minister, Binyamin Netanyahu, into conceding for the first time in public, however grudgingly, that the Palestinians must have a state. All the same, the outlook is still, on the face of things, exceedingly bleak (see page 30). Despite his two-state utterance, Mr Netanyahu sounds as obdurate as ever. Several of his advisers assume that the latest diplomacy will fizzle, leaving "for-tress Israel" intact. If Mr Netanyahu refuses to stop all settlement-building on the West Bank, as Mr Obama is demanding, the Palestinians may then dig in their heels and refuse to resume talks. Mr Netanyahu gives the impression that he would not much care. His recent insistence that Jerusalem can never be shared makes negotiation even harder.

The immediate outlook on the Palestinian side is no rosier, mainly because of a bitter rift between the secular Fatah party, led by the Palestinians' hamstrung president, Mahmoud Abbas, who runs the West Bank, and the Islamists of Hamas, who run the Gaza Strip, still under an Israeli blockade. No deal with Israel will stick unless both Palestinian groups endorse it. Yet Hamas's refusal formally to recognise Israel makes it hard for a Palestinian unity government to emerge.

But all is not lost. The outlines of a deal have long been clear. The border of the two states must run close to that of 1967, with three big Jewish settlement blocks in the West Bank are compensated with land swaps elsewhere. Jerusalem must be shared as the capital both of Israel and Palestine. And the

Building on the "parameters" laid down by President Bill Clinton in 2000, along with various other convergent scenarios such as the Arab League's initiative of 2002 and the unofficial Geneva Accords of 2003, he could delineate the contours of an agreement. It is not just that many Palestinians and Israelis would embrace this basic plan. At the moment politicians on both sides define themselves by the extremism of their most unreasonable opponents. With an authoritative Obama plan, Mr Obama has begun to point the way. Now he must add the details and start banging heads together. ■

Just dive in

This is precisely why Mr Obama must soon get still more emboldened. Following his Cairo speech to Muslims, he should address the Israeli people directly, telling them why a Palestinian state is their only long-term guarantee of security. Ideally, he would also persuade Israel's government to lift its siege of Gaza, now that Hamas has, at least temporarily, stopped firing rockets at Israel. In return the leaders of the Arab world, including Syria (which he is rightly wooing), should be bullied into offering Israel tokens of good faith, such as permission for overflights and reciprocal commercial offices. They could also push much harder to help reconcile the two Palestinian groups—and, by the way, insist that Hamas unambiguously disavows violence and, at least de facto, says it accepts Israel.

Above all though, Mr Obama must soon spell out in detail his vision for the two states—and how it can be achieved. Building on the "parameters" laid down by President Bill Clinton in 2000, along with various other convergent scenarios such as the Arab League's initiative of 2002 and the unofficial Geneva Accords of 2003, he could delineate the contours of an agreement. It is not just that many Palestinians and Israelis would embrace this basic plan. At the moment politicians on both sides define themselves by the extremism of their most unreasonable opponents. With an authoritative Obama plan, Mr Obama has begun to point the way. Now he must add the details and start banging heads together. ■

Japan's elections

Demolition men

Breaking the mould of Japanese politics requires tackling the country's domineering civil service



THE best thing about the new campaign manifesto of the Democratic Party of Japan (DPJ) is not what it says but that it exists at all. Voters in post-war Japan have been denied much of a voice by one-party politics. But on July 27th the opposition DPJ set out a "contract" with the electorate that it wants to be taken as a binding list of policies it will pursue if, as seems likely, the voters make history next month by breaking the Liberal Democratic Party's near-monopoly on power. Anyone who wants Japan to cast off its 20-year economic funk will welcome that. But the DPJ will succeed only if its leaders also take the next, bolder step—and scrap the country's "iron triangle" of lobbies, political barons and bureaucrats.

Barely a year ago the DPJ looked unfit to lead Japan. Its domestic policies were incoherent and unfunded, its foreign policy worryingly anti-American, its members an odd coalition of socialists and exiles from the LDP. All it had done since winning control of the Diet's upper house in July 2007 had been to block the LDP. Its then leader, Ichiro Ozawa, secretly plotted to form a grand coalition with the ruling party, lamenting that his own lot "lacked credibility".

Nothing sobers you up like responsibility. The DPJ has now backed away from some of its worst gimmicks. The manifesto unveiled by its new boss, Yukio Hatoyama, has sensible ideas, like cutting the elaborate system of state handouts and using a consumption tax to move the pension system away from companies, which the state shields from failure partly because of their role in dishing out social payments. Electing the DPJ is still plainly a risk: the party is inexperienced and, like the LDP, an improbably broad church. But it no longer looks foolish.

However, the DPJ will achieve little unless it also tackles Ja-

pan's fearsome bureaucracy. During decades of LDP rule, large parts of government were subcontracted to the civil service. Bureaucrats worked with powerful party bosses and industrial lobbies to set the agenda, flesh out policy—and neuter any reform that threatened their narrow interests. Even Junichiro Koizumi, the most charismatic and reform-minded of all the LDP prime ministers, struggled to get things done. With an electorate wary of rapid change and a system designed to frustrate it, Japan has rejected the reform it needs.

Reassuringly, the DPJ acknowledges the struggle ahead (see page 44). Its central promise in this week's manifesto is to show "the bureaucrats who is boss". But that calls for two things. The first is a combination of coaxing and courage. Coaxing because a new government will have to spot the bureaucrats who want reform (they do exist) and enlist their help. And courage because the system will fight back by spreading poison, just as it did the only other time the LDP lost power, for a brief 11 months in 1993-94, when civil servants colluded with their old bosses to discredit the new government.

Tokyo temptation

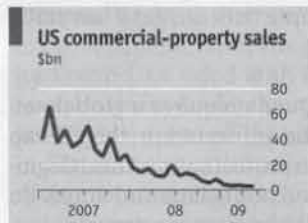
The second thing the DPJ needs is self-restraint. Its own people will be tempted to practise politics the old-fashioned way, by pulling strings outside the cabinet and working in league with the bureaucracy. Nobody is more dangerous than the former leader, Mr Ozawa—brilliant, unpredictable and a black belt in the dark arts of manipulation. The wisest thing Mr Hatoyama can do is to insist that his more impressive predecessor join the cabinet, where he should do least harm.

It is a tall order to expect the DPJ to reinvent the machinery of government overnight, or even in the four years it says it needs. But the party's reward would be great and the reward for Japan would be greater still: a two-party system that can at last begin to hold wayward politicians to account. ■

Commercial property

A concrete problem

Banks face another round of property-related bad debts: this time it will be flashy offices, not rundown homes



THERE is something comforting about investing in bricks and mortar. To many people it is a solid, "real" asset, unlike those complex pieces of paper that flighty financial markets spend all their time trading.

But that very tangibility can lead to reckless speculation. Banks are almost always willing to lend against the security of property. The more they lend, the higher prices are driven. History is littered with stories of property crazes that ended in tears, from the Florida land boom of the 1920s to the recent subprime bubble.

After two years of pain, American house prices seem to be stabilising. But attention is now switching to the commercial-property market. Here too loans were bundled together to make complex securities, known as commercial mortgage-backed securities (CMBSS), on which defaults are now rising. And here too prices were driven higher by the use of borrowed money. Thanks to cheap finance, investors could use the time-honoured trick of covering the interest payments with the rental yield and hoping for capital growth on top.

Of this, there was plenty. IPD, an information group, calculates an index of global commercial-property returns. Between 1998 and 2007, this index trebled, easily outstripping the performance of the world's stockmarkets. And last year, while ►►

the MSCI World Index of global share prices suffered a negative return of 40.3%, commercial property lost just 0.1%. The good news is that, in most developed markets, the boom did not result in a glut of new building. But the good news pretty much ends there. Vacancy rates are rising sharply and in some businesses, such as investment banking, demand for space may never reattain its previous peak.

The next shoe to drop

The aftermath of bubbles can last for a long time in financial markets. Wall Street has been celebrating the return of the Dow Jones Industrial Average to the terrain above 9,000. But it first passed that mark in April 1998. As with paper, so it can be with property. In Japan land prices are still nearly 60% below the peak they reached in 1991. Earlier this decade American homebuyers took false assurance from the oft-quoted fact that house prices had not fallen, at the national level, since the second world war; well, they have now. At the moment transactions have dried up in the commercial-property market as owners try to avoid selling at a loss. Those owners are implicitly assuming that a rebound is imminent, yet the downturn may be prolonged.

Such a downturn could inflict further damage on the banks. All the bad news may not yet be reflected on their balance-sheets, although they have had to take the hit on traded securities, like CMBs, banks are usually slow to write down proper-

Spies under the thumbscrews

Torture and intelligence



SPEND time with spies on either side of the Atlantic—and you will discover that they are worried. That is partly because their profession, already sullied in recent years, may be hit by more bad news. In Europe the ordeal has already begun: an officer in Britain's MI5 is under police investigation, and prosecutors in Italy, Germany and Spain are looking at cases linked to the CIA's actions. In America, the centre of the problem, the spooks are preparing themselves for an onslaught that could be as bad as anything since the Church commission in the 1970s. There are hints of criminal investigations against CIA officials and a battery of lawsuits—to extract information and to claim compensation. But for the leading spymasters, there is an even bigger worry: they are finding it increasingly hard to do their jobs properly (see pages 20-22).

The reason for all this? Torture. In the aftermath of the attacks on September 11, 2001, it became widely fashionable—in allegedly liberal parts of American academia as well as Dick Cheney's office—to argue that torture was a necessary part of democracy's defence. In fact, those who fought against that pernicious argument, including this newspaper, possibly underestimated our case. For all its short-term uses (both claimed and, alas, real), torture has always been illegal and immoral, and ultimately counter-productive too. Long before Abu Ghraib, it was obvious that it would create terrorists as

Torture, long a moral stain, is now hindering intelligence services' attempts to fight terrorism

Would you tip off Pakistan?

well as help capture them. But the extent to which torture would corrode the West's security networks that are supposed to fight terrorism is only now becoming clearer.

Torture throws sand into the gears of intelligence. At first harsh interrogation may well yield information, both valuable and valueless. But over time it chokes the defences of democratic societies, because their courts and political systems cannot digest it. The work of Western intelligence is being gummed up with legal protocol. More information has to be vetted by lawyers before being passed on. America has warned Britain that intelligence-sharing will be curtailed if its secrets are divulged in court. Equally, many worry about what will emerge in American proceedings. The first lesson of the September 11 attacks was that intelligence agencies have to work more closely; "need to know" had to yield to "need to share". These days, alas, it has become "need to get a lawyer".

Fighting a global network like al-Qaeda requires a global network of intelligence agencies. The information they swap should remain confidential, so as to protect sources and (legitimate) methods. But if judges, elected politicians and voters do not have confidence in their spooks, the system unravels.

The task is to restore trust. But how? In America Barack Obama moved quickly to ban the most abusive methods of interrogation and promised to shut the detention centre at Guantanamo Bay. He released four Bush-era memos which had twisted legal doctrine until it proved that CIA interrogators

► could simulate drowning, among other techniques, without turning themselves into torturers.

Mr Obama's stand against torture is a start. But the president and senior Republicans should reconsider their resistance to a "truth commission", which could offer some immunity from prosecution to those who speak openly. An investigation would disrupt the intelligence services—but less than lengthy court battles, which would fail to stop revelations yet still leave a suspicion that wrongdoing remains hidden.

The third step is to be readier to prosecute terrorists for their crimes. The struggle against terrorism will be long; in a democracy methods have to be sustainable. Legal process is not a luxury for good times, but a tool to rob terrorists of legitimacy and show that locking them up is justified. That way those who share the terrorists' religion or race are less likely to be silent accomplices. More could act as sources themselves.

Fighting terrorism will always be messy. Sometimes you

have intelligence about an attack, but not enough evidence confidently to make an arrest; yet you don't have the luxury of being able to wait. Western spies inevitably have to work with the secret police of Pakistan, Egypt and others who often abuse prisoners, but also have more access to jihadists than the West ever could. Here, co-operation is a matter of wary judgment, not absolutes. For the West to refuse to deal with such countries would be as wrong as for it to put its agents in rooms where electrodes touch flesh. In between, lies the murky territory in which the West must not only trade intelligence, but must also seek assurances that people are not being abused. Ultimately, if those assurances are broken, the West will have to limit its co-operation with abusive intelligence agencies—even if that might make information harder to get. Do not forget, though, that al-Qaeda has been unable to attack America since 2001 and Europe since 2005. That is in large part thanks to legitimate intelligence co-operation, not torture. ■

Spain's happy-go-lucky government

When good politics is bad economics

The prime minister's aversion to tough decisions risks prolonging the slump



AS SPAIN'S prime minister heads off for his summer holiday, he has some cause for satisfaction. Although his country is mired in recession, José Luis Rodríguez Zapatero stands out among the small band of

centre-left heads of government in Europe because he has managed to keep his head more or less above the political waters (see page 49). Next door in Portugal, the socialist government looks headed for defeat in an election in September; so does Britain's Labour government next year. But Mr Zapatero's Socialist party has slipped only slightly behind the opposition People's Party, according to an opinion poll this week. Even if Mr Zapatero himself is less popular than he was, he still bests Mariano Rajoy, the plodding opposition leader. That is despite an unemployment rate that has shot up to 19%, double the average in the euro area.

In clearing his desk, Mr Zapatero pulled off a couple of deals that will shore up his position. First, he clinched an agreement over changes to the financing of Spain's autonomous regional governments (see page 24). This will give more money to Catalonia, and should earn him the backing of Catalan nationalist parties for the budget vote in parliament in the autumn. Without their support, the budget might bring down his government, since his party lacks a parliamentary majority. Second, he sided with the trade unions to block demands from business leaders to reform Spain's two-tier labour market. That has seen off the risk of a general strike.

For all their tactical political deftness, these agreements carry an economic cost for Spain. They are, alas, typical of Mr Zapatero's way of governing. By his refusal to countenance unpopular measures and his habit of showering public money on any problem, he risks prolonging the recession.

Spain's decade of growth has come to a painful end. In contrast to much of Europe, which is home to a few green shoots (see page 23), Spain's economy still looks as arid as the *meseta*.

True, other European economies may contract more than the 4% decline the IMF forecasts for Spain this year (for that Mr Zapatero and his government's big fiscal stimulus deserve some credit). The problem is that the recession looks set to drag on much longer in Spain than elsewhere; many forecasters see no recovery before the end of 2010.

That is because Spain's problems stem not just from the global crisis, but from weaknesses at home. Its growth was based on low-skilled, labour-intensive industries such as house-building and tourism. Although 1m homes remain unsold, construction still accounted for 10% of GDP in the first quarter of this year—twice its share in Britain. Spain needs to use the time bought by deficit spending to reshape its economy.

An expensive, poorly educated labour force

That means reforming not just the dysfunctional education system but also the disastrous labour market. Mr Zapatero refuses "to cheapen the firing" of the two-thirds of the workforce on permanent contracts, who must be paid 45 days for each year of service if they are laid off. His refusal blunts the incentive to hire. Collective-bargaining rules mean that wages for the country's labour aristocracy are rising even as prices are falling. Since Spain, a euro member, can no longer devalue, its businesses are becoming even less competitive.

An initially strong fiscal position is rapidly eroding, with the budget deficit heading for 12% of GDP this year. If growth remains elusive, investors will soon demand a higher return on the government's bonds. But Mr Zapatero is spending regardless. Catalonia had something of a case for a bigger slice of the cake. But it looks as if the regional financing deal will add another percentage point of GDP to the deficit.

Mr Zapatero seems to be counting on inertia to pull his country out of its slump, allowing him to win a third term in 2012. He will be lucky to get away with it. Even if he does, it is a formula for the Italianisation of Spain. Put off the pain of reform now—and recovery will take longer. As Spaniards head for *la playa*, it is time their government told them so. ■

A matter of life and death

SIR - Your leader on assisted suicide assumes that it is "perfectly possible to frame a law that allows suffering people who are close to death to die quickly and peacefully, if they wish" ("Going gently", July 18th). However, the "safe guards" you describe actually illuminate the complexities and dangers of such a law. For example, you advocate a "waiting period" before dispensing lethal medication to ensure the desire for death is "settled". How would one define "settled"? And would we simply use units of time - minutes, hours, days or weeks - as a clear measure of the sincerity of such a request? It is naive to imagine that a tangible landmark exists during this tumultuous waiting period that clearly separates an "unsettled" wish from a "settled" one.

You conclude that assisted suicide is problematic for very sick individuals who could expect to live for many years as "giddy relations will put pressure on the elderly to choose to die." Sadly, it is true that such a propensity can exist whether a relative is terminally ill or not. But it is not only avarice that motivates a wish for death; there is also the strain that caring for a sick family member brings, and the subtle coercion that can flourish under such pressurised circumstances. If one recognises that such human tendencies pose "too great a danger" for the non-terminally ill, then surely the terminally ill are entitled to equal protection under the law.

LADY HOWE
House of Lords
London

SIR - You are right to say that legislation should not create risks for vulnerable people. Safeguards were built into Oregon's law and are enshrined in the proposed bill in Britain. So the obstacles to assisted-dying legislation are ideological, not practical. Religious objections to assisted dying cannot, and should not, be resisted. Those with a deep conviction can opt out. Within the medical profession, resistance to assisted suicide represents a residual paternalism that has been discarded in other areas of care. Doctors need to consider the pressure that a population with increasing long-term chronic conditions places on health-care budgets. I would sooner be given the opportunity to make an autonomous choice about how my life should end than to feel coerced into making one as a result of rationing.

DR MICHAEL WILKS
Deputy chairman
British Medical Association
Winchester

SIR - Taking your views to their logical conclusion, why shouldn't every depressed teenager be allowed access to a lethal dose of barbiturates if they so choose? When people have embraced death, the traditional reflex has been to help them, to counsel them from their misery and to sustain their happiness so far as possible so that life may go on. Now, however, death is to be enshrined as a "right". This is individualism gone mad. No sane civilisation can allow itself to sit back and watch its people self-destruct.

EDMUND ROGERS
Barne, Canada

SIR - Whose life is it anyway? Every competent adult who is not into suffering and that sort of redemption should be able to limit his or her pain, and have their companion of choice right there at the end. I do not want the government or religious dogma interfering with my choice.

JERRY DINCIN
Highland Park, Illinois

SIR - In a society that puts a high premium on individual freedom, shouldn't all people, and not just the terminally ill, have the right to die when they want? Arnaldo Momigliano, a classicist, informed us that in the Greek colony of Massalia (today's Marseille), "Whoever wanted to commit suicide asked for authorisation from

SIR - I enjoyed your leader contrasting Texas with California ("America's future", July 18th). But you set up a false choice: America's future is best secured by balanced public spending and the ideal is a middle course. California spends way too much. State and local spending per person

Politics in Bolivia

SIR - I take issue with several statements in your recent article on Bolivia ("The permanent campaign", July 18th). First, you describe the policies of President Evo Morales as "divisive". The president has a substantial democratic mandate for reform, gaining 54% and 67% of the vote in two elections. Opposition leaders are free to make their voices heard and challenge government decisions. Second, you refer to the imprisonment of Leopoldo Fernandez, the ex-governor of Pando, but do not mention that Mr Fernandez is implicated in a violent attack that resulted in the deaths of at least 11 people.

Third, the Bolivian government had nothing to do with the attack on the house of the former vice-president, Victor Hugo Cardenas. The current vice-president, Garcia Linera, issued a statement condemning the attack. Fourth, your mention of Venezuelan troops suppressing a rebellion at Santa Cruz airport in 2007 has no basis in fact.

Lastly, you said that the terrorists who were intercepted in Santa Cruz in April this year were "killed in their beds". The forensic police report of the incident shows that there was an exchange of gunfire before they were shot.

BEATRIZ SOUVIRON
Ambassador for Bolivia
London

The state of things to come

SIR - I enjoyed your leader contrasting Texas with California ("America's future", July 18th). But you set up a false choice: America's future is best secured by balanced public spending and the ideal is a middle course. California spends way too much. State and local spending per person

ELON SALMON
Barnard Castle, Durham

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were good, he was given hemlock free of charge." If such an option were on offer today, would more people be ready to engage confidently with life?

The Economist August 1st 2009

is 12% above the national average, although its higher-education system is the envy of the nation. Texas spends way too little, 17% below the national average, and has a weak education system. Its health and human services are among the poorest in America.

If spending in Texas was at the national average the state could spend \$23 billion more a year on education and human services. With that kind of money, plus the federal matching dollars it would bring, Texas could have several first-rate universities, strong public schools and community colleges, and health and human services that aren't an embarrassment. For a prosperous future, you don't want to be between the two.

BILL HOBBS
Lieutenant governor of Texas,
1973-91
Houston

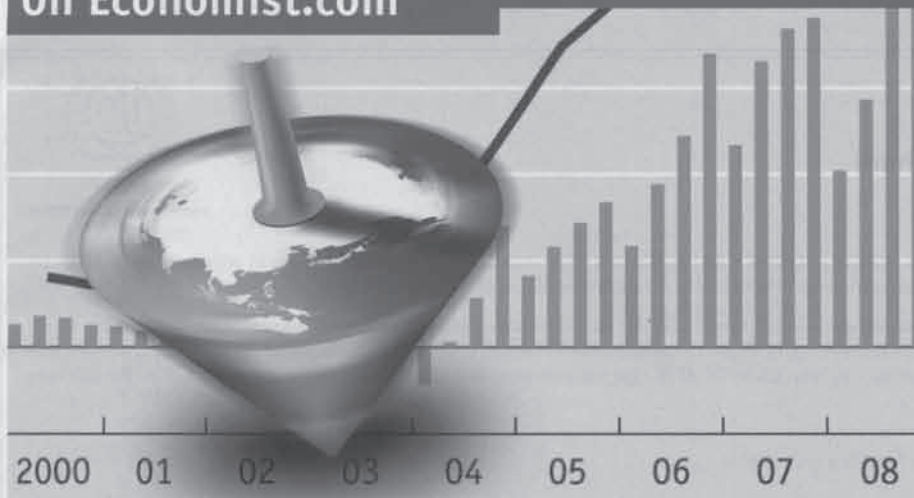
SIR - Yes, California is currently a mess, but this is attributable to rigidly ideological politicians in Sacramento and one rigidly ideological former president, ironically, a Texan.

WILL BRUZZO
Orange, California

SIR - Texas's high-school exam still flunks an appalling number of students despite efforts over the years to lower standards and make passing easier. I took the test three years ago. One page showed a map of the Long March in China, with a massive arrow indicating where Mao and his men moved through the country-side. The accompanying question did not test students' knowledge of Chinese history, but asked, "Which end of the arrow symbol marks the destination and which end of the arrow marks the beginning?"

BRIAN REINHART
Houston

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Videographics on the global economy

Back in kilter?

A series of animated charts considers how the world's four biggest economies must change to ensure sustainable global growth

REBALANCING the world economy requires substantial changes in savings and consumption habits in the United States, China, Germany and Japan, the world's four largest economies. American consumers went wild in recent years, driving global growth while the other big economies ran current-account surpluses. Now, as Americans are compelled to save more, will consumers elsewhere bolster the global economy by opening their wallets?

To accompany a series of articles in the newspaper looking at the prospects for these four big economies, we publish online "videographics"—animated and nar-

rated charts—each Friday. The first of these presented a history of American growth over the past 50 years, noting a dramatic increase in private consumption since 1980. This week's videographic looks at booming China, where surpluses may now be declining but domestic imbalances (notably between too little consumption and too much investment) remain uncomfortably large. Forthcoming videographics will assess first Germany and then Japan. ■

Watch the videographics at:
Economist.com/videographics

Other highlights



Liberty and terror Shami Chakrabarti, the director of Liberty, a pressure group, talks about the decline of human rights in Britain in the past decade. She derides "Kafkaesque" control orders in the country, rejects the slogan "war on terror" and explains why nobody has the right to be shielded from offence

Economist.com/audiovideo/britain

Techs and the city San Francisco may conjure up images of hippies and leftist politicians, but it attracts scientists in equal measure. Our correspondent spends a week among them in the labs of the Bay Area
Economist.com/correspondentsdiary

Jazzy behaviour James March is a management guru's guru. Enthusiasts say his work on organisational behaviour was to business theory what Miles Davis was to jazz
Economist.com/management

Ancient wonders Why have only two pagodas in earthquake-prone Japan collapsed in the past 1,400 years? Think of a tightrope walker, a stack of top hats and a pendulum that is unable to swing
Economist.com/techview

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Briefing Spies, torture and terrorism

The Economist August 1st 2009



The dark pursuit of the truth

Torture still casts a long shadow in the battle between spies and terrorists

JACK BAUER famously does whatever it takes to save America from disaster, be that disaster nuclear, biological or computer attack. Week after week, the hero of "24" acts brutally, and endures brutality, for the greater good. It is a sign of the times that this year's season opened with Bauer being hauled before a congressional committee to face the charge of committing torture. He was unrepentant.

This television character, who first appeared in 2001, has been oddly at the heart of the arguments over the conduct of America's "war on terrorism". Critics in the American army have complained that he encourages young soldiers to abuse prisoners. Supporters, such as Antonin Scalia, a Supreme Court justice, praised him for the episode in which he saved Los Angeles from nuclear attack, even though it meant staging the mock execution of a family to get a Middle Eastern villain to talk. "Is any jury going to convict Jack Bauer? I don't think so," said the judge.

In contrast with Europeans, who strongly reject the use of torture, the American public is pretty evenly divided about its use to extract information from terrorists (see charts on next page). But President Barack Obama, for one, is clear. No sooner had he been sworn into office than he banned torture, rescinded legal opinions

allowing simulated drowning and other harsh methods, ordered all American agencies to comply with the army's field manual on interrogation, announced he would close the prison at Guantanamo Bay within a year and ordered a series of policy reviews on detention and interrogation. "From Europe to the Pacific", Mr Obama said in May, "we've been the nation that has shut down torture chambers and replaced tyranny with the rule of law." Dick Cheney, George Bush's vice-president, sneered at such talk as "recklessness cloaked in righteousness".

Many people thought that Mr Obama's election would finally settle the controversies about counter-terrorism's "dark side" (as Mr Cheney once put it): a darkness that concealed secret prisons, abusive interrogation and "rendition" to countries that practise torture. The distorted DRY legal framework that treated suspected terrorists as neither criminals nor prisoners-of-war, leaving them in an unprotected grey zone between civil and military law, would, many liberals hoped, be put right.

In April, against the wishes of current and former CIA directors, Mr Obama released four secret memos from the Department of Justice, written in 2002 and updated in 2005, that made legal the CIA's use of "enhanced" interrogation techniques such

Mr Obama said that he did not want to prosecute those who operated within these rules. He knows that if he takes action against interrogators he could be accused of seeking scapegoats; if he goes after the CIA chiefs he would be charged with undermining America's security; and if he investigates leaders of the Bush administration he would look as if he were conducting a witch-hunt against his political rivals. "Nothing will be gained by spending our time and energy laying blame for the past," he argued.

Yet the past casts a long shadow. Some of Mr Obama's supporters want a "truth commission" to establish what happened and, perhaps, recommend prosecutions. Congress is incensed that the CIA did not tell it of a secret programme (which may have had to do with the assassination of terrorists), apparently under orders from Mr Cheney, bringing the former vice-president a step closer to formal investigation. The attorney-general, Eric Holder, is thought to be about to appoint a special prosecutor to investigate those interrogators who exceeded the already lax limits set by the so-called "torture memos".

Even before this, CIA officials had been hitting lawyers in anticipation of trouble. ▶▶

Some of Mr Obama's favourite spooks have been unable to take up senior appointments because of their association, sometimes only peripheral, with the interrogation programme. John Brennan, a veteran CIA figure, was withdrawn from consideration as the agency's director and was given a job in the White House instead. Philip Mudd, a respected intelligence man currently on secondment to the FBI, pulled out of his nomination to the senior intelligence post in the Department of Homeland Security. The Obama administration may have chosen these men but it put little effort into backing his choices.

The big chill

How will all this affect future intelligence operations? There is a distinct chill. Some reckon that the CIA and other agencies face their worst crisis since the post-Watergate inquiries in the 1970s uncovered evidence of spying on Americans and plots to assassinate foreign leaders. "There is undoubtedly some nervousness," says one senior source. "It does not stop you taking action, but it makes you think twice and talk to your lawyer."

Britain's close relations with America are causing it similar problems. Its intelligence agencies are being dragged into the legal limelight, not for torturing suspects but for allegedly colluding in their maltreatment by others—whether they are Americans, Pakistanis or Moroccans. One member of M15, Britain's domestic intelligence agency, is under police investigation.

Increasingly lawyers are being brought in to scrutinise British intelligence before it can be passed on. Will handing over the name of a suspect to America lead to him being killed by an unmanned aircraft in Pakistan? Will sharing a telephone number with, say, Egypt's spies, lead to the arrest and torture of somebody who should instead be merely watched? Will submitting questions to be asked of a man held in a foreign prison mean that British agents will be held responsible for his treatment?

Agents have become warier of questioning detainees abroad for fear that they will be blamed for any abuse they may have suffered. The number of requests by officials in M16 (Britain's foreign intelli-

gence service) for the legal cover known as "Article 7", in which the foreign secretary approves actions that are illegal in Britain, has shot up.

Many of the woes of British agencies are embodied in the case of Binyam Mohamed, an Ethiopian asylum-seeker in Britain, who gave up his drugs habit after rediscovering Islam. He went to Taliban-ruled Afghanistan to see an Islamic state at work. There he underwent some form of military training—to help the resistance in Chechnya, he says, not to fight the Americans. He was arrested trying to leave Pakistan in 2002 on a forged passport. He was beaten in prison, where he was seen by members of the FBI and M15. He was then taken by the Americans to Morocco, where he says he was tortured by a questioner called Marwan, who took a sharp blade to his chest and penis while asking questions that had plainly been fed to him by M15.

The British authorities say that once Mr Mohamed had left Pakistan, they did not know his whereabouts or conditions of detention; all questions were submitted through the Americans. Much of America's programme of secret detention and interrogation was formally hidden from allies. The top-secret "torture memos" were classified "NOFORN" (no foreign nationals). But stories of prisoners being abused by the Americans were already circulating in 2002. Indeed some British officials had expressed concern at what they saw.

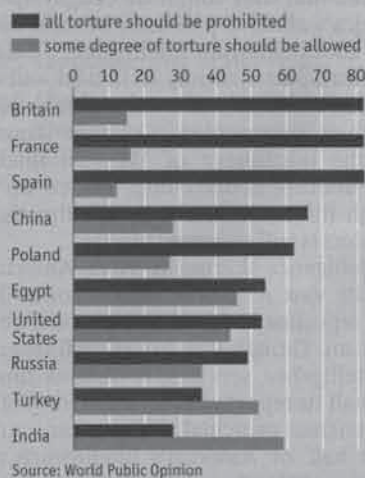
It was under torture, Mr Mohamed says, that he admitted to meeting Osama bin Laden and to taking part in plots including the detonation of a dirty bomb. This is what he would be accused of when he got to Guantánamo Bay in 2004, via a secret prison in Afghanistan. But, like many others, Mr Mohamed was released in February this year without charge.

By then Mr Mohamed's lawyers, among them Clive Stafford Smith, founder of a legal charity called Reprieve, had been in full swing on both sides of the Atlantic. They sued the British government to release documents that might prove Mr Mohamed's innocence, obtaining a High Court judgment that was critical of M15 and led to the police investigation of one of its officials, known only as "Witness B".

...compared with some others

Views on torture, January-May 2008

% responding:



In a parallel case in America, Mr Mohamed and other Guantánamo inmates are suing Jeppesen DataPlan, a subsidiary of Boeing, which allegedly provided aircraft for the CIA's rendition programme.

Mr Mohamed's release has not stopped the litigation in either America or Britain. Both governments argue that the lawsuits should be thrown out because state secrets cannot be divulged. Indeed, the Obama administration has warned Britain that intelligence-sharing would be jeopardised if secret information provided by the CIA were to be revealed in British courts. Similarly, officials in Britain are alarmed by what may be disclosed in America.

Waterboarding the agencies

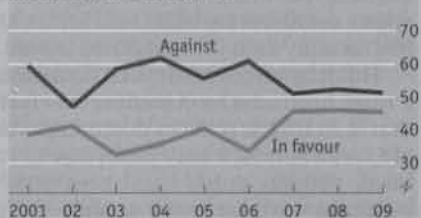
These days it is the intelligence agencies that find themselves under interrogation. Each snippet they provide produces requests for more information. And the courts, suspicious of what the agencies may be hiding, are demanding ever more disclosure. One source of information has been the succession of freedom-of-information requests for official documents, including the "torture memos", by the American Civil Liberties Union (ACLU).

Legal campaigners are waging an information-gathering effort that earns the grudging respect of intelligence operatives. "They are chasing the paper trail and winning," says one. "They are chipping away at state-secret privilege [the doctrine that courts can dismiss lawsuits if classified information will be released]. They could disclose an awful lot of information—names of interrogators and medical personnel. If secrets start seeping out, countries that have been sharing information may be disinclined to do so."

The controversies show the extent to which torture and other forms of harsh interrogation—even though they may have been abandoned—cloud the legitimate

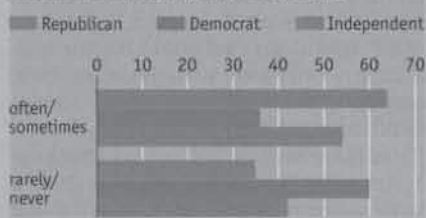
America's thoughts on torture...

Public opinion on the use of torture to extract information on terrorism*, %



Sources: "U.S. Public Opinion on Torture 2001-2009", Darius Rejali and Paul Gronke, Reed College; Pew Research Centre, April 2009 national survey

Is torture to gain important information from suspected terrorists justified?, % responding:



work of counter-terrorism. American sources say that in the latter years of the Bush administration, European agencies, worried that they might be caught up in America's abusive practices, became reticent about sharing intelligence. Today, America's partners may hold back out of fear that America will not be able to protect their information. Officials lament that the machinery of Western intelligence-sharing is becoming "gripped up"—though information about "life-threatening" plots is still swapped briskly.

Intelligence-sharing is vital. America, with its vast resources, has become the main repository of information on global terrorism. Though Britain has well-regarded intelligence services, it obtains more than half its reports on terrorism from other agencies, principally American. And about half of America's intelligence reports on al-Qaeda until 2006, says a former senior official, came from detainees.

The Justice Department's memos were prompted by the arrest in 2002 of Abu Zubaydah, a man with close links to al-Qaeda. The CIA wanted clearance to exert greater pressure on the first of its "high-value detainees"—even though FBI investigators would later claim that Mr Zubaydah was already talking freely.

Degrees of pain

The memos gave the CIA licence to use "enhanced" techniques derived from American training advice to pilots and other personnel on how to withstand torture if they should fall into enemy hands. They are shocking for their bureaucratic punctiliousness. They parse the degrees of pain that would constitute forbidden torture ("an intensity akin to the pain accompanying serious physical injury"). They set out in incongruous detail the limits of abuse.

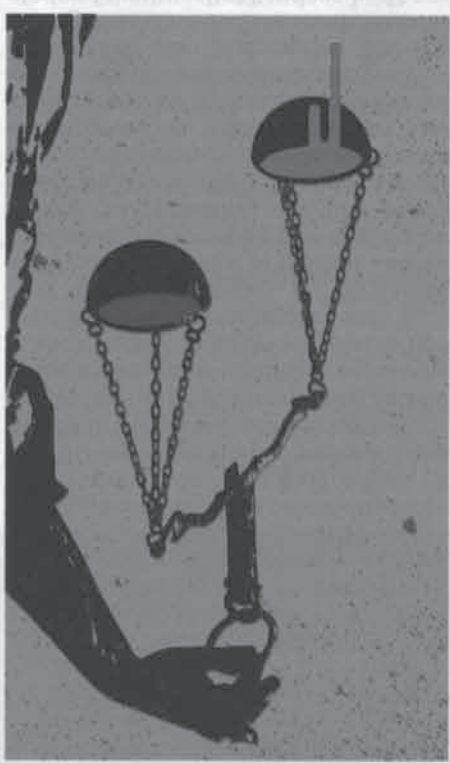
A prisoner could be deprived of sleep, but for no more than 180 hours before being allowed to rest for eight. He could be stripped naked but only if the room was warmer than 68°F (20°C). He could be doused in water but it had to be potable. He could be waterboarded with cold (saline) water poured onto his face but each application should not last more than 40 seconds, there should be no more than six applications per session, no session could last more than two hours and there could be only two sessions in 24 hours.

The ACLU's next target is a comprehensive and still largely secret internal CIA report written in 2004 by John Helgerson, then the agency's inspector-general. This is believed to be particularly damning, providing evidence of abuse that went well beyond the permitted guidelines. Compared with the antiseptic legal memos, called "The Dark Side", the Helgerson report is a "Technicolor horror show", including accounts of people who died in

the enhanced techniques. Though he decries Bush administration's policies, including in large measure, argues Mr Cheney, to the America after September 11th was thanks to that there was no follow-on attack on committed in military prisons.

However, ignores all manner of abuses just three people were waterboarded. This, "handed" techniques set out in the memos, third of those were subjected to the "enhanced" techniques set out in the memos. Just three people were waterboarded. This, however, ignores all manner of abuses committed in military prisons.

That there was no follow-on attack on Bush administration's policies, including in large measure, argues Mr Cheney, to the America after September 11th was thanks to that there was no follow-on attack on committed in military prisons.



custody. A version of the report, so heavily redacted with black deletion marks as to be barely comprehensible, was released in 2008. A more complete version is expected in the coming weeks, although the Obama administration has asked for delays.

Crucially, the report is critical of the value of the information obtained through harsh interrogation. It apparently concludes that there is no evidence that such intelligence prevented any imminent attacks. But this argument was strongly contested by the Bush administration.

Michael Hayden, the CIA's director from 2006 until earlier this year, wrote in April that enhanced interrogation had led the agency from one big fish to another.

nounced the release of the memos that allowed these methods, he now wants further documents to be published that would, he says, demonstrate their success. People familiar with the inner workings of intelligence suggest a more ambiguous story. Intelligence, they argue, is about piecing together fragments of information and building up spider diagrams of connections between suspects. "Intelligence is whole beach," says one veteran.

It is true that in 2001, a time when the CIA and other agencies were woefully ignorant of al-Qaeda's methods, the prisoners captured after the overthrow of the Taliban were the first rich source of information to help "map the enemy", as one intelligence source puts it. But, says a former counter-terrorism official, the most valuable information from Mr Zubaydah's capture came not from his interrogation but from his address book. With Mr Mohammed, says another analyst, the most important factor in stopping further attacks on America was not what the terrorist said under duress, but that he had been captured in the first place.

Intelligence officials maintain that detainees under interrogation provided as many, perhaps more, specks of information as other sources of intelligence on terrorism, including signals and agents. The question that nobody can answer is how much of this could have been obtained without torture.

Bleak choices

The danger for Mr Obama, as he seeks to overhaul the intelligence system, is that a fresh attack on the American mainland would immediately expose him to the accusation of being soft on terrorism. In May Congress revolved against any attempt to move detainees from Guantanamo to American soil before a plan for the disposal of its 229 prisoners had been drawn up. Yet three task-forces examining the matter, including future policy on detainees, have delayed issuing their reports because of the complexity of the problem.

Mr Obama has decided to keep the revised military commissions, albeit with definite detention for some prisoners, with judicial and congressional oversight. Lacking in the background are the lesser-known problems of America's prison at Bagram, its main base in Afghanistan, where detainees are being held with much less scrutiny than those at Guantanamo.

Holding terrorism suspects has become a huge headache for America. One fear is that in future, it tracks down important al-Qaeda figures, it may prefer one of two bleak options: either turn them over to countries with far fewer qualms—or just drop a bomb on them. Jack Bauer would be delighted. ■



The euro-area economy

First, the good news

The economy has probably seen its worst, but a strong recovery may be too much to ask for

AT THE beginning of June Jean-Claude Trichet, the head of the European Central Bank, set out its latest forecasts. Though the worst of the downturn had probably passed, he said, the euro-area economy would be unlikely to grow until the middle of 2010. Just a few weeks later Mr Trichet looks too gloomy. Figures published on August 13th are likely to show that GDP shrank again in the second quarter, but that this will probably be the low point.

More timely indicators suggest the economy has started to grow again. Businessmen are cheerier. The gauge of German business sentiment published by Ifo, a research institute in Munich, rose in July to its highest level for seven months. Confidence in France increased for a fourth straight month, according to a survey by INSEE, the national statistics agency. The brighter mood reflects orders and sales. Euro-zone industrial output rose in May for the first time since September. A broader index, based on surveys of purchasing managers in manufacturing and services, was much stronger in July.

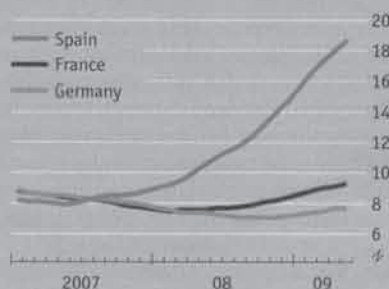
This revival of animal spirits counts because so much of the downturn owed to a collapse in business spending. Firms slashed their capital budgets and pared back stock levels when their export sales collapsed. Foreign demand is now return-

ing. Euro-zone exports to China rose by over 40% between January and June, according to Goldman Sachs. Shipments to India have also picked up. Orders in Germany are improving as its capital-goods firms benefit from infrastructure spending in Asia. The fresh signs of life in America's housing market raise hopes that recession is lifting in Europe's biggest export market.

Consumers are also perking up, though compared with firms they had barely cut back. In the year to the first quarter, the worst period for the economy as a whole, consumer spending in the euro area fell by 1.2%, less than in America and far less than

Spanish flu

Unemployment, as % of labour force



Source: Eurostat

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Europe.view, our online column on eastern Europe, appears on Economist.com on Thursdays. The columns can be viewed at

Economist.com/europeview

in Britain. That figure conceals a split: consumption in Germany was stable, and in France, it grew; but in Italy and Spain it fell off sharply. Spending in the euro zone as a whole has since strengthened, though the North-South divide remains. Retail sales picked up in Germany in April, and again in May, but faltered in Spain and Italy. In France household spending on manufactured goods jumped by 1.4% in June. Government incentives to support new car sales by offering cash for old ones have tempted buyers into showrooms. Spending power has also been boosted by falling consumer prices.

Three (modest) cheers

A revival in trade, business optimism and resilient consumers: that combination promises modest growth this quarter. There may even be some pleasant surprises in the next few months. Germany's economy could bounce back faster than expected, because its cuts in business investment and stocks have been so savage.

But the good news ends there. One worry is that more pain is due in Spain, Italy and elsewhere. The surprisingly large fall in second-quarter GDP in Britain is a blow to its euro-zone trading partners. It is also a warning that recovering from housing and credit busts is hard. Spain and Ireland were big sources of euro-zone demand, before their housing busts. Spain will soon find it harder to offer fiscal support to its economy. Italy's exporters are struggling with high wage costs and a strong euro. Eastern Europe, once a fast-growing market, is also sickly.

The longer-term fear is that unemployment will drag the economy back down. The risk is greatest in countries where job

gate still spend more than they earn, despite cuts in investment. Action taken to bridge that gap while financing conditions are still tight would include job cuts. As in Germany, that process could be slow and rely more on hiring freezes than lay-offs, says Julian Callow at Barclays Capital. But it would weigh on consumer demand all the same. Although Europe shows signs of recovery, there are plenty of reasons to fear it will not be a robust one. ■

Passport woes

Visas in the Balkans

When visa requirements are relaxed tensions can mount

EVERY summer millions of young folk explore Europe using cheap, convenient rail and bus passes. Thanks to a new visa-free deal, more of those strumming guitars on the Ramblas in Barcelona or the Spanish Steps in Rome should soon hail from parts of the former Yugoslavia—but not yet from all of the western Balkans. That is creating political tensions.

For years visas have been a neutral issue in the region. So a recent recommendation by the European Commission to scrap visas for Serbs, Montenegrins and Macedonians from the start of 2010 should be good news. If it takes effect, it will give people in these countries free access to the Schengen area of 25 countries, including almost all EU members plus Switzerland, Norway and Iceland.

Before the wars of the 1990s Yugoslavs did not need visas to travel to the rest of Europe. Today it is said that 70% of students at Belgrade University have never been abroad. For years EU foreign ministers have been berated about this by their Balkan colleagues. Their answer has often been that, if it were up to them, all would be fine. But interior ministers, fearful of organised crime and drug- and people-trafficking, refuse to agree. The counter-argument has been that criminals will hardly wait in line for visas they can buy or forge, so visa rules merely punish ordinary folk and legitimate businessmen.

To achieve visa abolition has taken a huge amount of work, the introduction of modern biometric passports being only a first step. Already the political fallout of the decision is being felt. In the Balkans visas and passports are not a mere technicality, but the stuff of high politics. And the commission's decision means that Bosnians, Albanians and Kosovars feel left behind. There is particular bitterness within Bosnia. Bosniaks (Bosnian Muslims) cannot travel freely, but Bosnian Croats can be-

cause of the scheme is equivalent to some 400,000 full-time employees. Such schemes cannot last for ever. Car firms and their suppliers have been among the keenest users of short-time working, anxious to keep skilled staff. Yet unless demand for cars stays high after "cash-for-clunkers" incentives fade, the car industry in Europe will need fewer workers. Similarly, labour hoarding in France also comes at a cost. French firms in agree-

Everyone's a winner in Alice in Zapateroland

MADRID

All must have prizes

Spanish devolution and the budget

cuts have so far been modest. Compared with Spain, where a nasty construction bust has already put many out of work, the jobless rates in France and Germany have barely responded to lower output (see chart on previous page). German job losses have been stemmed by a government scheme that subsidises the wages of those on short-time working. Around 1.4m workers are receiving the short-time allowance. The reduction in labour supply be-

AFTER a year of muddling and re-crimination, Spain's prime minister, José Luis Rodríguez Zapatero, has finally worked out how to stop regional governments squabbling over the shrinking pot of public finances. The solution is simple. They can all have more.

An extra €11 billion euros (\$15.6 billion) will be distributed, marking another step in the march of power away from Madrid towards the country's 17 regions. With the budget deficit already ballooning, the deal will make sound economic management still harder.

Even those regions run by the opposition People's Party (PP), which include Madrid and Valencia, did not vote against the offer. They abstained. They do not like the new system but facing economic problems of their own, prefer to take the money. The deal is frustratingly vague about numbers, though some regions, such as Catalonia, will be bigger winners than others. It is the financing model that best reflects the reality of Spain, said Mr Zapatero.

So if everyone is a winner, who loses? The central government will have less, says Jesús Fernández-Villaverde, of the University of Pennsylvania. Economists think the deal will increase the budget deficit—already heading towards 12% of GDP—by one percentage point. The finance minister, Elena Salgado, admits the deal will increase the central budget deficit a bit, but argues it will mostly transfer existing debt from the regions to the central government. Future taxpayers are losers too, as they must pay off Spain's debt in the long term.

For the moment, Mr Zapatero looks like the winner. At elections last year, his Socialist Party fell seven seats short of an absolute majority. Many of the extra parliamentary votes Mr Zapatero needs are in the hands of small regional nationalist or separatist parties. There is no better way to keep them sweet than to increase funding for their home regions.



And my deficit is just this big

The new deal certainly reflects one of Spain's new realities: the big spenders of public money are regional governments, who run education, health and myriad other services. It did not, however, fix one big problem. Regional governments may decide where a lot of the tax money goes, but have little influence over how it is raised (except in the Basque Country and Navarra, which remain outside this deal). So there is less pressure on them to be efficient.

The spread of devolution has been a game of follow-the-leader: independent-minded regions such as the Basque Country and Catalonia show the way; the others demand equal treatment. The latest financing rules are, in many ways, a result of Catalonia's status of autonomy, passed by the Socialists in 2006. Under Mr Zapatero, devolution continues apace. What no one can say is where, or when, it will end.



► cause they have long used Croatian passports, for which visas were abolished some years ago; Bosnian Serbs may now apply in large numbers for Serbian passports. All this weakens Bosnia's fragile statehood. It is outrageous, say Bosniaks, that a fugitive like Ratko Mladic, indicted

for murdering some 8,000 Bosniaks in Srebrenica in 1995, is now in theory able to travel freely on a Serbian passport whereas the relatives of his victims cannot.

Still, Bosnians and Albanians know that it is only a matter of time before they too qualify for visa-free travel. Not so the Kosovars, who have yet to start working on the issue with the EU. Matters are complicated by the fact that, because Serbia does not recognise Kosovo's independence, it cannot refuse to give Serbs and Albanians living there its new biometric passports. But as part of the deal on visa-free travel for Serbia, the EU excludes them.

Hence a Serbian passport for somebody in Kosovo will be worth less than one for a Bosnian. And if Serbia and Croatia can hand out passports in Bosnia, why should not Albania issue passports to Kosovar Albanians? Some people may even start to ask why the Albanian nation should be split between two states. Bureaucratic anomalies can have mighty consequences. ■

Gennady Timchenko and Gunvor International BV

In a section of our special report on Russia entitled "Grease my palm" (November 29th 2008) we referred to Gunvor and its co-founder, Gennady Timchenko. We are happy to make it clear that when we referred to the "new corruption" in today's Russia, we did not intend to suggest that either Gunvor or Mr Timchenko obtained their Russian oil business as a result of payment by them of bribes or like corrupt inducements. Rosneft sells only 30-40% of its oil through Gunvor rather than the "bulk" of Rosneft's oil (as we described it). We accept Gunvor's assurances that neither Vladimir Putin nor other senior Russian political figures have any ownership interest in Gunvor. We regret if any contrary impression was given.

Language rows between Slovakia and Hungary

Hovorte po slovensky!*

BRATISLAVA

Slovakia criminalises the use of Hungarian

LANGUAGE laws may protect minority rights or infringe them. Slovakia's new law, which comes into force on September 1st, is under fire for its harshness. It imposes fines of up to €5,000 (\$7,000) on those who break rules promoting the use of Slovak in public. Hungarian-speakers, who number around a fifth of the population, mainly in the south of the country, see that as a direct attack on their right to speak their mother-tongue. So do politicians in neighbouring Hungary. A long-running dispute between two of Europe's most prickly neighbours is turning nasty.

Slovakia's left-leaning populist government has been needling Hungary since it took power in 2006. It sidelined plans for a joint Hungarian-Slovak history textbook last year and has publicly endorsed the Benes Decrees, which expelled most Germans and many Hungarians from the then Czechoslovakia after 1945, as a punishment for their supposedly Nazi sympathies. The new law tightens rules about speaking Slovak in dealings with public officials: not just police officers or teachers, but also, say, doctors. Exceptions apply to monoglots, or in districts where the minority makes up a fifth or more of the population. Hungarian-language schools must

conduct their administration in Slovak. The new law also lays down detailed instructions for the way in which memorials and plaques may be inscribed.

A party representing the Hungarian minority is mounting a challenge in the constitutional court: it calls the law "19th-century language imperialism". The Slovak response similarly accuses the Hungarians of hankering for the 19th century: they dominated the region in the Habsburg era. The Slovak prime minister, Robert Fico, said the real problem was those wanting to bully Slovaks in the south of the country into learning Hungarian.

The Slovak foreign ministry has published (unilaterally) an expert opinion drawn up in confidence by Knut Vollebaek, high commissioner for national minorities at the Organisation for Security and Co-operation in Europe, a Vienna-based international organisation. Mr Vollebaek agrees that bill does not in itself contravene international law or Slovakia's earlier commitments to protect minority languages. But his opinion also highlights concerns over the hasty passage of the new legislation and the danger that it may be interpreted arbitrarily.

The big question is the meaning of the requirement that Slovak be used "in public". Would, say, a Hungarian-speakers' po-

etry club have to arrange for their meetings to be translated into Slovak? Perhaps not, but it is an odd thing to have to worry about these days in the European Union.

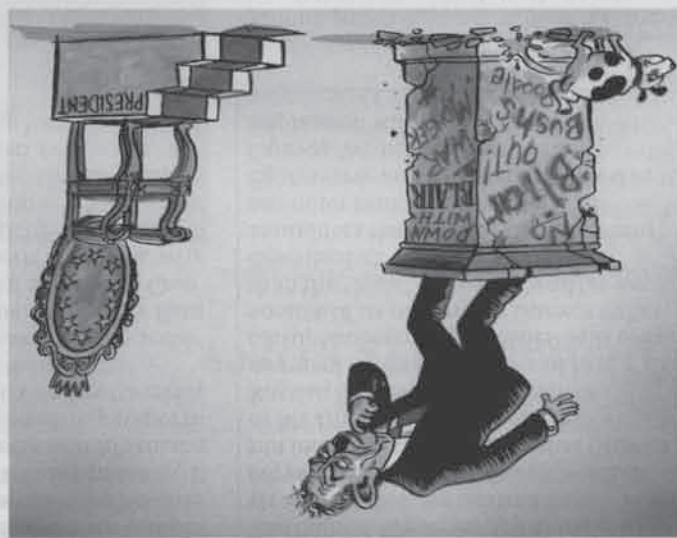
Grandstanding in the run-up to elections has fuelled the row. Mr Fico is gaining record popularity ratings. It helps divert opinion from issues such as corruption and economic decline. Mikulas Dzurinda, a former prime minister and opposition leader, says that the real danger to the Slovak language comes not from tongue-tied ethnic Hungarians, but from the debasing of Slovak by foul-mouthed chauvinists in the government, such as the leader of the Slovak National Party, Jan Slota. He recently provoked uproar by calling a policewoman (she says) a "cunt". The charming gentleman's complaint? She had refused to allow his driver unauthorised entry to a parliamentary garage. ■



*Speak Slovak!

Charlemagne | Unwelcome, President Blair

Europe does not yet know what kind of foreign policy it wants. It may soon have to choose



was asked about Mr Blair. Winging it, she called him her government's candidate; this was a blunder, not a clever ploy.

The episode did Mr Blair no favours. But it may have done the EU a good turn. It is time that Europeans had a proper debate about the global presence they want. The Lisbon treaty creates two big new foreign-policy posts. Apart from the council president, there will also be a befeefed up "high representative", a kind of foreign minister who will chair meetings of EU foreign ministers (ie, will have political power) and be a vice-president of the European Commission (ie, will have pots of money, thousands of staff and offices round the world). Possible contenders include Carl Bildt, Sweden's foreign minister, who says he does not want the post, and Olli Rehn, the Finnish enlargement commissioner, who probably does. Some talk of Dora Bakoyannis, foreign minister of Greece, or Ursula Plassnik, an ex-minister from Austria.

Most people in Brussels are confident (indeed, overconfident) that the two new jobs are coming soon. Conventional wisdom says the Irish will be sufficiently covered by the economic crisis to vote yes to Lisbon in early October, allowing EU leaders to discuss the new jobs at a summit later that month. Remarkably, most other details have not been nailed down. Lisbon is silent on the question of how the council president and high representative will avoid getting in each other's way.

Inside the Brussels bureaucracy, the view is that the high representative will be the more powerful figure; the post's budget, staff and institutional reach count for more than the fancy title of "president". In Paris and London, by contrast, the view is that the council president, as the envoy of national leaders, takes primacy. France's president, Nicolas Sarkozy, has in the past suggested Mr Blair would make a fine president. Of late he is reported to have cooled on the idea, although he would still want a big hitter. France sees Europe as the lever for achieving global clout. For all its wariness of Europe, Britain's position is not that dissimilar. It sees the EU's population of 500m people and its economic heft as a route to relevance on issues such as climate change. As David Milliband, Britain's foreign secretary, said in June, if Europe wants to avoid a "G2 world" shaped by China and America, the EU needs to offer itself as a partner for "G3 co-operation".

Big power, soft power or no power?

This matters. If great-power diplomacy is Europe's goal, it needs a council president who is seen as a peer by world leaders (well hello again, Tony). But not everyone agrees. Senior figures in the Brussels foreign-policy establishment (and in Germany) argue that the EU enjoys "moral and legal legitimacy" precisely because its overseas actions are not based on the interests of a few big states, but are approved by consensus. Smaller countries say similar things, mainly out of fear of being bullied by big members. Fredrik Reinfeldt, the prime minister of Sweden, holds the rotating presidency of the EU. He says small and medium-sized countries "are not interested" in an over-strong president; he prefers to speak of a "council chairman" rather than a president.

In the end the decision may be taken by default. EU jobs are awarded in long, unpredictable horse-trading: leaders may give one job to a star, and the other to a plodder, thus fixing their relative clout. If it were to be, say, President Schüssel and High Representative Bildt, the high representative would run foreign policy. If the EU ends up with two plodders, irrelevance beckons. ■

Oddly, Mr Blair is not even a confirmed candidate. But last month Britain's minister for Europe, Glenys Kinnock, caused a sensation when she was quoted as implying that he had Britain's official backing. This undammed a torrent of hostility. Continental commentators sniffed that Mr Blair was a phoney, who called himself a European but never made the British love Europe (they should try). British newspapers lazily declared that Mr Blair was in it for the salary and perks, and called his successor, Gordon Brown, "Machiavellian" for promoting his cause. Alas, the story was untrue. Lady Kinnock, a former member of the European Parliament, had been a minister for about five minutes when she

Why such animus? Doubtless some people think Mr Blair loathsome, even wicked, for his actions as Britain's prime minister between 1997 and 2007. But that is not a common view among the senior European politicians and officials who also oppose him. Something else is at work: a telling rejection of what a president Blair would say about the EU, and its foreign-policy goals.

Apart from Mr Blair, other possible candidates mooted so far include Felipe Gonzalez, Raavo Lipponen and Wolfgang Schäuble, ex-government heads from Spain, Finland and Austria respectively. None triggers the same reactions as Mr Blair. He is the only prospective candidate with his own protest website, www.stopblair.eu, signed to date by 32,000 people.

The holder of the new position, to be created by the much-debated Lisbon treaty, would speak for the 27 national leaders and chair their summits for a term of two and a half years, renewable once. The job is not "President of Europe", as some call it, but president of the European Council, the bit of the EU controlled by national governments. The holder will have to work with the European Parliament (which hates the Council) and the European Commission, a hybrid executive bureaucracy.

seeds of today's economic crisis. The Thatcher-inherited neoliberal politics that sowed the him for "Thatcher-inherited neoliberal politics" that sowed the ment he calls a Blair candidacy "absurd", damning him as a zealous advocate of the Iraq war that divided Europe, and blaming prominent euro-politicians into paroxysms. Take Daniel Cohn-Bendit, co-leader of the Green faction in the European Parliament. He makes people so cross? Something about the idea sends WHY does the thought of a "President Tony Blair" in Europe



The quality of teachers

Those who can

copy to keep them around. Although beyond the reach of the outside world, the account for most British was built.

CANTERBURY

Education reforms will never work unless teaching attracts more high-fliers

I SET up a Fantasy Football competition between some of my toughest pupils," one young man explains. "They get goal-keeping points for good attendance, and defence points for behaving well. Good punctuation and spelling translate into their midfield performance, and coming up with good ideas, into attack." Around the room, pens scribble furiously. "Pupil x hated me," a woman tells the group; she describes how she changed that with weekly phone calls to his parents and postcards praising his (intermittent) good behaviour. More notes are made.

This is the Teach First summer institute: six weeks in Canterbury, a southern cathedral city, at the end of which nearly 500 new university graduates will teach full-time, for £15,000 (\$24,500) a year, in some of England's toughest schools. The 360 who started the programme last year are here too, handing on to the raw recruits their tips for coping with bad behaviour and keeping lessons fresh, and demonstrating to their tutors what they have learned. In another year, those old hands will be qualified teachers, trained on the job and in tutorials and summer schools.

Recruiting the right kind of teachers has been difficult in England for some time, and though recession has brought temporary relief, the task is getting bigger as those hired to teach the baby boom near retire-

ment. Head teachers, worn down by constant official policy changes and an avalanche of paperwork, are retiring early. A study in 2007 by McKinsey, a consultancy, concluded that countries whose students perform well tend to recruit teachers from the top of the class. But a recent report by Politeia, a think-tank, found that the bar for getting into teacher training in England is, by international standards, unusually low. Trainee teachers can resit basic literacy and numeracy tests as often as they like—and 13% need at least three goes at the latter. Around 1,200 each year graduated with the lowest class of degree, a third.

The result is a general sense that the country's teachers have been scraped from the bottom of the barrel. That makes it unlikely that ambitious graduates will consider joining the profession, or stay in it if recession persuades them to do so briefly.

Modelled on Teach for America, a programme founded in 1989 that now trains 4,000 teachers a year, Teach First aims to reverse this vicious cycle by creating a route into teaching for high-fliers. Applicants are screened for leadership and communication skills, and the successful ones promise to teach for two years in "challenging" schools: those where few pupils get good exam results or where more than 30% are poor enough to receive free school meals. Such schools tend to have the least

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Bagehot is on holiday

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qualified teachers and to suffer from high turnover. One summer-school participant is about to start teaching mathematics to 15-year-olds who have had 22 teachers in the subject in the past three years.

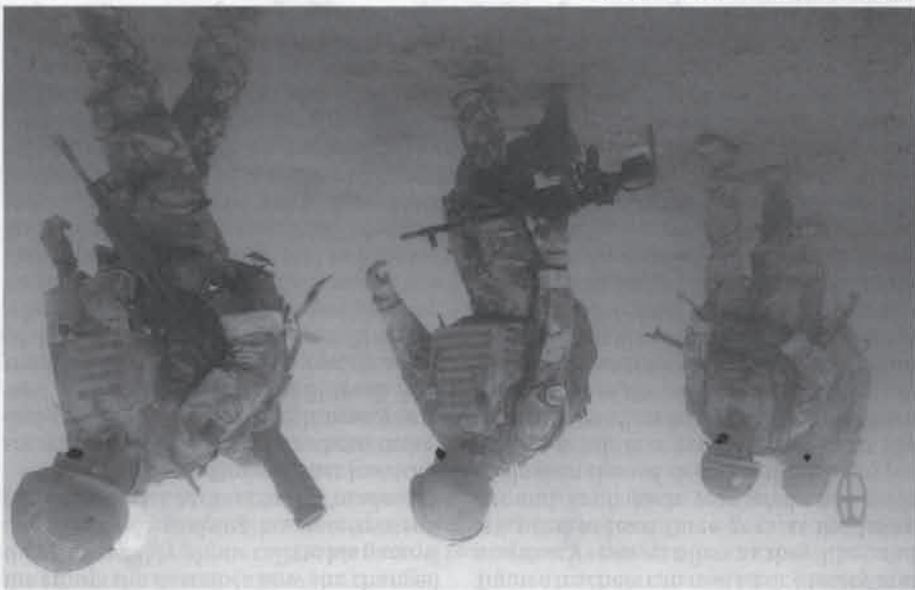
Unlike government recruitment drives, which tend to present teaching as appealing, even easy, Teach First describes the job as tough and demanding because the right people are those who are attracted by the most daunting tasks. Few at the Canterbury summer school think they would have considered teaching without that approach: the standard one-year postgraduate course is, they say, "too slow", "too theoretical" and "boring". Strong links with businesses, including prestigious graduate recruiters who often scoop up those who decide not to stay in teaching, help bring them in too. Some employers, like HSBC, a bank that is one of the charity's biggest donors, guarantee those who leave after their two years a first-round interview.

Since 2003, when it received 1,300 applicants for just 200 places, Teach First has grown fast. Nearly a tenth of Oxford's class of 2009 will be Teaching First this autumn. The programme already has its first head teacher, Max Haimendorf, hired to lead a new school in London after just three years teaching. It expects to take on 850 recruits in 2012, making it one of Britain's largest graduate recruiters. To date almost three-fifths have stayed on after their two-year stint, which means that retention of teachers is almost as good as with traditional routes into the classroom.

Around 40,000 people train to teach each year in England. Making Teach First the main way to do so would dilute the

To hear an interview with Max Haimendorf of Teach First go to Economist.com/audiovideo/britain

forces charity, points out that the AFCS was only meant to be a stopgap until the old War Pensions Scheme could be properly replaced. Medical advances mean that soldiers often come back with collections of wounds that would previously have been fatal, and do not fit easily into its categories. Sir John Major, prime minister before Tony Blair, worries that the scheme is lopsided: soldiers can get over £500,000 for the worst physical injuries (losing both eyes and two arms, for example, or all four limbs) but the award for mental injury is capped at £48,000. Others say it is simply a favouritism: a favourite case is that of a civilian air-force typist, not covered by the AFCS, who was awarded £484,000 for repetitive-strain injury in 2007, whereas under the AFCS total blindness in both eyes is worth just £402,500. General Sir Mike Jackson, once head of the army, says diplomatically that the scheme is "not one of generosity". This latest outbreak of unseemly penny-pinching is symptomatic of a government that is struggling to pay for the armed forces. Concern that the army is fighting two wars on a shoestring budget refuses to go away. The government spent much of July embroiled in an argument with generals (of both the real and armchair varieties) about whether troops have enough helicopters to ferry them around Afghanistan, that account for most British war deaths. Earlier this year the MOD was forced to allow Nepalese Gurkha mercenaries who have served in the British army to settle in Britain. On July 29th, aware that his department had again badly misjudged public opinion, Bob Ainsworth, the defence secretary, rather lamely brought forward a planned review of the AFCS scheme from next year to this, though he made clear that it would not affect the cases now in court. ■



A long way home, and to what?

Lions led by accountants

Army compensation

Those who do not stay in education and lead new schools. Business leaders will also be influential. They are apt to bemoan the awfulness of Britain's school-leavers, but since few went to sink schools themselves, or send their own children to them, the remedies they prescribe are not notably informed. That drawn from the programme's ranks. Teach First's most important contribution is to get the best people teaching in the most challenging schools. ■

tion, though, may be to shake up education research and policy. "New teachers aren't enough adrenalin junkies out there, anyway. Rather, the programme hopes to change the profession less directly. As Teach First becomes better known, teaching will start to be seen as a job for ambitious go-getters. It should help with the shortage of school heads, too. And if the Conservative Party wins the next general election, as seems likely, Teach Firsters may help to make its slightly half-baked plans to open hundreds of new schools a reality. Brett Wigdortz, the charity's founder and chief executive, says that many participants tell him they would be keen to set up and lead new schools.

Almost all education-policy documents and research papers these days start with a reminder that a child's family background is by far the strongest influence on his educational achievement. This evident truth could spur teachers to greater efforts to lean against that wind: instead, it is generally used to explain away poor children's weaker performance. Teach First challenges such defeatism. "We believe educational inequity is a solvable problem," says Mr Wigdortz, "and that the way to solve it is to get the best people teaching in the most challenging schools." ■

Ministers have an inexplorable tin ear when it comes to the armed forces. Compensation Scheme (AFCS), which pits geomorphology into 15 categories according to rank and service, which politicians, generals and veterans' associations have come together to criticise the government. The Royal British Legion, an armed-

It is hard to think of a more combustible topic than Britain's foreign wars. Patriotism and appreciation for soldiers doing the dirty work wrestle in the popular imagination with anger over official mishandling of conflicts seen by many as an illegal and costly mistake (Iraq) or an unwinnable misadventure (Afghanistan). Ever-bigger crowds turn out to greet the bodies of soldiers coming home for burial: four more returned on July 28th. That same day, with the government appealing against a pensions-tribunal decision to increase the compensation awarded to a pair of wounded soldiers.

One of the soldiers was shot in the leg in Iraq, and is now serving in Afghanistan. The other broke a leg on a training exercise. The Ministry of Defence (MOD) awarded them £9,250 (\$15,144) and £8,250, respectively. But the soldiers argued that they had had further problems during treatment and judges raised the sums to £46,000 and £28,750 this year. The MOD maintains that only initial injuries should be eligible for compensation, and that the ruling jeopardises the principle that payment should be about injuries rather than disablement. A decision is expected in October.

The case has focused attention on the perceived injustices of the Armed Forces

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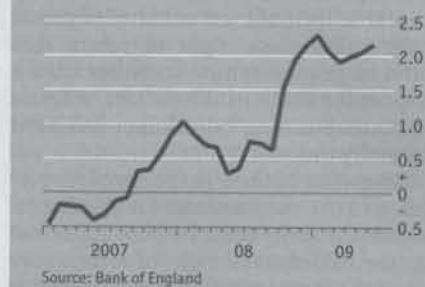
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tate agents to a code of conduct. TPO tries to steer its members towards signing its own code, but there is no obligation to do so. There is not even a proper record of the number of estate agents in the country. By the end of June 6,904 firms representing 10,437 offices had registered with TPO. It reckons this is about 95% of the market.

An estate agent needs no professional qualification and the spectrum of practitioners is wide, from chartered surveyors, with letters after their name and their own tradition of integrity, to fly-by-night salesmen. It is the latter who have been worst hit by the downturn. The wiser fraternity, having seen housing blips before, kept something in reserve during the decade-long boom to 2008. Keith Johnson at JW Woods in Durham, for example, reduced his staff from 90 to 58 in the course of 12 months but closed none of his seven offices. A handful of smaller agents were forced to shut up shop around him.

Now, it seems, the worst may be over. Many sources are registering a small rise in house prices from May to June. The Land Registry, which logs actual sales, reported a 0.1% increase overall, with big regional differences. John Nicholas, an agent in Pembrokehire, said his business was declining in June, whereas Roger Punch, at Stags in Plymouth, saw a "serious upturn". Interest in south-coast holiday homes has revived.

Spread between banks' two-year swap funding rate and fixed-mortgage rate for customers percentage points



In a recovering but fragile market "who needs more red tape?", asks Grant Shapps, the Conservatives' shadow housing minister. Yet better regulation of estate agents and letting agents is on the government's agenda. Three hefty reviews—the Carsberg, the Jones and the Rugg—have thudded onto civil servants' desks in the past 14 months. The National Association of Citizens Advice Bureaux has produced a clutch of cautionary tales about letting agents' abuse of both tenants and landlords, including theft of rental payments and deposits. All conclude that the sector should be better regulated. The proposals range from mandatory but privately enforced codes to external policing.

ant to be relaxing bank- in the downturn. And there government schemes to ures on less fortunate bor- here is no cure for the mort- ere mispriced in the boom are the variable "tracker" oke juicy when the Bank of se rate, which they track, ove the banks' own cost of time the base rate hit a low arch, however, the mortgages ce ceased to make the banks Boulger, at the mortgage Charcol, says that his perso- ortgage is costing him a ove the base rate.

up for their past errors, many w charging much higher ew lending. The margin on ortgages soared last Decem- vo percentage points above eoretical cost of funds, and pped since then (see chart). eft room for the banks with ggage to enter the market or presence at competitive front of the pack is HSB, e bank, First Direct. The pair

are consistently near the top of comparison websites. Handelsbanken of Sweden, which has some 60 branches in Britain, is enjoying lending to the well-off. And the state-owned Bank of China is offering the best rates for buyers planning to let their property. With only five branches in Britain, it uses "mortgage packagers" who deliver clients with most of the paperwork done. As the bank insists on a face-to-face interview with every borrower and applies strict lending criteria this is hardly an assault on the mass market—yet.

Letting and managing agents are a particular problem because there is little record of births and deaths. Standards are in a muddle. "There's a feeling that this part of the industry has been running wild," says Julie Rugg at York University, who was responsible for one of the reviews.

A government consultation on the matter is in progress but has lost momentum. Little is likely to be done before the next general election, due by June. And then the reformers may have to reckon with Mr Shapps, who says he would scrap any attempt at "top-down regulation". He can live without more statistics, he says: "I don't know how many kettle manufacturers there are, and it doesn't bother me." ■

The Economist



Not quite as gloomy as they look

Israel and Palestine

The contours of a peace deal are clear. But who has the courage to draw them?

JERUSALEM AND RAMALLAH

BACK in the autumn of last year, Ehud Olmert, then Israel's fading prime minister, and Mahmoud Abbas, the Palestinians' more durable president, were astonishingly close to a peace deal. Judging by an interview with Mr Olmert published in *Newsweek* in June, after he had given up his post, they appeared to have been only a whisker apart—though Mr Abbas has since called the gap “wide”. But it is worth spelling out what Mr Olmert says he offered, in an account that other senior Palestinians have pretty much verified. For it starkly shows what both sides need to do to clinch the deal—and how feasible it is.

According to the report, Mr Olmert offered the Palestinians nearly 94% of the West Bank as the basis of their would-be state, plus land swaps of Israeli territory to make up the difference, amounting to nearly 6%, plus a safe-passage road corridor to link Gaza with the West Bank.

Mr Olmert is said to have also offered to internationalise the sovereignty of the east side, the Israeli one on the west.

Finally, perhaps most controversially, Mr Olmert says he offered to let a small number of Palestinians return to the lands in Israel from which they or their forebears had fled after the Jewish state was founded.

In 1948. That did not, says Mr Olmert, amount to a “right of return”. The number who would go back to Israel was “smaller than the number the Palestinians wanted”. Although Mr Abbas put a different slant on the offer, they were groping towards what some diplomats say might be a mutually acceptable formula: an acknowledgment of the Palestinians’ right of return that would largely be symbolic, rather than a passport for millions. Elsewhere, a figure of 30,000 returning Palestinians has been informally mooted.

If drawing borders is the simplest problem and the mechanisms for sharing Jerusalem the most complex, the argument over the Palestinians’ right of return may well be the thorniest of all, because if huge numbers of Palestinians returned, Israel would no longer be a predominantly Jewish state. A formula has been aired whereby the number could go up or down, year by year, in sync with Israel’s population.

Benjamin Netanyahu, Israel’s present prime minister, seems to want to be more rigid than Mr Olmert was, by insisting as a precondition for talks that the Palestinians drop their claim to a right of return and that they formally acknowledge Israel as a “Jewish state”. But for the Palestinians this would pre-emptively destroy the hope even of a symbolic statement by Israel acknowledging the “catastrophe” (*nakba*, in Arabic), as they term it, that befell them when Israel was created. Moreover, the Palestinians fear that, if they gave in to Mr Netanyahu on this score, that might under-

Those toxic settlements

Hence Barack Obama’s concentration on squeezing Mr Netanyahu into stopping the settlements’ building and expansion, including what is known as “natural growth” to cater for burgeoning settler families. In the past few weeks the Israeli leader has been trying to wriggle off Mr Obama’s hook, with suggestions of a moratorium (of perhaps three to six months), with permission to finish buildings already under construction. The Palestin-

ian side, the Israeli one on the west, both states, with the Palestinian one on the application, would be shared as a capital of by Muslims. The city of Jerusalem, by im-Dome on the Rock) above it that is revered to Jews, and the al-Aqsa mosque (the Western (“Wailing”) Wall, which is sacred “holy basin” of Jerusalem—principally, the internationalise the sovereignty of the Mr Olmert is said to have also offered to dor to link Gaza with the West Bank.

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Morever, the entire negotiation that followed the meeting at Annapolis in late 2007, under the aegis of President George Bush, was “poisoned”, in the words of the chief Palestinian negotiator, by Israel’s refusal to stop building Jewish settlements in the West Bank. Recently it was reported that the number of Israeli settlers there (excluding the 190,000 Jews who now live in what used to be Arab East Jerusalem) had surpassed 300,000. The figure has doubled in a dozen years. The longer the Israelis continue to settle the West Bank, and to cut roads through it that can often be used by Israelis only, the harder it will be to create a workable Palestinian state on contiguous land rather than a series of cantons criss-crossed by Israeli roads connecting settlements. Moreover, Israel’s security barrier already fences off more than 9% of the West Bank, according to a recent UN report. The longer the settlers have to dig in, the harder it will be to displace them under a final agreement.

Those toxic settlements

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ians, however, still say they will not resume talks unless all settlement-building stops, as Mr Obama has demanded.

At least Mr Obama has persuaded Mr Netanyahu to concede the principle that the Palestinians should have a state of their own, something he had resolutely opposed in public. However, since the Israeli prime minister spat out the words "Palestinian state" (prefixed by "demilitarised") just once in a speech in mid-June, he has shown scant enthusiasm for bringing one into being.

A number of his close friends say there is no chance of it happening, anyway. In a telling vignette in July, Benzion Netanyahu, the prime minister's 100-year-old father, a historian and leading ideologue of the Israeli "Revisionist" school that promotes the idea of a Greater Israel stretching from the Mediterranean to the Jordan river, confidently assured Israelis in a television interview that his son had set conditions for the Palestinians that he knew they could never accept.

By insisting that they recognise Israel as a Jewish state as a precondition for talks, Israel's prime minister has already demanded more of the Palestinians than Mr Olmert did. Mr Netanyahu has also gone on to declare that they must recognise Jerusalem as Israel's undivided capital. This contradicts the Palestinians' passionate belief that the eastern (and once overwhelmingly Arab) part of the city would be their own state's capital.

Indeed, on the question of stopping the building of Jewish settlements in the West Bank, Mr Netanyahu's government has insisted it will continue to sanction "natural growth" across the Israeli-occupied territory. It will also encourage the continuing expansion of Jewish neighbourhoods in East Jerusalem. This, in turn, makes life more irksome for Palestinians from that part of the city, because of the rigorous and intrusive Israeli controls they are subjected to.

All the same, even if Mr Netanyahu is bent on building settlements, he has been rattled by Mr Obama's apparently equal determination to stop him. It is the first time in nearly two decades that an American president has twisted Israel's arm so hard. It is possible that something close to a freeze will be agreed on with Mr Obama's envoy, George Mitchell. After Mr Netanyahu met him this week, he agreed to halt a building project in East Jerusalem. If the Palestinians can be convinced that settlement-building has "stopped" (Mr Obama's word), peace talks may yet resume.

Who speaks for Palestine?

Yet the Palestinians' own divisions may well be deep enough to prevent progress. For it is widely acknowledged, at least outside Israel, that no deal between Israelis and Palestinians will stick unless it is endorsed both by the Islamists of Hamas and



by its secular rival, Fatah, the movement led by Yasser Arafat until his death in 2004, when he was succeeded by Mr Abbas. The two groups are at loggerheads, despite the efforts of Egypt and others to bring them together in a unity government. This would, among other things, accept all prior agreements of the Palestine Liberation Organisation, the national umbrella movement, with Israel—including recognition of it (see our next article).

In 2006 Hamas defeated Fatah in a general election, getting 44% of the votes to 41%, winning a large majority of seats in the Palestinians' parliament. But because Hamas refused to recognise Israel or disavow violence, its government was isolated by Israel, with the endorsement of America and a Quartet of countries and organisations, including the UN, the EU and Russia. A year-and-a-half later, after a short-lived spell in coalition with Fatah, Hamas violently took over the Gaza Strip. Complaining about the countless rockets that the Islamist group was firing into Israel, last December Mr Olmert's outgoing government launched a fierce assault on Gaza, which left at least 1,200 Palestinians and a dozen Israelis dead. But Hamas's control over the territory has not wavered.

In the past few weeks, blood between the Palestinian rivals has been as bad as ever, with Hamas arresting scores of Fatah people in Gaza, while Fatah returned the compliment in the West Bank. Each side is accused of torturing its prisoners.

Yet, as Mr Obama changes the mood and raises expectations, prominent Palestinians on both sides realise that only if they accommodate each other will they have a chance of getting a state for themselves. Amid massive doubts, Fatah insists it is about to hold a party congress in Bethlehem, on the West Bank, to produce a more dynamic leadership; it would be Fatah's first such event in 20 years.

In January the Palestinians are due to hold presidential and parliamentary elections. Pollsters, who have not always been

accurate in their predictions of Palestinian voting, say Fatah should win. A recent poll gave it 35% to Hamas's 19%. The Islamists may be even less popular in Gaza, where some blame them for the grievous suffering under Israel's continuing blockade.

Mr Abbas might win the presidency against Hamas's Gaza-based prime minister, Ismail Haniyeh. But if Marwan Barghout, a charismatic Fatah man now in an Israeli jail, could run, he would handily beat them both. He would also have a better chance of conciliating Fatah and Hamas—and a better one of striking a deal with an Israeli government.

The two-state idea will not come to fruition, certainly not in the next few years, unless the Israeli government sincerely wants it to, and unless Palestinian leaders settle their own differences in the interests of their people. Mr Mitchell knows this. Mr Obama probably knows it too.

Mr Olmert, who came closer to a deal than anyone realised, was once a Greater Israel man. Some say Mr Netanyahu may be persuaded to follow his predecessor down the same path. Many Palestinians once believed that time was on their side and that Israel would one day disappear. Now even Hamas seems to concede that Israel is there to stay. Large majorities of Israelis and Palestinians now want two states, side by side. It is still possible that one day they will get their way. ■

Hamas's foreign policy

Acceptance versus recognition

GAZA

A Hamas spokesman wants Barack Obama to talk to him

"HAMAS is very close on recognition of Israel," says Ahmed Yousef, the Islamist movement's deputy foreign minister, speaking from the top floor of a high-rise building in Gaza City. "We show all sorts of ideological flexibility on this." That does not, alas, mean he can unequivocally accept the three conditions the Quartet (the United States, the European Union, the UN and Russia) laid down three years ago if Hamas is to join international negotiations. But he comes close to doing so, sounding almost desperate to stretch the semantic elastic to satisfy the doubters. It is a formulation that sticks closely to the enunciations of both Khaled Meshaal, the movement's Syria-based leader, and Ismail Haniyeh, its prime minister in Gaza.

Hamas "honours" all previous agreements of the Palestine Liberation Organisation [with Israel], which include recognition, provided the other side abides by all its reciprocal promises. Hamas is ready to ▶▶

election results. Now, only days before his inauguration for a second term, Mr Ahmadinejad has fallen out with a clutch of powerful conservatives whom he had formerly counted as allies.

The latest row revolves around Mr Ahmadinejad's short-lived appointment of a vice-president. Esfandiar Rahim Mashaei is almost part of the family (his daughter is married to the president's son), but last year he angered conservatives by suggesting that the Israeli people could be friends of Iran. So when Mr Ahmadinejad tapped him for the vice-presidency, Ayatollah Ali Khamenei, Iran's supreme leader, immediately told the president to ditch his friend. Mr Ahmadinejad sulkily acquiesced but then defiantly made Mr Mashaei his chief of staff.

The president may have been trying to show that he has a mind and a power base of his own. He may also have been seeking to mollify his reformist opponents by showing the world that he is not quite as fanatical about Israel as he has often sounded. If that was his plan, it flopped. After failing to secure his own man as vice-president, he lost his minister of culture and Islamic guidance, who promptly resigned. Mr Ahmadinejad then fired his intelligence minister, who had criticised Mr Mashaei's appointment.

At Friday prayers a week after Mr Khamenei's hostile intervention, the president then caught a blast of cold air from one of his conservative supporters, Ayatollah Ahmad Jannati, who heads the powerful Guardian Council. He cautioned Mr Ahmadinejad against rubbing up Mr Khamenei the wrong way. Some have argued that the supreme leader has looked weaker in the past few weeks, but this episode is a reminder that he still wields a lot of clout. Following Mr Jannati's comments, two-thirds of Iran's parliament, which has tipped up the president before, signed a letter telling Mr Ahmadinejad to sort himself out and to do Mr Khamenei's bidding.

It is by no means the first time Mr Ahmadinejad has faced opposition from within the conservative camp. His domestic millenarian populism has long irked his more pragmatic conservative allies. Hardliners are not always keen on him either. At least one group with links to the basej militia has said it wants to wrest power from Mr Ahmadinejad, offering its own preferences for government posts.

In the past the president has been cushioned from criticism by Mr Khamenei's steady support. It is said that Mojtaba Khamenei, the supreme leader's power-brokering son who apparently has pretensions to succeed his father, broadly backs Mr Ahmadinejad. So the president still has powerful allies. Even so, just now these latest ructions within the establishment may matter more for Iran's future than protests on the street. ■

Israeli-Palestinian deal should be put to all those in the diaspora, he insists that if people choose a two-state solution, " Hamas would not object", even though it would still prefer a single state for "all the Abrahamic faiths, maybe a Holy Land federation... we leave it to the next generation to decide what kind of arrangement".

Like most Hamas officials, he breezily dismisses the movement's charter, with its anti-Semitic slurs and its chilling calls for the Jewish state's violent destruction. It is "not an important document—we don't use it. Why should we change it when we never use it?" If Hamas wanted to show good will as part of its campaign to enter negotiations, the junking—or drastic editing—of its blood-curdling charter would be a telling token of intent. ■

Ructions at the top

Iran's president in trouble

Mahmoud Ahmadinejad is being buffeted on all sides

IT HAS been a rough fortnight for Mahmoud Ahmadinejad, Iran's beleaguered president. Mr Hossein Mousavi is proving an unexpectedly tenacious opponent, accusing Mr Ahmadinejad's government of a catalogue of crimes against the Iranian people. In a Friday sermon at Tehran University, Akbar Hashemi Rafsanjani, a former president and one of Mr Ahmadinejad's leading foes, ominously called the turmoil "a crisis". Muhammad Khatami, another former president, has called for a referendum on the disputed presidential



The president hears many voices

extend its present "unilateral ceasefire" if the other side formally agrees to one; not exactly the Quartet's demand for a definitive disavowal of violence. And when it comes to recognising Israel, "the issue is not Israel's right to exist. We know Israel is there. It's not a matter of recognition." The distinction, it seems, is a semantic but nonetheless ticklish one: between acceptance and recognition. Some diplomats draw an analogy with the Irish republicans of Sinn Féin, who engaged in negotiations with Britain over Northern Ireland after disavowing violence, but still refused to accept the province's legitimacy as part of the United Kingdom.

Musing his arguments, Mr Youssef repeatedly insists on Hamas's eagerness to jump into the diplomatic fray. Again echoing Mr Meshal, he pins fresh hope on Barack Obama, copiously praising his Cairo speech to the Muslim world in June. "In general it was excellent," he says. "I do believe he's sincere. But is he ready to walk the way he talks?" Or will he succumb to "pressure from Christian fundamentalists and the Jewish lobby? We wait for facts on the ground." Mr Youssef also lauds George Mitchell, Obama's special envoy. Mr Mitchell, incidentally, was largely responsible for drawing in Sinn Féin.

"Let us sit down and talk. It's unfair to place preconditions," says Mr Youssef, citing a string of UN resolutions which, he says, Israel has flouted over the years without being barred from negotiation as a result. "[The Israelis] deceive the world community by saying Hamas does not recognise Israel. We have said we accept a Palestinian state in the 1967 borders—that is 20% of the land of Palestine. Fatah [formally] recognised Israel but what did it get [in return]? We have even offered a hudna [truce] of 10-20 years, to build confidence, to make a better climate." Perhaps, suggests Mr Youssef, the two sides could agree to an immediate ceasefire for a year, to build on today's "period of quietness".

In any event, if Hamas is to follow suit, Mr Obama must then call an international conference.

Mr Obama must also "boost the Egyptians to go ahead with national reconciliation between the Palestinians." "We should blame ourselves as well as others for failing to achieve national reconciliation." Mr Youssef promises that Hamas, which won the Palestinians' last general election, in 2006, would gracefully bow out of office if it were to lose next time round, maybe early next year. "We accept the peaceful rotation of power."

Repeating Hamas's argument that any

Iraq's Kurdish election

The times they are a-Changing

SULAYMANIYAH

A new party dents a Kurdish duopoly. But does it bring independence closer?

THE Kurds still have a dream. One day most of them hope to cut their ties with Iraq and end their lot as the largest stateless people in the Middle East by establishing a sovereign Kurdistan, starting with what is now northern Iraq. (There may be 24m Kurds, all told, living mainly in four countries in the region: Iran, Iraq, Syria and Turkey.) Arab Iraqis reject this dream, fearing that Kurdish secession would destroy their country and, by the by, cost it a lot of oil. So, under American pressure, in 2003 they granted the Kurds some autonomy, which the Kurds have cherished; the Arabs hoped it would be enough to placate them. But every little shift in Iraqi Kurdish politics is judged by whether it brings sovereignty closer. Whether regional elections on July 25th have done so is open to question.

What is indisputable is that the Kurds' two-decade-old experiment with democracy has passed a milestone. For the first time, their regional parliament in Erbil will have a real opposition. The Change movement, a collection of civil-society campaigners, won about a quarter of the seats, and other opposition groups notched up at least 15% of them, ending the parliament's reputation as a rubber stamp. "Change is here to stay," says Asus Hardi, an independent editor.

Part of Change's appeal is its demand for more autonomy. But the main reason



Barzani gives them the finger

for its success is its opposition to the perceived corruption of the two main parties. Many Kurds have been disgusted by the extent to which people tied to the ruling clans, the Barzanis and the Talabanis, have lined their pockets. Despite regular elections since 1992, the two have acted in a quasi-feudal fashion, controlling a lion's share of business while also running security. Even after losing almost a third of their seats, they will still be able to form another government, having run in the election on a joint list.

Masoud Barzani was comfortably re-elected as the region's president. But the old spoils system, run by his Kurdistan Democratic Part (KDP) and the Talabanis' Patriotic Union of Kurdistan (PUK), may be beginning to break down. The two clans' power, especially that of the Talabanis, from whose party the Change movement was mainly drawn, has been weakened. The PUK may even start to fade. And the Talabanis' old rivals, the Barzanis, may now face unprecedented and unwelcome scrutiny of their finances.

As an exercise in democracy, the election was far from perfect. Change credibly alleged large-scale voter fraud. At polling stations KDP people wearing the Kurds' traditional baggy trousers and embroidered sashes danced away, while behind the scenes their colleagues are said to have stuffed ballot boxes. Some clan loyalists are said to have voted 20 times. Yet the electoral commission, dominated by the two old ruling parties, was unmoved.

Even so, Change did pretty well. As a result, KDP supporters smashed the offices of opposition groups in Erbil, the Kurdish capital and the KDP's biggest fief. One person is said to have been killed and a dozen hurt. Independent journalists say they fear retribution by the Kurds' security forces, which are dominated by the two old parties. "There could be assassinations," says Ahmad Mira, an editor at *Lvin* magazine. One of his reporters was murdered last year, apparently for digging too deep.

Once proud of being a model for democracy in Iraq, some Kurds now worry that the "democracy gap" with the Arab Iraqis has been narrowed. Moreover, Iraq's prime minister, Nuri al-Maliki, has already begun to play the Kurds off against each other, diminishing their influence in the central government in Baghdad. Jalal Talabani, the PUK's founding leader, who has been Iraq's national president, may have to cede his job next year to a Sunni Arab. Mr Talabani has been a proponent of compromise. So his departure could hurt the chances of resolving the Arab-Kurdish dispute over land and oil in the border region around Kirkuk, a city and province which the Kurds say is theirs. The old duopoly's weakening could make it still harder for the Kurds to get closer to independence.

In any event, their mood is hardening.

Sadi Pire, the PUK's head of public relations, says, "Don't underestimate our fighters. Saddam did that and you've seen the result." While they often worry about what is going in Baghdad, many Kurds also worry that their foreign sponsors may betray them, as they have several times in the past century.

As Kurdish-Arab relations in Baghdad worsen, the Americans may be starting to lean towards the more important of the two sides: the Arabs. General Ray Odierno, the American commander in Iraq, has called the Arab-Kurdish dispute "the number one driver of instabilities" in Iraq. Mr Barzani, following his re-election, said he rejected UN proposals for sorting out the territorial row. Robert Gates, the American secretary of defence, flew to Iraqi Kurdistan to talk to Mr Barzani after the poll.

In sum, a durable settlement between Iraq's Arabs and Kurds looks no closer. In the short run, the Kurdish election result may lead to a period of instability among the Kurds themselves, which is unlikely to tilt them—or the Arabs in Baghdad—towards compromise. ■

Sudan's border dispute over Abyei

Do they agree? Yes, no, and sort of

JUBA AND KHARTOUM

A ruling from The Hague pleases the north and vexes the south

OFFICIALS in Sudan's government in Khartoum could hardly believe their luck when, on July 22nd, the Permanent Court of Arbitration in The Hague ruled on the fate of the disputed Abyei state, which sits astride the oil-soaked border between Arab northern Sudan and the ethnically African (and largely Christian) south Sudan. Surprisingly, the court reversed an earlier commission's ruling and redrew Abyei's borders, snipping out the lucrative Heglig and Bamboo oilfields (see map on next page) and giving them to the north.

The ownership of these oilfields has soured relations between the north and south Sudanese ever since a peace accord was signed between them in 2005, ending a civil war that had raged on and off for nearly half a century at a cost of some 2m lives. So tense had the situation in Abyei become that last year much of its capital was burned to the ground in fighting between militias from the two sides. Now, however, the north seems to have got what it wanted by law rather than by force.

The head of President Omar al-Bashir's National Congress Party delegation in The Hague, Dirdeiry Muhammad Ahmed, said it was a "great achievement" that ownership of the oil had been settled "without



However, perhaps intoxicated by "conflict".

by suggesting that the government in Khartoum would stop paying half of the oil revenue from Heglig and Bamboo to the south, as it must do under the 2005 peace deal. As South Sudan's government relies on oil for almost all of its revenue, these comments were bound to provoke. Other northerners were more conciliatory. In any case, the north's true position will become clearer after a technical committee of north and south begins work on the border's final demarcation.

Ministers in South Sudan's capital, Juba, at first claimed they had "won the case", then grew puzzled. Then a sense of "won" after all. For southerners looking forward to independence, the thought of losing any oil is upsetting. That may explain why this Heglig field has not been granted to the north at all but is still in the south because it extends into Unity state. This blithely contradicts the case South Sudan made at The Hague. "It's a rather desperate measure," admits a well-placed southerner. Even if the south has no chance of winning the oil back, it may drag out legal proceedings to satisfy its hot-

heads at home. At least the court ruling pleased the Ngok-Dinka people. When the south votes in the 2011 referendum, Abyei state will exercise a special dispensation (which is nothing to do with the ruling at The Hague) letting it choose whether to stay in a federal Sudan or to secede with the south. As the state is now smaller within its new boundary, the Ngok-Dinka is the dominant tribe in it—so their vote will probably ensure that Abyei goes to the south. Yet oil has blinded both sides to the question of land. Heglig and Bamboo produce low-quality crude. Oil men say their production is dropping off quickly, to 53,000 barrels a day. That could reduce rev-

enues to less than \$300m a year by 2011—hardly enough to go to war over. It is access to land that has always been the more combustible issue in this part of the world. The Missertiya people, who are Arab pastoralists, had hoped the ruling would give them the right to run their cattle freely through Abyei, as they have long done, often in violent opposition to the sedentary Dinka people. Yet under the court's ruling, the Missertiya may now have to pay grazing fees to the Dinka. A dissenting Jordanian judge on the arbitration court said the ruling makes the Missertiya "second-class citizens on their own land and creates conditions which may deny them access to water." Some Missertiya protested after the ruling. Usually allies of the government in Khartoum, and sometimes its proxy fighters, they say they have been betrayed for a few dry oil wells.

So a mess prevails. People now look forward to the demarcation of electoral districts and the rest of the north-south border for national elections next year and then for the referendum. Both north and south appreciated the openness and speed of the court's mediation. Some say it could be a model for solving the many other outstanding issues between the quarrelsome Sudanese. If only. ■

A taste of the Taliban

Islamist attacks in Nigeria

An Islamist insurgency in the north comes on top of another in the Delta

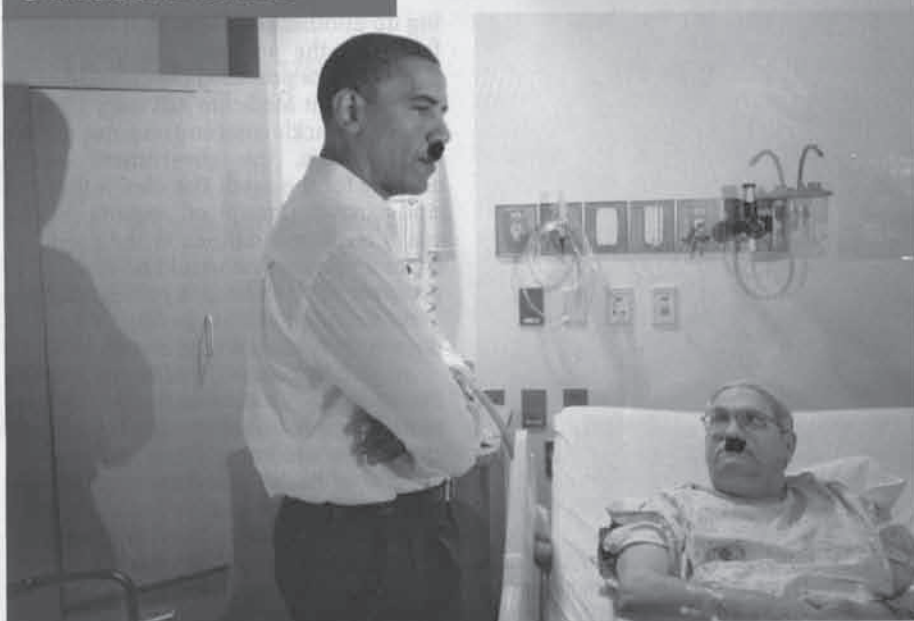
VIOLENCE has often disfigured religion in Nigeria. Usually, it has been a matter of bloody confrontation between Muslims and Christians in the middle of the country, where the largely Muslim north rubs up against the mainly Christian south. This week, however, Nigeria experienced its most serious outbreak of another kind of religious violence, provoked by Islamic fundamentalists who take their inspiration from the Taliban of Afghanistan. At least 180 people were killed in five days of clashes between militants and the police.

The fighting started on July 26th in Bauda, a town in the north. The police arrested several suspected leaders of an Islamist sect called Boko Haram, a local Hausa term that means "education is prohibited". In particular, the group is against Western education and influence. It wants to impose a pure Muslim caliphate on Nigeria. In retaliation for the arrest of their leaders, militants went on the rampage in several northern states, attacking the police with anything that came to hand, from machetes to bows and poison arrows.

The police fought back, killing, so they claimed, 39 militants in Bauchi. Fierce fighting took place in Maiduguri, capital of Borno state, where the sect has its headquarters. On July 28th the army was called in to shell the compound where the sect's leader, Muhammad Yusuf, has been based. As well as killing scores of Boko Haram fighters, the police arrested hundreds of suspected members of the group. The "Black Taliban", as such groups are dubbed in Nigeria's northern states, have carried out isolated attacks for several years. This time the violence has been more widespread and prolonged. Muslim sharia law was introduced in 12 northern states after general elections in 1999, but the states' Muslim rulers have usually been cautious in applying it. This has prompted the militants to demand a more extreme form of Islamist rule and for sharia to be extended to the whole of Nigeria. Nigeria's federal government, along with Western intelligence agencies, has long worried that extremist groups in the north may link up with Islamist terrorist groups elsewhere in Africa, in particular with al-Qaeda in the Maghreb. This outfit grew out of the blood-soaked struggle by Islamists to overthrow Algeria's government in the 1990s. Such connections raise the spectre of a concerted Islamist threat against Nigeria, a close ally of America and a large oil exporter. But the links have not been proved and little is known about groups such as Boko Haram.

On this occasion Nigeria's president, Umaru Yar'Adua, acted swiftly. But it was an exception to his presidential rule. Now halfway through his four-year term, the former governor of the northern state of Katsina has achieved little. His administration is beset by indecision and drift. This week's violence in the north comes on top of unceasing violence in the southern Niger Delta region, where an insurgency by militants demanding a bigger share of the country's oil wealth continues to disrupt oil exports. By some estimates, Nigeria now exports only half of what it should: Angola has taken over as sub-Saharan Africa's biggest producer.

Despite flooding various well-meaning plans to pacify the Delta, the government has failed to stop the region's unrest. The fall in tax revenues, as a result of illegal bunkering and the sabotage of pipelines, means that Mr Yar'Adua has even less chance of tackling his country's other problems, such as a chronic lack of electricity. The insurgency in the Delta has thrived on the back of dire poverty and high unemployment in what should be a relatively wealthy region, were it not so poorly governed. Some fear the Islamist militants in the north may profit from the same lack of opportunities, which saps the morale of young Nigerians and makes so many of them prey to extremists. ■



Health reform

What now for Obamacare?

NEW YORK

The president's plan to overhaul America's health system hits turbulence in Congress

"IT'S a lot easier to be Santa than Scrooge," harrumphs Jim Cooper. The congressman from Tennessee is complaining about the health-reform plan unveiled in July by the Democratic leadership in the House of Representatives. He thinks it is a populist initiative that will end up fuelling rather than curbing America's runaway health inflation. Such tough talk would not be in the least surprising coming from the opposition party; but Mr Cooper is a Democrat. And he insists that reform efforts have gone so badly wrong that it is time to "go back to the drawing board".

Health reform is the domestic priority for Barack Obama, who has been pushing both houses of Congress to come up with final health bills before the August recess. On current plans, the House of Representatives is supposed to wind up its session on July 31st, while the Senate is scheduled to stay at work one more week.

A few weeks ago, it had seemed that his efforts were working, as both chambers were making progress on health legislation. But after months of building up momentum, Obamacare has hit serious snags, and Mr Obama's deadline looks likely to be missed. Whether this merely delays reforms until the autumn or scuppers them altogether remains to be seen.

The health bill supported by the House leadership quickly won approval from two of the three relevant committees, but then got bogged down in the Energy and

Commerce committee. That is because Mr Cooper and half a dozen like-minded fiscal conservatives (all part of the "Blue Dog" coalition of Democrats, see next story) threatened to keep it from advancing to a vote by the entire chamber. On July 29th the Blue Dogs agreed to stop blocking the committee's work if the party leadership agreed to various changes in the draft bill, including a cut in spending of some \$100 billion, and to a delay in the final House vote until after the recess.

What then? Nancy Pelosi, the House Speaker, declared recently "When I take this bill to the floor, it will win." Hang on a minute, though. Just because the House leadership forged ahead in crafting a bill before the Senate did does not mean it is a good bill or that it will get through. The highly partisan effort, which contains provisions for a government-run insurance plan and tax hikes for the rich, was always going to have a hard time winning broad support. Mr Cooper is convinced that Ms Pelosi does not have the votes in her own party necessary to pass the bill as it stands.

Moderate Democrats are reluctant to pin their names to a bill that conservatives are branding as big government and anti-business. The House proposal has also been criticised by non-partisan outfits including the Mayo Clinic, a respected hospital chain. The Congressional Budget Office (CBO), an independent agency, suggests it does not do enough to curb costs.

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Lexington is on holiday

Democracy in America, our blog on American politics, is open to commentary daily at

Economist.com/democracyinamerica

Small businessmen are also upset about the House bill's "employer mandate", which requires most firms to provide health coverage or pay a hefty fine. Nydia Velázquez, the Democratic chairwoman of the House's committee on small business, complained on July 28th that this was an unfair burden. The deal announced by the Blue Dogs the next day acknowledged this concern by raising the threshold below which firms would be exempted from the mandate.

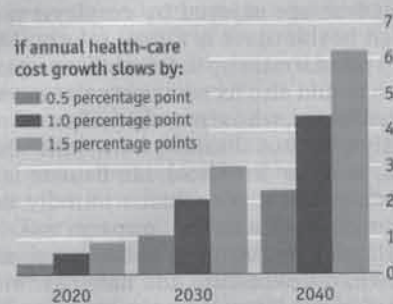
This in-fighting is reinforced by the fact that Democrats do not yet know whether a more appealing compromise that meets the test of revenue neutrality laid out by Mr Obama may yet emerge from the other chamber of Congress.

The Gang of Six at work

At first blush, it seems the Senate is lagging far behind the House. The Senate's health committee has passed a highly partisan bill, but the more important Finance Committee has yet to do so. And the Senate's Democratic leader, Harry Reid, has already admitted that he cannot bring a bill that

The upside

Forecast reduction in federal budget deficit due to health-care reform, % of GDP



Source: Council of Economic Advisers

ing up another good idea that had nearly fallen by the wayside. Last month the White House proposed the creation of an Independent Medicare Advisory Council (IMAC) to tackle costs and improve quality in Medicare, the government health scheme for the aged. The idea is that this non-partisan group of experts would make recommendations to the president twice a year, and he would be required to accept or reject them as a package. If Congress did not reject the package within 30 days the proposals would come into force. A poll conducted this week for *The Economist* by YouGov underlines the potential importance of this step. Voters (see chart) overwhelmingly care more about the cost of health care than about the beloved Democratic goal of achieving near-universal coverage. So far the administration has focused too much on the latter.

The IMAC approach has the virtue of shielding difficult decisions about cost-cutting from petty politics. Such an approach worked well when used by the Pentagon to decide which military bases to shut down. But an earlier and softer version of this idea, known as MedPAC, flopped. Nancy-Ann DeParle, the White House's head of health policy, served as a commissioner at that agency. She recalls that Congress simply ignored many recommendations that proved politically inconvenient. So the idea of giving such an agency teeth should be welcome. Mr Orszag argues that it has two big merits: it insulates tough decisions from politics and it encourages ongoing rather than one-shot reform. As the IMAC idea hit a snag on July 25th when the CBO insisted that it would not save much money over the next ten years. Among the shortcomings the agency identifies is the fact that the IMAC proposal does not contain specific cost-cutting targets or "triggers" that would act to cut costs automatically.

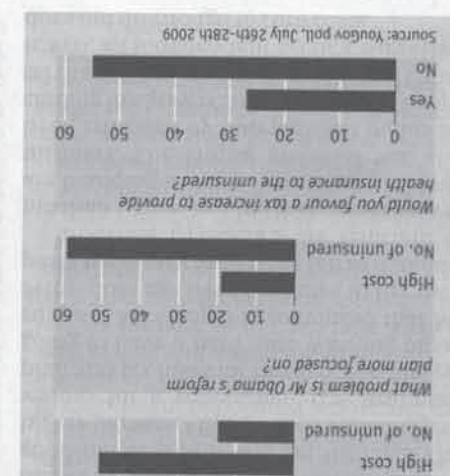
Why did it not? If IMAC were to get real clout, many Democrats fear that the Republicans would try to paint it as an effort to "ration health care". That points yet again to the importance of the bipartisan approach taken by the Senate Finance Committee. Such an approach might even lead to other important reforms making it onto the table. Mr Cooper is hopeful that tort reform will make it as a "last-minute sweeter", and an influential senator, Ron Wyden, says other innovative ideas from an excellent earlier bill he proposed are now getting a "second and third look". Whether the Gang of Six reaches an accord before the recess or after matters less than the eventual outcome. Of course, it may all go horribly wrong in the end, dooming Obamacare altogether. A good Senate bill will be hard to reconcile with a bad House one. Mr Grassley, though, is confident that the Senate version will prevail. This is a gang worth watching. ■



Baucus (left) and Grassley hatch a plan

proposed a tax on the costliest health plans sold by insurance companies. The insurance lobby grumbles but misses the point: this proposal is meant to discourage only extravagant plans that prompt overuse of health care. Though not as elegant as a direct cap on the tax exclusion, this proposal is both a big step forward and politically palatable. Peter Orszag, director of the White House's Office of Management and Budget, confirms that the Obama administration is "open to this idea", and Mr Cooper also thinks it is promising.

The Gang of Six also appears to be taking a provision would end up taxing low-skilled workers and destroying jobs.



merges the output of those two committees to a vote by the full chamber until the autumn. Yet it is the Senate Finance Committee that still offers a chance for sensible and successful health reform this year. That is because the committee's boss, Max Baucus of Montana, has pursued an impressively bipartisan approach. He has formed a core group, comprised of three senators from each party; its members have been meeting for hours a day for many weeks to hash out a compromise. There was no final deal ready as *The Economist* went to press, but one could well come very soon. Chuck Grassley, the ranking Republican on the committee and a member of this powerful Gang of Six, reports that his group is "making progress by inches". He defends this painstaking process as a "more careful and less partisan" approach than the one taken by the House or the Senate's health committee. That is a big boast, but he is right.

The working group has courageously rejected several reform proposals popular with senior Democrats (including the president) and is considering including other measures that are unpopular with influential lobbyists. If these bold ideas make it into the group's final compromise the Gang of Six may yet come up with a version that will win strong bipartisan support and form the backbone of any final reform bill. The working group is edging towards rejecting two shibboleths of the left, both present in the current House proposals: a public plan and an employer mandate. Mr Obama has bargained on about the need for a government-run insurance scheme to compete against rapacious private insurers, but moderates argue that reforming private insurance markets (as other countries including Switzerland and the Netherlands have done) offers a better solution. Labour activists have demanded a "pay or play" provision that would force companies to pay a hefty fine if they did not offer coverage, but many economists think such a provision would end up taxing low-skilled workers and destroying jobs.

The right ideas, at last
Just as important is what the group appears to be putting back into the mix. Many experts think capping or ending the tax advantage enjoyed by employer-provided health cover is a vital reform. Not only could it raise up to \$250 billion a year but it would also fix some perverse incentives. Unions, whose members often enjoy overly-generous health plans, hate this idea, and Mr Reid told Mr Baucus last month to kill it. Mr Obama roundly denounced the idea on the campaign trail. Happily, this virtuous notion has resurfaced in different form and now has "visibility" in the Finance Committee, according to Mr Grassley. Senator John Kerry has

The Democratic Party's centrists

Blue Dog days

WASHINGTON, DC

Conservative Democrats are making the weather

AMERICA'S capital, filled with politicians and pundits, is a noisy place. But the howls of one group have risen above the rest. The "Blue Dogs", a group of 52 fiscally conservative Democratic congressmen, have been at the centre of the fight over health care, after threatening to torpedo the climate-change bill in June. Barack Obama invited a group of them round to the White House on July 21st. Henry Waxman, chairman of the House Energy and Commerce Committee, wooed them with a bouquet of compromises. On July 29th Blue Dog leaders managed both to win a deal and humiliate Nancy Pelosi, the House Speaker. Their delay is likely to prevent her from bringing the bill to a full vote before the August recess.

The Blue Dogs' evolution has proceeded in fits and starts. After the Republicans seized Congress in November 1994, a group of mostly Southern Democrats formed a coalition to distinguish themselves from their own party liberals. They said they were yellow-dog Democrats (a traditional Southern term for a loyalist who would vote for a yellow dog so long as it was a Democrat) "choked blue" by their leaders. Their main goal has been to resist the tax-and-spend policies too often pushed by their party's barons; their home-page features a federal debt clock that on July 30th stood at \$11,226,807,380,955.11. But for much of the past 15 years they have been a marginal force.

Since 2006 the Blue Dogs have enjoyed a new era of influence. They helped swing the House to the left—11 Blue Dogs seized Republican seats in 2006 and a further five in 2008. Since the start of this year, without

the threat of a Republican presidential veto, their clout has grown. Contributions to the Blue Dogs' political action committee look set to break previous records, according to the Centre for Public Integrity, based in Washington, DC. Charlie Stenholm, a former congressman and founding Blue Dog, contends that "this is the first year for the new kennel in which their votes are really going to make a difference." A victory came on July 22nd, when the House passed a bill requiring any new spending or tax cut to be offset elsewhere. The debate over health care, however, may be the pinnacle of the group's power so far. Seven Blue Dogs on Mr Waxman's committee refused to let a bill proceed without more measures to contain costs.

Despite all this, the Blue Dogs' grip on power is far from secure. The group does not always vote as a block. Its members, hailing from swing districts, are inherently vulnerable. What is more, some say their centrist role is overstated. The Blue Dogs are more conservative than average Democrats, but their voting record is closely aligned with their party nonetheless, according to a study by Burdett Loomis of the University of Kansas. Only 12 voted against a bail-out of the car industry last December. Only ten voted against the stimulus bill. Robert Borosage of the Campaign for America's Future, one of many critics on the left, thinks the Blue Dogs bend their ideology when it suits their district, be it a rural area or one dependent on coal.

Nevertheless, the Blue Dogs are carving out a distinct role in a partisan era. Congress has become much more polarised since the 1960s, according to an analysis of party votes by James Thurber of American University. "Partisan extremism has meant that the vast majority of Americans feel unrepresented," argues Jim Cooper, a Blue Dog from Tennessee. Blue Dogs, he says, provide a voice of moderation. For now, at least, the group has the attention of the White House, party leaders and the media. The dogs are having their day. ■

Crime and exoneration

Hidden evidence

NEW YORK

DNA is changing the way America fights crime, not its policies towards convicts

A JUDGE can tell prospective jurors that in a criminal trial, unlike an episode of "CSI: Crime Scene Investigation", scientific evidence is not necessary to secure a conviction, an appeals court in Baltimore ruled on July 7th. Quite right, too. The evidence submitted in real courts is often not as cut-and-dried as it seems on television. Yet the use of DNA to secure convictions is growing fast. The people not benefiting from this are those who may have been wrongfully convicted before DNA was routinely examined, and who are being denied access to evidence that could set them free.

Much is being made of a recent Supreme Court ruling that William Osborne, a prisoner in Alaska, has no constitutional right to DNA testing to prove his innocence of the 1994 rape for which he was convicted and jailed. Nina Morrison of the Innocence Project, a New York-based non-profit legal outfit that represents Mr Osborne, fears the decision could lead to many innocent prisoners remaining in jail—or even facing execution.

Since Congress passed the DNA Fingerprint Act in 2005, federal authorities have been collecting DNA samples from everyone they arrest or detain. The FBI's national DNA database (NDIS) gets more than 1m DNA profiles a year. By last May CODIS, an FBI index that compares forensic evidence at local, state and national level, resulted in 90,900 "cold hits", where biological evidence from an unsolved crime matches a profile in the database. This has led to many arrests and convictions.

But three states (Alaska, Massachusetts and Oklahoma) give prisoners no statutory rights to a DNA test, even though such a test might exonerate them. Though exonerations have occurred in Massachusetts and Oklahoma by way of appeals from defence attorneys, access to testing is still hard to get. Many other states allow testing only in limited circumstances. Kentucky, for instance, restricts its DNA testing to death-row inmates. Someone serving a life sentence is not eligible.

Texas and Illinois, whose laws do permit simple post-conviction access to testing, boast the highest number of convictions that have been overturned thanks to DNA evidence: 38 and 29 respectively, says the Innocence Project. Texas, which accounts for half of all executions in America, passed a bill in May establishing the Timothy Cole Advisory Panel on Wrongful ▶▶



Convictions, named after a man posthumously exonerated through DNA testing. A team set up to study the causes of wrongful convictions and to devise ways of preventing them is to report to the governor no later than 2011.

Prosecutors can use their state's statutes of limitations (which set time limits for the introduction of new evidence after sentencing) to decline prisoners' requests for DNA testing. They argue that cases could be strung along endlessly and expensively by frivolous appeals if there are no such limits. Yet this seems a weak argument when it comes to DNA, which might establish innocence or guilt without much scope for prolonged debate.

Many prisoners might be cleared were DNA testing more routinely available. The American legal system encourages plea bargains, whereby accused people accept a much lower sentence than would be imposed if they were found guilty. In the absence of the DNA evidence that would clear them, even innocent people may conclude that a plea bargain is the safer option. More than 90% of convictions in the United States result from such bargains.

Seven Benjamin of the National Association of Criminal Defence Lawyers contends that the restrictions on post-conviction testing amount to a fear of the truth. He may be right. ■

Criminal justice

Room service not included

NEW YORK
Should prisoners pay for being in prison?

PAY-IF-YOU-GO will be the new model for the criminal justice system if Jim Tedisco, a New York state assemblyman, gets his way. Mr Tedisco, a Republican who wants to "protect law-abiding citizens' tax dollars", has introduced a bill that would require rich inmates to pay for their involuntary stay in New York's prisons. The state spends more than \$25,000 per inmate each year, more than \$1 billion in total.

The bill has been dubbed the "Madoff bill", after the financier-turned-swindler who was sentenced in June to 150 years in jail. Why should taxpayers have to pay for Mr Madoff's prison-sentence, asks Mr Tedisco, when he has already cost people so much? The bill would require people with incomes of \$40,000 or more to pay for part or all of their incarceration costs, depending on the size of their assets.

In theory, the bill sounds like justice delivered to Mr Madoff and other crooks. But ironically the law, if it passes, would not apply to the man who inspired it. Mr Madoff is in a federal prison, not a state or local one. The millionaires residing in

Let's have a party

Optimism in Mobile, Alabama

MOBILE
A city that looks beyond the recession

IN JUNE a delegation of officials from Alabama packed their bags for the Paris Air Show. Along with officials from Mississippi and Florida they held a reception in the Eiffel Tower and enjoyed a cruise on the Seine. They appeared to be having a very good time, reported someone from Washington state, which is nervously eyeing Alabama's growing aerospace industry.

How, in these bad times, can Alabama or Mobile, its most charming city, be so job-ly? In June the state's unemployment rate hit 10.1%, more than double what it was a year ago. And things will get worse before they get better: a new survey from the University of Alabama says that business leaders expect the state's economy to go on shrinking in the third quarter.

Nevertheless, people in Alabama, particularly in the south-west corner that includes Mobile, are refusing to be daunted. And their confidence is not misplaced. In recent years both city and state have been



on a blitz of economic development. Most Alabamans trace the change back to 1993, when the state managed to land a Mercedes plant. This was a \$300m investment that gave Alabama a big credibility boost. Honda and Hyundai plants followed and the state now has over 300 car-related companies. In 2006 Alabama won a Golden Shovel award from *Area Development* magazine, and this June it got a silver.

Mobile has had its own successes. Austral, an Australian shipbuilder, came to the city in 1999 and has been expanding. The port recently opened a new container terminal. ThyssenKrupp is building a large steel plant that will bring 2,700 jobs to the region next year. Boeing, Alabama's aerospace giant, is based in Huntsville but is spreading to the south of the state.

At the same time the city is smartening up. Ten years ago, says Win Hallett, the head of its Chamber of Commerce, the centre of Mobile was so ragged that he worried about visitors being frightened away by the hotels. In 2001 the schools superintendent gave out a dire warning: unless voters approved a property tax rise, he would have to cut the football programmes. The rise went ahead.

All this has given Mobilians their sunny outlook, despite the current economic woe. Last year Moody's Economy.com ranked Mobile County first among America's 363 metropolitan areas for projected economic growth between 2007 and 2012. In June *Forbes* included Mobile (and Huntsville) in its list of the ten cities best placed for recovery.

Mobile and Havana became sister cities in 1993 and, so far as they can, have kept up their ties ever since. There is a long relationship between southern Alabama and Cuba which, several hundred years ago, and Spanish explorers. In the 19th century Mobilian doctors helped their Cuban peers fight yellow fever by destroying mosquitoes and a Cuban student who studied in Mobile returned home with a baseball and bat. City leaders are looking to benefit should there now at last be a change in America's policy towards Cuba. ■



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Shopping

Keeping it local

A rising vogue for shopping near home

IN 2002 the city of Austin planned to expend about \$2m in incentives to a developer who wanted to build a new Borders bookstore on a prominent downtown corner. This was an unpleasant prospect for the owners of two local independent businesses, BookPeople and Waterloo Records. If the deal had gone through they would have faced a big competitor located directly across the street. Steve Bercu, the owner of BookPeople, says that he always assumed that local businesses were better for Austin for sound economic reasons. But in the circumstances, he wanted to test the proposition.

So BookPeople and Waterloo called in Civic Economics, a consultancy. They went through the books and found that for every \$100 spent at the two locals, \$45 stayed in Austin in wages to local staff, payments to other local merchants, and so on. When that sum went to a typical Borders store, only \$13 went back into circulation locally. Although the study was part-funded by BookPeople and Waterloo it gave a boost to the growing "buy local" movement in America. For years business and community leaders have been full of reasons for people to do their shopping close to home. They say that local and independent businesses have more individual character, and that they are owned by your friends and neighbours. Some stores, particularly grocers, point out that it takes much less carbon to haul a truck from a few towns over than from halfway across the country.

At the moment, the economic argument has special traction. Dan Houston, a partner at Civic Economics, says that in recent studies he has found that locally-owned businesses put about twice as much money back into the community as the chains do, not three times, as the Austin study found. But that is still enough of a "local multiplier" to catch people's attention. Stacy Mitchell of the Institute for Local Self-Reliance in Portland, Maine, reckons that some 30,000 local independents have joined about 130 independent business alliances around the nation.

Big companies are taking note that customers are rooting for the home team. Ms Mitchell points to a telling development in Seattle, Washington, where Starbucks got its start. On July 24th the company opened a new coffee shop there. The newcomer is not called a Starbucks; it is called "15th Ave. Coffee & Tea". It promises "a deep connection to the local community," and its seats

California's Chinese-Americans

From nightmare to dream

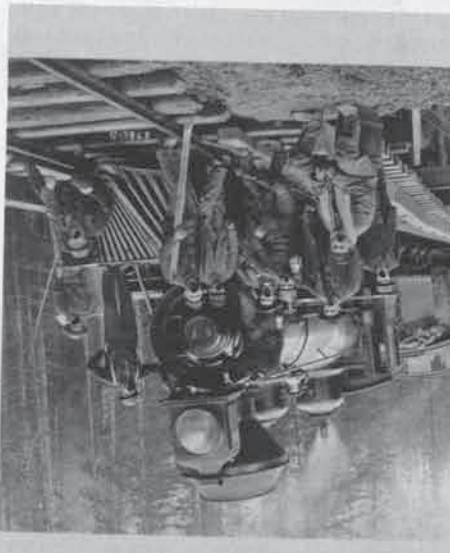
An official apology for the past marks a story of success

HAUNTING Chinese poems speaking of pain are still visible on the faded walls of the old detention centre on Angel Island in San Francisco Bay. The island, today a state park, used to be the West Coast twin of Ellis Island in the east, and is the place where America showed a very different face to yellow newcomers than to white ones. Paul Fong's granda-

ther was detained there in 1939. Today Mr Fong is a state assemblyman representing Silicon Valley, a place teeming with successful Chinese-Americans such as the co-founders of YouTube and Yahoo!. The Chinese in California are now arguably its most successful ethnic group, says Mr Fong. All the more reason for California to acknowledge what they overcame. This month, its legislature passed a resolution, co-sponsored by Mr Fong, apologising for a long history of discrimination.

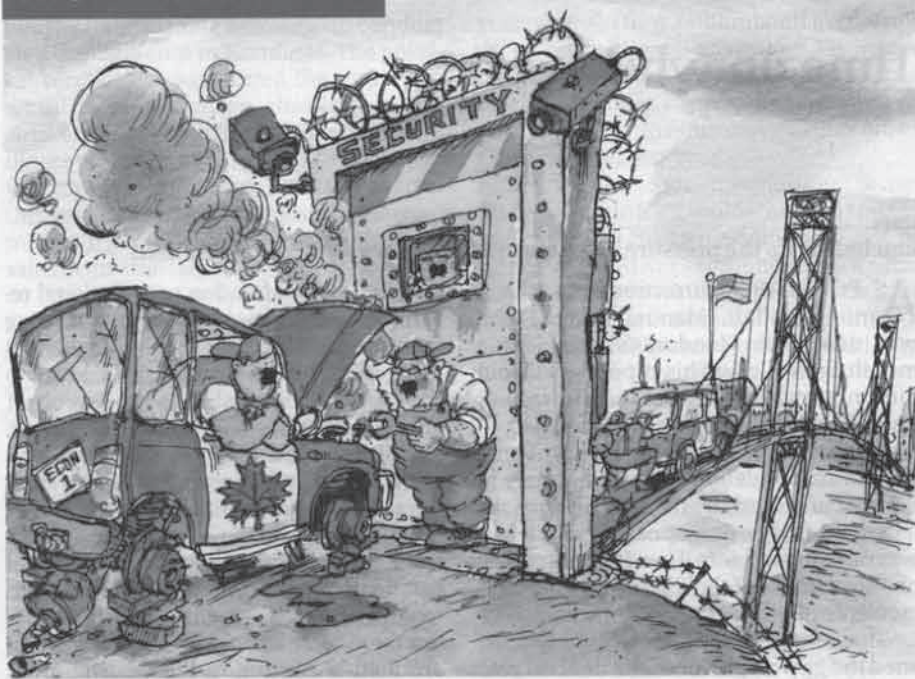
In 1852, during the Gold Rush, California levied a punitive "foreign miners tax" aimed at the Chinese diggers; whites paid nothing. In the following years, tens of thousands of Chinese blasted tunnels through the Sierra Nevada, with great loss of life, to build the western arm of the transcontinental railway. America

is now full of reasons for people to do their shopping close to home. They say that local and independent businesses have more individual character, and that they are owned by your friends and neighbours. Some stores, particularly grocers, point out that it takes much less carbon to haul a truck from a few towns over than from halfway across the country.



Welcome only as labour

are recycled from a local theatre. There is an insular element to the trend. "Is it pure local protectionism? Sure, to some extent it is," says Mr Houston. But the advocates are not zealots. One national campaign is asking people to shift a mere 10% of their spending to local outfits. The Borders project in Austin eventually fell through, and the proposed site is now occupied by the flagship of Whole Foods Market. The chain was founded in Austin and is local in a sense, although it is now publicly traded. Throughout the shop, produce advertises its credentials: local, organic, fairly traded, made in-house, vegan, and so on. This week its customers faced an ethical dilemma: is it better to buy the organic watermelon from California, or the conventionally-grown kind from Lexington, Texas? ■



Canada's stalled economy

The humbling of Detroit North

WINDSOR, ONTARIO

The decline of America's car industry has hurt the Canadian economy too. Revival depends on making it easier to cross the border—or on seeking markets elsewhere

FOR almost a century the fate and fortune of Windsor, Ontario, have been intertwined with those of Detroit, Michigan. General Motors (GM), Ford and Chrysler made cars on both sides of the Detroit River, sending parts and vehicles back and forth at will. Windsorites worked in the car plants, loyally bought the cars, followed American sports teams, and thought nothing of driving over the Ambassador Bridge or popping through the Detroit-Windsor tunnel for a night on the town.

So the collapse into bankruptcy of GM and Chrysler has brought Windsor down along with Detroit. A blue-collar city of 273,000 people, Windsor now has the highest jobless rate in Canada (14.4%) and faces an uncertain future. Its decline is visible on Ouellette Avenue, the main commercial artery. On some blocks, more shops have shut down than are still open. The brightest sign on the street announces the grand opening of Dollarama, a deep discount store. On the riverside promenade the headquarters of Chrysler Canada, opened with much hoopla in 2002, stands partly empty, a "For Rent" sign on the plate-glass window of its showroom. Truck traffic between Windsor and Detroit—the busiest crossing-point on the Canadian border—fell by a third in the first six months of this year compared with the same period in 2008.

Windsor's woes are echoed across southern Ontario, the heartland of industrial Canada, which depends on exporting to the United States. Tighter security at the border after the terrorist attacks of September 2001 and a stronger Canadian dollar constrained the region's economy even before the American economy plunged into recession in late 2007, with Detroit leading the decline.

Between them, Canada's federal government and Ontario's provincial administration contributed C\$14.5 billion (\$13.4 billion) to the bail-outs of GM and Chrysler. That was enough to deter them from pulling out of the country. But they will cut



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a slimmer figure. Output and employment in Canada's car industry will end up at least a third below the 1999 peak of 3m vehicles and 160,000 workers at assembly plants and parts-makers, says Dennis DesRosiers, an industry analyst. It helps that Toyota and Honda, with factories in Ontario, are keeping most of their workers.

Ontario's problems go wider than cars. Recession has curbed demand for its minerals and forest products. Nortel, a telecoms firm that was once Canada's leading high-tech company, recently entered bankruptcy. Bits of it are being sold off piecemeal. Two-thirds of the 370,000 jobs lost in Canada between October 2008 and June 2009 were in Ontario, most of them in manufacturing.

Ontario's economy is still the biggest in Canada. But it is no longer the richest. Indeed Ontario is now classified as a have-not province, making it eligible for hand-outs from a federal fund to equalise public spending across the country. It has even been granted its own federally funded economic development agency.

Some pundits reckon that rather than bailing out industrial dinosaurs government should be encouraging new technologies. Supporters of Dalton McGuinty, the province's premier, say that he had no choice but to help to bail out the car industry because of its size. (He also offered a subsidy of C\$10,000 to each purchaser of an electric car.) Critics contrast this largesse with the government's failure to help Nortel. Stephen Harper, Canada's Conservative prime minister, faces nationalist pressure to veto a bid of \$1.1 billion from Sweden's Ericsson for its wireless technology division and find a Canadian buyer.

Even in car-mad Windsor people are starting to realise that change is inevitable. ▶▶

Time on whose side?

Post-coup Honduras

Eddie Francis, the mayor, says he hopes to make the municipal airport a processing centre for perishable cargo. He says that some of the city's car-parts makers have started supplying oil companies and Quebec's aerospace industry.

But diversification is not easy. Caesars

Windor, a massive casino, convention centre and hotel aimed at the 17m American

who live within a three-hour drive, is suffering along with the car industry. Its workforce has shrunk from a peak of 5,400 before 2001 to 3,800 today. "It's not true that casinos are recession-proof," says Keith Andrews, the casino's spokesman. He is sitting in the hotel's 10,000 square-foot (930 square-metre) lobby, where statues of Roman gods and goddesses outnumber guests.

Canada's economy, like that of the United States, shows signs of recovery.

Though weakened, the car industry will survive. The biggest headache for places like Windor may be the thickening border.

Since June 1st those returning to the United States from Canada have been required to show a passport (or another approved identity document), where a driving licence was always sufficient, Janet

Napoli, the secretary for homeland security, talks of treating America's northern border more like its southern one with Mexico (where the building of a fence on long stretches continues).

Security measures are not the only impediment to travel between Detroit and Windor. The privately owned Ambassador Bridge and the public road and rail tunnels that link the two cities are old and narrow. Plans to build a new bridge, or add a span to the existing one, have bogged down in lawsuits. The owner of the Ambassador Bridge wants to protect his near-

monopoly. Like it or not, Canada is uncomfortably dependent on the United States as a market, with 76% of its exports going to its southern neighbour. Mr Harper's government has tried to open new markets. It is now negotiating a free-trade agreement with the European Union, for example. But places like Windor, just a short stretch of water from the flickering beacon that is Detroit, can only hope that the American economy is quickly restored to health. ■

Bolivia and Venezuela: In our recent story on Bolivia

("The permanent campaign", July 18th), we stated that "Venezuelan troops helped quell a rebellion centred on the airport at Santa Cruz in the east in 2007". Both the Venezuelan and Bolivian governments deny this (see page 14), and Venezuela's government has publicly asked us to retract this assertion. We based our statement on television footage aired at the time which shows a Venezuelan air force plane and uniformed Venezuelan personnel at Santa Cruz airport shortly after it had been seized by the Bolivian government from the local authorities. No official explanation has been given for their presence. However, we are happy to clarify that this footage does not prove Venezuelan troops played an active role in quelling the rebellion. We have placed the television footage on our website at www.economist.com/santacruz.



Zelaya, and his hat, wait at the border

Mr Zelaya to office with limited powers: he do not object to Mr Zelaya's removal. Armed with that support, Mr Michelletti stalled a mediation plan proposed by Oscar Arias, the president of Costa Rica, with the support of the Organisation of American States (OAS). This would return

to the support of the Organisation of American States (OAS). This would return

Armed with that support, Mr Michelletti stalled a mediation plan proposed by Oscar Arias, the president of Costa Rica, with the support of the Organisation of American States (OAS). This would return

In Tegucigalpa, the capital, life goes on. Shops are open, traffic is heavy, and the curfew now starts later, at 10pm. Soldiers guard government buildings but no longer patrol the streets. In opinion polls 60%-70% of those who express an opinion say they do not object to Mr Zelaya's removal.

AS POPULAR insurrections go, it is a modest affair. Manuel Zelaya, who was ousted as Honduras's president a month ago, called on his supporters to join him in a makeshift camp on Nicaragua's border with his country in an attempt to put pressure on its de facto rulers. But only a few hundred defied an all-day curfew in the area and evaded army patrols to make it to the muddy border post. Having taken a symbolic step into Honduran territory on July 24th, Mr Zelaya retired to the nearest comfortable hotel on the other side.

These stunts have not discernibly loosened the grip on power of the de facto government headed by Roberto Michelletti. He was installed by the Congress after the army arrested and deported Mr Zelaya, whom the Supreme Court ruled had violated the constitution by trying to organise a referendum on constitutional reform with the apparent intention of seeking a second term. But the outside world saw Mr Zelaya's removal as a military coup. No government has recognised Mr Michelletti.

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ters say he is forming a "militia" to conduct civil disobedience in Honduras. The political conflict has aggravated the impact of world recession on an already poverty-stricken economy. The strikes and road-blocks mounted by Mr Zelaya's supporters will trim two percentage points from GDP this year, says Manuel Bautista, an economist in Tegucigalpa. He reckons that retail sales in the two largest cities have dropped by 30% since the coup. The government's coffers are empty, because of the aid suspensions and Mr Zelaya's profligacy.

If Mr Micheletti's initiative comes to nought, the only means of forcing the de facto government to yield—besides the military invasion threatened by Mr Chávez—would be trade sanctions. Honduras's small, open economy is heavily dependent on trade with the United States and Central America. But implementing a trade embargo would hurt its neighbours too. It is in everyone's interest for diplomacy to succeed. ■



Affirmative action in Colombia

Debating quotas

BOGOTÁ

Black Colombians suffer "structural discrimination"

ASK Colombians about racism in their country and many will say that the country's *mestizos*, blacks, *mulatos* and whites live in harmony. Some Afro-Colombians, such as Edna Martínez, a sociologist, tell a different story. She remembers seeing, as a child growing up in Bogotá's poor neighbourhoods, a sign in an apartment window that read, "For rent, but not to blacks". More recently when out with friends she was turned away from three different night clubs that either claimed to be closed for private parties or threatened exorbitant cover charges. A lawsuit last

year won them a public apology. "But it didn't really change anything," Ms Martínez says. Such experiences are why some black Colombians support a government plan to present an affirmative-action bill to Congress later this year.

Colombia's 1991 constitution recognised the country's multiethnic character, and provided for two additional seats in Congress for Afro-Colombians and a similar quota for Amerindians. Two years later Afro-Colombian communities on the Pacific coast were granted collective titles to land occupied by their ancestors when slavery was abolished in 1851.

Despite such steps, a committee to study racial inequality set up by the government and headed by Francisco Santos, the vice-president, concluded in May that black Colombians face "structural discrimination". It reported that they were more likely to be poor and that their infant mortality rate was half as high again as that of the rest of the population. In Chocó province, where four out of five people are black, life expectancy at birth is 58.3 years, compared with the national average of 70.3. "We recognise now that there is a problem," said Mr Santos.

The committee proposed quotas for blacks in universities, government agencies and the armed forces, and incentives for companies to recruit Afro-Colombians as middle managers and for political parties to field black candidates. The role of Afro-Colombians, today little more than a footnote in history books, would be highlighted in school texts.

"The myth that there is no racism here is the maximum expression of discrimination," says César Rodríguez, who heads a research centre on socio-legal studies at Bogotá's University of the Andes. Afro-Colombian leaders have called for affirmative action for years. Some worry that the proposals will not be implemented, and that the committee was aimed mainly at placating the Congressional Black Caucus in the United States, in the hope of gaining its backing for a free-trade agreement between Colombia and the United States. But other black leaders fear that quotas may ignite racial conflict. Daniel Mera of Fundación Color, an NGO, says that what is needed instead of quotas are better educational and social policies so that black Colombians can compete on equal terms.

The first problem will be deciding who is black. In the 2005 census 10.6% of the population thus defined themselves, but some demographers say the real figure could be as high as 26% (which would mean that Colombia has the third-biggest black population in the Americas, after Brazil and the United States). That is because many *mulatos* do not see themselves as black. This may be either because they do not feel discriminated against—or as a means to avoid discrimination. ■

Chile's stricken salmon farms

Dying assets

SANTIAGO

A bankrupt industry faces reform

THIS time two years ago some 300 million Atlantic salmon were being fattened in farms off the coast of southern Chile. Now its sheltered bays contain just a tenth of that number. Many fish have died of infectious salmon anaemia (ISA), a virus, whereas others have been prematurely harvested for fear they would catch it too. Coho salmon and trout, which Chile also produces, are not susceptible to ISA. Even so, output of the country's fish farms this year is expected to be down by at least 40%. The industry faces a long road back to health.

This blow comes after 15 years of meteoric growth that saw exports rise more than tenfold to \$2.3 billion in 2007, turned Chile into the world's second-biggest salmon producer after Norway, and brought prosperity to a far-flung area with few other jobs.

Salmon farms in Norway, Scotland and Canada have all suffered ISA too. Even so, Chile seems to have been unprepared for the virus when it turned up, apparently in imported salmon eggs. The farmers seem to have been blinded by booming profits. The National Fisheries Service, the industry's regulator which is more used to policing catch quotas at sea, lacked both a plan and the powers to deal with ISA. The resulting disaster has bankrupted the industry, which had piled up \$1.8 billion in bank debts by last December.

With over half of salmon farms now empty of fish, the industry has the chance to restock and start again, says César Barros of SalmonChile, the industry association. He reckons output will be back to its 2007 level within four years. It could take longer. Congress is, slowly, debating a bill to regulate the industry more tightly. The fisheries service will have to be strengthened. And the farms need working capital to restock. The banks may not oblige, although they have renegotiated much of the debt.

The industry has also come up with a voluntary plan to reduce the use of antibiotics to control disease—a practice which has harmed the image of Chilean salmon in the United States. Hitherto, lower production costs allowed Chilean salmon to compete in the United States against less distant rivals. The reforms might erode that advantage—but perhaps not if they work: salmon farmers hope that fewer dead fish will compensate for the cost of cleaning up their act.

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The opposition peers ahead

Japan's election

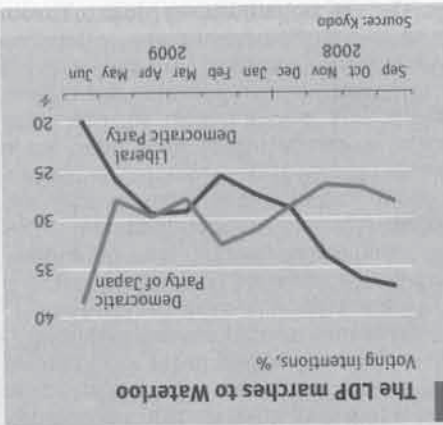
The DPJ lays out its credentials for governing

WITH an election due on August 30th, an animated cartoon has proved a surprise internet hit in Japan. At a candlelit dinner, a smooth-talking suitor with wavy locks like the opposition leader's leans over and whispers to his companion, "I can make you happier, why not switch to me," promising her a worry-free life blessed by free child-care and a generous retirement. How will you pay for all this, she wonders? "Don't worry," he purrs. "I'll sort out the details once we're married."

This is Japan's first taste of attack advertising. The cartoon's sponsor, the ruling Liberal Democratic Party (LDP), may be a shambles, empty of ideas and brought low by in-fighting, but its ruthless political instincts have not deserted it after half a century of nearly unbroken rule. It accuses the left-leaning Democratic Party of Japan (DPJ) of being both callow and extreme, fit neither to oversee Japan's security alliance with the United States, nor to protect the nation's rocky finances.

The charge of inexperience may not stick. Given the sleaze and incompetence of the mightily experienced LDP, which has produced four prime ministers in as many years, freshness has a certain appeal. The second charge, of extremism, though, may yet damage the DPJ. So on foreign

policy, the opposition is tacking to the centre. In the past, its leader, Yukio Hatoyama, has questioned parts of the security alliance with America and the role of Japanese forces abroad. Two years ago, having won control of the upper house of the Diet (parliament), the DPJ claimed the scalp of a prime minister, Shinzo Abe, by attacking the Japanese navy's refuelling mission in the Indian Ocean, there to support anti-terror operations in Afghanistan. The mission, it said, breached the country's pacifist constitution. Now "continuity" is Mr Hatoyama's watchword. To recall the mission



Whether the DPJ's sums add up at this stage, however, matters less than its ability to carry out its main campaign promise: wholesale "administrative reform". This bland phrase amounts to a revolution. The party promises "rule by politicians not by bureaucrats", something that did not happen during the LDP's decades in office. Unlike in other democracies, power in Japan has rarely resided in the government of the day. Rather, influential bureaucrats have worked with "tribes" of politicians to protect the interests of road builders, construction companies, farmers and other jobbies. In addition, ministries control special

agencies, but they are not allowed to spend public money on anything. More than anything, the pension system that cannot keep up with an ageing population. More than anything, the pensions mess brought the LDP low (it lost some pensioners records).

The opposition's proposals amount to 3.5% of GDP and paying for them seems to depend on more than a sprinkle of fairly gold. More than ¥9 trillion (\$95 billion), the party says, will be found in savings from public works and other wasteful spending. The party rules out raising Japan's 5% consumption tax for at least four years, though that is key to turning round the dire public finances. Gross national debt is 180% of GDP and rising, as LDP stimulus packages—justified by the global slump—kick in.

"would be a very reckless idea." The alliance, he now says, must not be rocked. Yet the election will be won or lost on domestic matters. In its election manifesto, issued on July 27th, the party promises to address Japan's deep-seated economic insecurities. It will introduce a child allowance, cut road tolls and taxes on small businesses, raise unemployment benefits, support farmers' incomes and revamp a pension system that cannot keep up with an ageing population. More than anything, the pensions mess brought the LDP low (it lost some pensioners records).

funds of their own, so the cabinet's hold over the national purse strings is weak. Policymaking bodies within the LDP itself have further undermined the authority of the prime minister. In the latest general election, in 2005, the then prime minister, Junichiro Koizumi, challenged the system by appealing directly to voters. He won by a landslide. But even before he resigned in 2006, the system was reasserting itself.

The DPJ's plans are much more radical than Mr Koizumi's. The cabinet will be responsible for the planning and execution of policy. Bureaucrats will be made accountable to their minister, and discipline enforced by putting more politicians into ministries. The budget-making process will be centralised, and items scrutinised line by line. The party's secretary-general, Katsuya Okada, says severing all connections with the bureaucratic habits of the past will be a prerequisite for carrying out the DPJ's other election promises.

That is probably correct but the question is whether so bold a reform is believable. The manifesto is central to the DPJ's credibility. That, in itself, is a first for Japan. The manifesto proposes a four-year programme for sorting out state pensions and rationalising the budget. Akira Nagatsuma, the DPJ's pensions supremo, says a copy of the programme will be posted in every government office, "a reminder to bureaucrats that this is the government's contract with the people." If the party pushes through its programmes, party members say, then it will ask voters in four years' time to approve the rise in the consumption tax that will presumably be needed. Should a tax increase be necessary before then, Mr Okada says, the prime minister should resign and call a fresh election.

Manifesto destiny

If the DPJ wins (and it is ahead in opinion polls, see chart on previous page), it can expect dogged resistance from the LDP and its bureaucratic allies. Even if it can defeat such campaigns—and it should get some help from modernising bureaucrats, who say they look forward to working under its proposed changes—two big uncertainties remain. One is that in addressing economic insecurities, the party appears concerned with redistribution at the expense of boosting long-run potential. Beyond a nod towards things like green technologies and nursing homes, the party appears to give little thought to increasing growth, allocating resources better or dealing with stubborn deflation.

The second uncertainty has to do with the role of the DPJ figure who towers over all his colleagues, Mr Hatoyama included: Ichiro Ozawa, once an LDP bigwig, then DPJ leader who was forced by a funding scandal to step down as party leader in the spring. Mr Ozawa is a bundle of contradictions. For nearly two decades he has

worked to bring about a political upheaval in which LDP-led rule is replaced by a competitive two-party system. He may succeed at last. At the same time, Mr Ozawa, an electoral strategist of genius, learnt from his years in the LDP to play politics behind the scenes. In the Diet he comes across as dour. In private his quicksilver manner can charm colleagues or just as quickly destroy them. By temperament, Mr Ozawa would rather not sit in the cabinet, accountable to the prime minister. But that informal style of politics is just what the DPJ promises to break with. Should the DPJ win on August 30th, what Mr Hatoyama does with Mr Ozawa will be the first test of whether the party can bring Japan's politics out of the shadows. ■

Asia's economies

From slump to jump

HONG KONG

The gap between growth in emerging Asia and the G7 has never been wider

EARLY this year Asia's economies were falling shockingly fast; now they are rebounding even more strongly than expected. Year-on-year growth rates conceal this bounce; to spot the turning-point, look at quarterly changes. Comparing the second quarter with the first at an annualised rate, South Korea's GDP grew by almost 10% (though it is still down 2.5% on a year earlier); Singapore's soared by 20% (3.7% down on the year). China does not publish quarterly figures, but economists think its GDP jumped by an annualised 15-17%.

Other economies in the region have yet to publish their GDP numbers, but they are also likely to show a rebound. During the second quarter, Taiwan's industrial production jumped by an annualised 89%. Even Japan may have enjoyed robust GDP growth; its industrial production rose by an annualised 38%. In contrast, America and Europe probably saw their economies contract during the quarter.

Quarterly growth rates are likely to moderate in the second half of this year. Singapore's bounce, for example, was partly due to a big increase in pharmaceuticals production, which is notoriously volatile. Nevertheless, Asia's recovery is on track. Peter Redward, an economist at Barclays Capital, expects average GDP growth in emerging Asia of almost 5% in 2009 as a whole. Meanwhile, the G7 economies are likely to contract by perhaps 3.5% this year. That growth gap of 8.5 percentage points would be the biggest on record.

Six months ago the Asian economies were among the hardest hit in the world, as exports to the rich world plunged. How

can they be bouncing back when demand in America and Europe remains feeble? One reason is that the plunge in output in late 2008 and early this year was exacerbated by massive destocking (companies were living off their existing supplies). With stocks now lean, orders are picking up and factories have started to hum again. Even more important, domestic demand has rebounded, thanks to the biggest fiscal stimulus of any region of the world. South Korea's real consumer spending rose at an annualised rate of 14% in the second quarter, spurred by a tax cut on car purchases and support for low-income families. Its exports also surged, by an annualised 53%, partly thanks to strong Chinese demand.

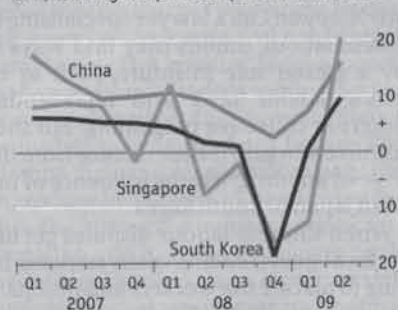
Sceptics argue that China alone cannot ignite economic recovery across the region because a large portion of Asia's exports to China are just intermediate goods, which are processed into exports to developed economies. The Asian Development Bank calculates that 60% of the region's exports eventually end up in the rich world. However, this ignores the huge boost that China's rebound is giving to business and consumer confidence across the region.

If the West continues to sputter, what happens when Asia's fiscal stimulus and restocking fade? A recent report by Frederic Neumann and Robert Prior-Wandesforde at HSBC argues that Asia's recovery will be sustained well into next year, thanks to loose monetary policies. Unlike in America and Europe, where crippled banking systems and high debts blunt the impact of low interest rates, Asia, especially China, is awash with liquidity, which will support domestic spending (see page 61).

Perhaps the main risk now facing emerging Asia is not feeble demand in the West but inflation or asset-price bubbles at home. The Reserve Bank of India has raised its inflation forecast for this year to 5%, well above its target of 3%. China's banking regulator has ordered banks to stick to the rules on mortgages and make sure lending goes into the real economy, not shares. If America's Fed had done this and worried a bit more about bubbles, the world might not be in such a mess. ■

V for victory

GDP, % change on previous quarter, annualised



Sources: Goldman Sachs; Thomson Datastream

Arbitration needed

China's labour laws

What lies behind the gruesome death of a manager at Tonghua Iron and Steel?

WORKERS' opposition to privatisation and job cuts is widespread but rarely takes so brutal a form as it did on July 24th in northeastern Jilin province, when steel workers chased down and killed an executive who had reportedly come to tell them that an imminent privatisation of their factory would bring massive job cuts. Hong Kong-based human-rights monitors reported that 30,000 workers were involved, though Chinese officials insist the number was lower. By all accounts, the ugly scene at the Tonghua Iron and Steel Plant ended in the bloody beating and death of Chen Guojun, general manager of the private Jiansong Group which already owned a minority stake in the plant.

The incident highlights not only China's labour discontent but the country's difficulty in dealing with it. Last year, Chi-

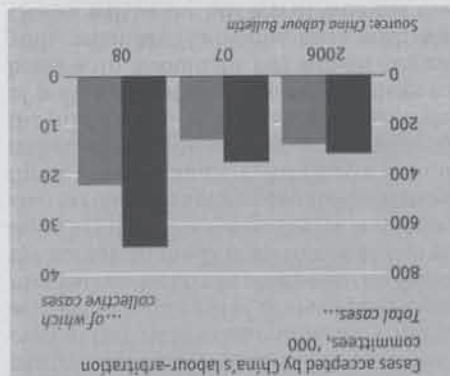
na introduced a series of labour laws that improved mediation and set up an arbitration process to give workers better recourse for their grievances, both individual and collective. Workers have indeed been using the process in greater numbers (see chart). But only a small share of disputes are taken up, whereas discontents are multiplying. Whether in factories, mines or construction sites, workplaces

conditions in China are often atrocious, and workers' safety an afterthought. Nominal legal provisions calling for minimum wages and guaranteed rest days are routinely ignored. One of commonest complaints is the failure to pay wages. Workers go months without being paid, leading to frequent sit-ins or demonstrations.

None of these actions is organised by unions. In name, the All-China Federation of Trade Unions (ACFTU) is a vast union bureaucracy running from the national level to small enterprises. In practice it is controlled by the Communist Party at the national level and, in companies, is mostly a tool of the management. According to Chris Xiaoyun Lin, a lawyer specialising in Chinese labour, unions may find ways to play a greater role in future, such as by drafting labour laws and representing workers in collective bargaining. But they are unlikely to gain independence from the party—or anything like the influence of unions in Japan or South Korea.

When Chinese labour disputes get un-

Instead of strikes



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When Chinese labour disputes get un-

Old soldiers fade away

Gurkhas in Nepal

On the day of the Tonghua incident, the provincial government ordered Jiansong to abandon its plan to buy out the steel plant. Placating protesting workers may help calm a tense situation. But in the absence of genuine unions or better enforcement of the laws, it may also serve to encourage more protests.

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Lahures love Lumley

Kyrgyzstan's election

Tulips squashed

The significance of the president's easy re-election

TO NOBODY'S surprise, Kyrgyzstan's incumbent president, Kurmanbek Bakiyev, won re-election for another five-year term on July 23rd. Even the percentage of people of who voted for him—76.4—was standard for a former Soviet republic. Most post-Soviet authoritarian leaders have learned by now that rigging the vote to get more than 90% invites ridicule. The modern dictator arranges to receive 65-85% of votes—high enough to intimidate opponents, low enough to look democratic.

The surprise of this election, however, was how poorly it was organised. Election day was marred by ballot-stuffing, inaccuracies in voter lists and multiple voting. The previous presidential election held in 2005, almost four months after the so-called Tulip revolution, got a thumbs-up from the Organisation for Security and Cooperation in Europe (of which Kyrgyzstan, rather oddly, is a member). This time, the organisation called the vote "a disappointment". That is also how many Kyrgyz feel about Mr Bakiyev. He won partly because the opposition was too divided to offer a decent alternative.

The Tulip revolution—during which the long-serving president, Askar Akaev, was literally chased out of his office by angry demonstrators—had been a time of hope. The election that followed was a new start for the 5.2m people of mountainous Kyrgyzstan, widely considered to be the Central Asian country with the best chance at democracy and most flourishing civil society. These hopes were soon dashed.

Once elected, Mr Bakiyev ignored his promises to limit presidential powers and to hand more authority to parliament. But he complied with the local custom of taking care of kith and kin by making one brother head of the state security service and another ambassador to Germany. For many Kyrgyz, it seems as if the disliked Akaev clan was being replaced by the Bakiyev one. Though salaries and pensions were boosted and government spending increased, corruption has become more endemic and lawlessness has increased. In April Sanjarbek Kadyraliev became the fourth parliamentarian to be assassinated since the revolution. Independent journalists are frequently targeted, including Almaz Tashiev, who died on July 12th after being beaten up by policemen.

But, quite unexpectedly, Mr Bakiyev has proven to be skilled at playing off Russia and America. He seems to know just what

Initiation rituals in Indian universities

Curbing the ragging trade

DELHI

India cracks down on hazing and harassment

ARSHEE KHOSLA, a pretty 19-year-old economics student, looks anxious as she approaches her Delhi University campus. More unsettling to her than first-day nerves is the line of khaki-clad police who stand guard at the gate. They are there to prevent "ragging", the bullying meted out to first-year undergraduates by older students in universities across India. Around the gates, alongside invitations to join myriad extra-curricular societies, posters declaim that "An Act of Ragging May Land You in Jail".

Initiation rites for new students occur in universities all over the world. Sometimes, they get out of hand. But in India, where ragging might involve forcing "fachchas", as freshers are known, to perform racy Bollywood dance routines before crowds, it has so often tended towards violent bullying that the government is trying to stamp it out altogether. In March an 18-year-old medical student,

Aman Kachroo, was beaten to death by third-year students in the northern state of Himachal Pradesh during a ragging ceremony. According to the Coalition to Uproot Ragging from Education (CURE), an NGO, this was the twelfth death caused by ragging in the past year, a tally that includes suicides.

There are several reasons why student bullying should have become dangerous in India. Harsh Agarwal of CURE believes that Indian undergraduates mimic the kind of hazing rituals they see in Hollywood movies "but they don't really understand and get it wrong". Many educationalists believe that as more low-caste Indians attend university, ragging is used to subjugate them—although "just as often it is lower castes trying to hurt upper castes", says Mr Agarwal. Sex plays its part; ragging is often an excuse for older students to badger freshers. In June a college in Uttar Pradesh banned female students from wearing "vulgar western" clothing. Sexual harassment, known in India as "Eve teasing", seems to be on the rise as the media expose a conservative society to more permissive cultures.

India's state and central governments are trying to curb ragging. Tamil Nadu became the first state to pass an anti-ragging law in 1997; a handful have followed. In February the supreme court declared ragging a "human-rights abuse in essence" and ordered measures to stamp it out, including stopping funding to universities with especially poor records. Delhi University, like others, responded with closed-circuit television cameras, mobile anti-ragging squads and reams of posters. Miss Khosla hopes she will "get away with a song."



Not really student fun and games

his country is worth in the fight against international terrorism. Kyrgyzstan is the only country to host both a Russian and an American military base. Mr Bakiyev was promised more than \$2 billion in aid and loans by Russia in February, after which he declared the American base at Manas would be closed within six months.

Recently Mr Bakiyev agreed to extend the lease of Manas, which provides support for personnel and cargo transiting in and out of Afghanistan as well as aerial refuelling, in exchange for more than tripling the annual rent to \$60m, plus more than \$100m in investment. Russia's response has been swift. The latest news is that the government in Moscow is negotiating to

set up a second Russian military base in Kyrgyzstan. That would bring in more rent.

The money is needed. Kyrgyzstan is suffering from the global slump, which has reduced the remittances sent home by its migrant workers in Russia and neighbouring Kazakhstan. The country faces a possible challenge from jihadists who may have been responsible for several firefights around its porous southern border. Some Islamist fighters of Central Asian background are believed to have returned there after the surge of American troops in Afghanistan and Pakistan's offensive against the Taliban in tribal areas. However skilful Mr Bakiyev's diplomacy may be, he still has his work cut out. ■

Banyan | Malaysia's chameleon

The rise, fall and rise of Anwar Ibrahim, South-East Asia's most extraordinary politician

the 1970s and was even jailed under the draconian Internal Security Act. Then he shocked his former colleagues by joining UMNO, where his rise was spectacular. By 1993 he was deputy prime minister and heir to Mahathir Mohamad, the country's long-serving leader. Malaysia seemed about to fall into his lap. "Ah," says Mr Anwar, "the good old days."

But during the Asian financial crisis of 1997-98, Mr Anwar moved too soon against his mentor, who after 16 years in power was not ready to bow out. Mr Anwar rallied against the UMNO cronysm from which he had benefited. Livid, Dr Mahathir threw him out of the cabinet and launched Mr Anwar's persecution. Mr Anwar's reformist movement sputtered out with his jailing.

Yet the hopes which that movement represented surged again after the general election of March 2008, and especially after August 2008 when Mr Anwar won a seat in Penang. In the election the ruling coalition lost its precious two-thirds majority which gave it power to change the constitution. It has since lost five out of six by-elections to Mr Anwar's forces, which also control four of 13 states. In getting out its message, the opposition has been helped by an explosion of internet opinion that has undermined the influence of the UMNO-controlled mainstream media.

UMNO's back is against the wall. Even its own officials admit to its arrogance, with corruption bound into the fabric of its power. The New Economic Policy (NEP, introduced in 1971) instituted racial preferences for majority Malays, when ethnic Chinese and Indians owned much of business. But instead of helping the poor, the NEP has enriched rent-seekers around the ruling party, while dragging down economic growth. Resentment has spread from Chinese and Indians to poor or pious Malays.

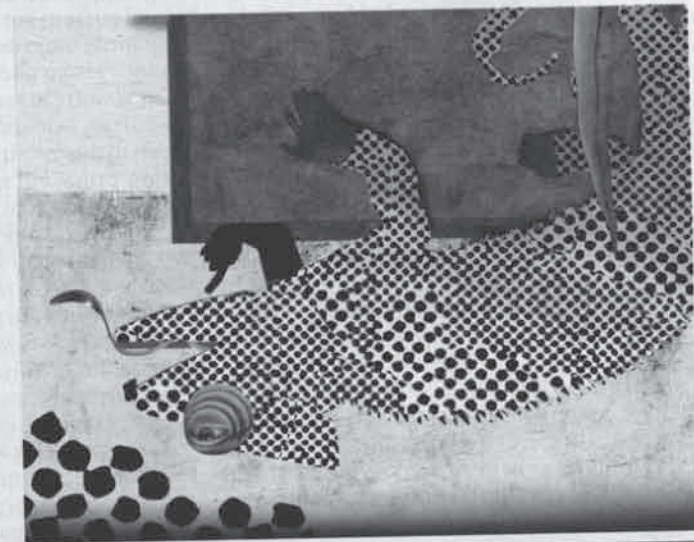
This has made possible Mr Anwar's strange alliance. In calling for the end to the NEP, he says poor Chinese and Indians need help as much as Malays—but because there are more poor Malays than other races, they will still get the lion's share of government help. It is a possible way out from the baneful influence of race on Malaysian politics. But the real strength of this alliance is that Mr Anwar's charisma and political nous holds it together. Alas, that it is potential weakness, too.

Trials and tribulations

The challenges for Mr Anwar and his alliance will now multiply. For a start, Mr Najib, prime minister since April, has said the NEP must adapt, stealing some of his opponent's thunder.

Then there is the time-consuming trial. Mr Anwar says he will win whatever the verdict. If he is acquitted, the government which brought the case will be discredited. If found guilty, tens of thousands of supporters will take to the streets. Mr Anwar hints tantalisingly at new information in a murder case that has gripped the country partly because of its links to Mr Najib. This, he suggests, gives him ammunition to fight back.

Intriguing, but it is unlikely to be enough. If Mr Anwar does go to jail, the alliance may not survive the loss of its leader. If he calls out his supporters—for something of the martyr lurks in him—may be blamed for the ensuing chaos. And if he appeals to international opinion, his local supporters may question that. This points to a trap waiting to catch the silver-tongued Mr Anwar, who deftly tells different audiences—religious or secular—what they like to hear. The same blogosphere that helped his meteoric rise may one day pay more attention to his chameleon qualities. Malaysians would then come to ask more closely: who and what exactly does Anwar stand for? ■



ONE evening in mid-July Anwar Ibrahim was deep in the rubber-tapping state of Kelantan in northern Malaysia, urging a crowd of rural folk to vote for a devout fishmonger. The candidate was from the conservative Islamic Party (PAS). A tiny by-election for the state assembly PAS already dominates is ordinarily small beer (or would be, if PAS allowed such a beverage, which it does not). But Mr Anwar needs PAS. For the paradox is that without the Islamists, the alliance he leads of Malay modernisers, Indians and secular Chinese has little chance of driving the ruling United Malays National Organisation (UMNO) from power. The coalition that UMNO dominates has ruled Malaysia since independence in 1957. Mr Anwar longs for UMNO's destruction. The feeling is mutual.

That morning, Mr Anwar had been in Perth where he had met Australia's foreign minister. What had he been doing with Stephen Smith? "Plotting," replies Mr Anwar, with a conspiratorial wink. Mr Anwar spends a lot of time abroad with national and religious leaders whose names he drops slightly too easily into an engaging conversational style. He moves like quicksilver from one intriguing subject to the next, but you get the uncanny sense that he is speaking to what interests you.

Mr Anwar thinks he will soon need international support. Two days after stumping in Kelantan, pre-trial hearings began in a case in which Mr Anwar stands accused of sodomising a political aide "against the order of nature". Mr Anwar vigorously denies the charges. He says he is the victim of a political stitch-up. International outrage might help him. Much is fishy about the case. Photographs of the former aide who brought the accusations show him with UMNO members, including people close to the current prime minister, Najib Razak. The charge has been changed from sexual assault to "consensual sex", yet his accuser has not been charged. (All homosexuality is illegal in Malaysia.) Mr Anwar has been here before. In 1998 he was charged with corruption and homosexual acts. In custody, he was beaten up by the chief of police. He spent six years in jail, mostly in solitary confinement, until his conviction was overturned. Upon release, his political career seemed over.

It is easy to forget now but for many years Mr Anwar led a charmed life. He made his name as an Islamist student leader in



The centre-left

The challenge of turning malcontents into (sensible) militants

SKIATHOS, GREECE

In most of Europe moderate leftists are having a bad recession—but things look more promising for them elsewhere

WHEN George Papandreou, the Greek opposition leader and president of the Socialist International—a global association of centre-left parties—convened the latest of his summer talkfests on the shores of the Aegean, the mood was upbeat. Veterans of the annual gathering said it was the cheeriest they could recall.

But the reasons for the optimism blowing in the pine-scented air were mainly local: after struggling for several years to rally discontent with Greece's ruling conservatives, Mr Papandreou is now doing well in the opinion polls. He has a good chance, some time over the next year, of becoming prime minister, following in the trail of his liberal grandfather and firebrand father.

Ségolène Royal, the French vice-president of the Socialist International (SI), also came to the Aegean with a success story of sorts, but it too was on a small scale. In the region of Poitou-Charentes, which she runs, the problem of voter apathy is being solved, she insisted, with newfangled experiments in grassroots democracy: for example, "citizens' juries" chosen by lot to monitor the work of local officials.

If the talk turned to town-hall matters, that was partly because, nationally, this is a bad moment for Ms Royal, whose party is in chaos. The picture is hardly more cheerful for much of Europe's moderate left, whether in power or in opposition. With the exception of Greece, the European elec-

tions in June were a disaster for social democratic parties. From France to Austria, centre-leftists failed to harness dislike of conservative incumbents. There was a swing against ruling socialists from Bulgaria (where they were ousted from national power in July) to Britain (whose prime minister, Gordon Brown, looks irredeemably unpopular). In Spain supporters of the ruling socialists tried hard to convince people that they were as upset as anybody about unemployment of nearly 20%, but voters still nudged to the right.

Elsewhere in the world, the picture is more mixed. But in almost every democracy, politicians who style themselves progressive face a common set of problems, to do with shrinking treasuries, looming environmental challenges, general pessimism and the resurgence of nationalism.

There is a paradox here. In many ways, the centre-left should be making hay. Whatever problems he may face at home, Barack Obama has emboldened critics of the status quo—and made life harder for purist conservatives—across the world. Mr Obama has given heart to those who argue that democracy (as opposed to street protests or violence) can produce real change; and helped those on the left who still say that America, for all its recent flaws, can be a guarantor of democracy and freedom.

Meanwhile the banking crisis and the global downturn have been seized on by

the Cassandras (many of them worthy centre-leftists) who said, even at the height of the boom, that global capitalism might become an uncontrollable monster.

But many voters seem unconvinced by the efforts of the centre-left to cash in with told-you-so talk. In some cases, that is because the right has stolen their clothes by launching economic rescue packages, and joining the denunciation of wild "Anglo-Saxon" capitalism. France's conservative president, Nicolas Sarkozy, for one, has borrowed personnel as well as rhetoric and ideas from the left.

In several countries the centre-right has held together with a judicious mixture of talk about tough border controls and promises of economic regeneration. "They sound just a little bit harder on immigration and voters get the hint," says Charles Grant of the Centre for European Reform, a think-tank. The centre-left, by contrast, has haemorrhaged votes, as malcontents drift to various extremes, or into apathy.

A Marxist moment

Indeed, if any group has been making told-you-so arguments with success, it is the radical foes of the system, including Marxists, who denounce their more cautious comrades for being complicit in the capitalist order. In Germany, for example, the far-left vote held up better than that of parties nearer the middle—though some thought it would do better still.

Admittedly, some of the travails of the European centre-left reflect problems that are peculiar to the old continent. Under parties of any stripe, Europe's relative weight in the world economy would be doomed to decline—along with its ability to fund welfare programmes whose roots go back to post-1945 reconstruction and the ideological contests of the cold war. ▶▶

recruiting to his party a young independent green, Kriston Arsenis, whose campaign against construction on Aegean islands had threatened vested interests, including pro-socialist ones.

But elsewhere, the terms of a political marriage between social democracy and greenery look uncertain. Many eyes are on Germany, where the Social Democratic Party (SPD)—now sharing power with the centre-right—did appallingly in the Euro-elections, with a record low of 21%, even as the Green vote held steady at 12%.

What does this portend for Germany's general election on September 27th? On the face of things, the only possibility of a left-of-centre government lies in a new "red-green" coalition, like the one that held power from 1998 to 2005, but with the greens dictating more of the terms.

A Green legislator, Kerstin Andreae, says the SPD is paying the price for internal strife and a lack of convincing leadership. The centre-left is still seen as the tree-hugger's natural partner. Recent German polls have sent a different message, however: that some voters like the idea of a more improbable alliance of greens and centre-rightists, a so-called black-green alliance of the kind that now has power in Hamburg.

Could it happen nationally? Ms Andreae notes that there are big gaps between her party and Germany's Christian Democrats (over nuclear power, say)—but she concedes that they have moved nearer the centre and "we have hopes for them." The only thing her party has ruled out is a "jamaca" (green-black-yellow) deal with Christian Democrats and the liberal Free Democrats, in which the Greens would represent a lone non-establishment voice.

If Europe's premier green party made a deal with the centre-right, that might leave the centre-left feeling lonelier than ever. But recent events in Ireland (where centre-rightists and environmentalists have been sharing power) contain some sobering lessons for anybody contemplating such a bargain. In the European elections, both parts of the ruling coalition were soundly thrashed by recession-weary voters, especially the Greens.

Still, even in Ireland, centre-leftists would be wrong to see the environmentalists as tame fellow-travellers, easy to co-opt because they have nowhere else to go. Whichever partners they choose, green-minded people will have their own ideas.

Take Nessa Childers, an Irish Labour politician. She, at least, is not about to convert to dogmatic leftism. "The old left-right divide has ceased to reflect the choices people have in their lives," she says. "Instead, she hopes her new colleagues will wrestle harder with the meaning of 'sustainable policies—for the fabric of society as well as for the planet.'" Another good topic for a summer symposium. ■

not parties of a more radical stripe. At the same time, Latin America's far left seems a less attractive option for people hard hit by recession. More than in Western Europe, voters there have expertise of far-leftist experiments—and their results. Administrations of a deep-red hue are now in power in a few countries, and worse than those of their neighbours. The "red-hot" 21st-century socialism of Venezuela's President Hugo Chávez has been obliged to cool down by sagging world energy prices. In Argentina's mid-term election, in June, the populist government of President Cristina Fernandez de Kirchner lost its parliamentary majority.

True, there is one country where a centre-leftist leader is struggling under the impact of the recession, and under threat from radicals—Peru. But even there, ultra-leftism is not in the ascendant: the main radical contender for the 2011 election, Ollanta Humala, has tried to portray himself as a moderate and stressed his differences with the fiery Mr Chávez.

Is green the new colour?

Both in the commodity-rich economies of the South, and in the tired old industrial ma—and perhaps, opportunity—for moderate leftists is posed by the environment. Especially in Europe, centre-leftist politics and concern for the planet have almost blended into a single, warm and sometimes fuzzy discourse. Mr Papandreou, for one, expects a full merger. He wants to add environmentalism to the SI's core ideals of democracy and social justice. At home, he has taken risks in defence of that idea, by

the expense of the ruling conservatives, more than of the centre-left, that gained at co's recent legislative election, it was the In-electoral contest this autumn. And in Mexico, coalition looks set to retain power in an far reasons, Uruguay's ruling left-of-centre feel the need to protect the poor. For similar election, mainly because voters is now tipped to win a forthcoming presidential election, three of whose constituents are members of the SI. The centre-left ruling coalition, three of whose constituents have boosted the popularity of the secretary-general, Luis Ayala—such measures designed to protect jobs. In Chile—reaped some benefit from stimulus packages designed to protect jobs. In Chile—

And in Latin America the centre-left has blue-eyed" bankers from the north. side: it is, as he puts it, the fault of "blonde, a winning mixture. He has managed to convince his compatriots that the recession was thrust upon the region from outside: it is, as he puts it, the fault of "blonde, a winning mixture. He has managed to convince his compatriots that the recession was thrust upon the region from outside: it is, as he puts it, the fault of "blonde,

the left is riding out the recession with comparative success. Take Brazil's President Luiz Inácio Lula da Silva, whose working-class origins and pragmatic policies are still a winning mixture. He has managed to convince his compatriots that the recession was thrust upon the region from outside: it is, as he puts it, the fault of "blonde,

In Latin America, meanwhile, the centre-left has helped the economy. promising a return to fiscal caution once rapidly emerging from the downturn. He is which buys Australia's commodities—is long boom, and by signs that China—lack: the cushion provided by a decade—advantages that his European counterparts are in a deep recession. But Mr Rudd has forming the country's environmental position in a deep recession. But Mr Rudd has difficulty of keeping promises and trans-Party scored a landslide victory in 2007, is holding up in the opinion polls, despite the

4 Australia's Kevin Rudd, whose Labor Party scored a landslide victory in 2007, is holding up in the opinion polls, despite the difficulty of keeping promises and trans-forming the country's environmental position in a deep recession. But Mr Rudd has advantages that his European counterparts lack: the cushion provided by a decade-long boom, and by signs that China—which buys Australia's commodities—is rapidly emerging from the downturn. He is promising a return to fiscal caution once In Latin America, meanwhile, the centre-left has helped the economy.



In the pink: Papandreou and Royal



Shipping in the downturn

Sea of troubles

The recession is buffeting the world of shipping—with even rougher waters ahead

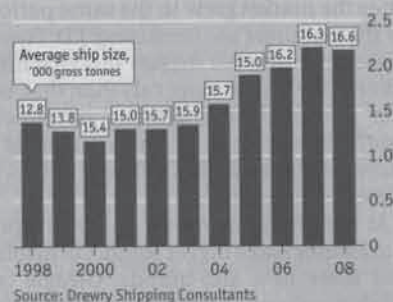
FROM the sheltered waters of Subic Bay in the Philippines to Falmouth on the south coast of England, a vast, swelling armada lies idle. In Asia's deep-sea havens 750 vessels—container ships, bulk carriers, tankers, car carriers and others—are laid up. A further 280 are sheltering in European waters. According to Lloyd's Marine Intelligence Unit, nearly 10% of the world's merchant ships are swaying gently at anchor because of a collapse in global trade.

Since the recession bit hard last autumn a lot of attention has been paid to the plunge in the Baltic Dry Index, a composite measure of the cost of shipping bulk cargoes such as iron ore and coal. It fell by over 90% between June and October last year, although it has since recovered slightly and is hovering at just above a quarter of its peak. World trade in general remains in its worst slump for generations, although it too is no longer falling. Two of the biggest shipping banks (RBS and HBOS) are in state-backed rehab. The parlous state of the world economy could mean more shipping companies following Eastwind Maritime, which went bankrupt in June. On July 28th Hapag-Lloyd, Germany's largest container-shiping company, secured a €330m (\$468m) bail-out from its shareholders while it seeks up to €1.75 billion to keep it from sinking altogether.

Worse, there is a huge supply of new ships on order and due off the slipways over the next four years. For bulk carriers alone, the backlog is equivalent to more than two-thirds of existing capacity. Philippe Louis-Dreyfus, departing president of

Full steam ahead

World shipbuilding completions, '000
Ships over 500 gross tonnes



the European Community Shipowners' Associations, has called for an industry-wide scrappage scheme to shrink the surplus. Warning of a "bloodbath", he said in June that shipping capacity would exceed the needs of the market by between 50% and 70% in the near future.

Nothing like this has been seen since the early 1970s, when lots of super-sized oil tankers, known as VLCCs (very large crude carriers), were built in expectation of huge growth in oil consumption just before the first oil shock. The result was a persistent surplus and no more orders for VLCCs for a decade. By the late 1990s the number of ships completed was running at around 1,300 a year. But from 2004 production picked up. Ships have also been getting larger (see chart). By last year annual completions were up by nearly 60% compared with a decade ago and the ships were 30%

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Economist.com/businessview

bigger. No wonder Lloyd's List, an industry journal, is full of news of ship seizures and bankruptcies.

Yet a ray of sunshine is breaking through the storm clouds. The world's shipbuilders are unlikely to convert all of their huge backlog of orders into deliveries given their unrealistic workloads and likely cancellations. Drewry Shipping Consultants estimates that nearly half the ships due to be delivered last year are still sitting on the slipway or the drawing board. Analysts at ICAP Shipping Research in London shrug off the idea that there will be a glut, since shipments of cheap Australian coal and iron ore to China have for years been constrained by a lack of big ships. More giant bulk carriers will lower the prices of ores delivered to China and stimulate trade growth, they say.

The outlook for tankers is less clear because of the volatility of crude-oil prices. Rates recovered strongly in June, according to ICAP, partly because large vessels were in demand for storage, as oil companies waited for crude prices to strengthen. Looking further ahead, the International Energy Agency expects oil demand to fall by 2.5m barrels a day this year, having already dropped by 300,000 b/d in 2008. But lower demand will be offset by a scheme to phase out single-hull ships on environmental and safety grounds in European and North Atlantic waters. The decline in production from mature oilfields in the North Sea and Alaska also means that replacement supplies will have to be hauled longer distances by sea to the refineries of Europe and North America.

The part of the shipping industry headed for the choppiest waters is the container trade, which had steamed ahead gloriously since the mid-1970s. The forging of global supply chains in the past 20 years, the rise in merchandise trade and the emergence of China as the workshop of the world created growing demand. Vessels became gigantic, with the latest capable of ▶▶

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Geely's version of the London black cab,

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Geely appears to have no difficulty

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2006, Geely has not only increased in

number of engineers it employs from 350

AT A time when most carmakers are struggling to cope with the worst crisis the industry has experienced in living memory, the ambitions of Geely, China's biggest privately owned car firm, are breathing new life into the industry. The company is simultaneously developing six modern platforms—an astonishing number even for a global giant such as Toyota—and is committed to launching nine new cars in the next 18 months and up to 42 new models by 2015. Its technical director, Frank Zhao, claims that Geely will have the capacity to make 2m cars a year by then.

A Chinese carmaker shrugs off the global downturn

The ambition of Geely

The Chinese car industry container trade may not resume. ■ economy recovers, the rapid expansion of most complete. So even when the world that this one-off restructuring may be a-

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number of engineers it employs from 350 to 1,200, but has established an entire uni-

There are also persistent rumours that Geely is negotiating to buy a European car company. A few weeks ago, Geely was said to be casting an eye over GM's Swedish unit, Saab, but nothing came of it. Now, Geely is supposed to be preparing to buy Volvo, a much bigger outfit than Saab, from Ford. But Ford would be a very wary seller, fearing that Geely might run off with too much valuable intellectual property. It is, after all, a carmaker in a hurry. ■

Mr Li's world-conquering plans were badly denied when a Russian car magazine crash-tested a Geely CR small saloon at 64kph (40mph). Both driver and passenger were given a survival chance of only 10%. Geely sold about 30,000 units outside

China last year and assembles cars from kits in Russia, Ukraine and Indonesia. It also plans to build factories in South Africa and Mexico. Mr Zhao thinks Geely's cars can now pass the strict emissions and safety standards of the rich world. The problem, he argues, is more to do with reputa-

tion than the firm's latest products.

the year after its initial public offering in Hong Kong, Geely exhibited its entire range of cars at the Frankfurt motor show, followed up with an appearance at the Detroit show in 2006. Mr Li talked about entering the European market in 2007 and breaking into North America by 2008, but

even now those remain fairly distant goals.

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A deal between Microsoft and Yahoo!

Bingoo!

SAN FRANCISCO

The world's biggest software firm and web portal team up to challenge Google

USERS will probably not notice the difference. But the deal between Microsoft and Yahoo!, the world's biggest software firm and the leading web portal, for a ten-year partnership in searches and advertising on the internet, may one day be seen as a momentous event. The combination, which was announced on July 29th after years of speculation about a tie-up, is not as far-reaching as originally envisaged. But it is likely to create a serious rival to Google, the online giant that dominates both of these activities.

The agreement is supposed to help both parties overcome their most pressing problems. Microsoft will significantly increase the use of its search service, called Bing, and its platform to place online advertisements, because Yahoo! will use both of them on its websites. The web portal, for its part, will be able to cut costs and increase revenues. Yahoo! will no longer have to invest millions in its search and advertising technology, both of which it will hand over to Microsoft. It will also get more money for the ads placed next to its search results. Carol Bartz, Yahoo!'s chief executive, said that the tie-up "comes with boatloads of value" for her firm. During the first five years of the deal, it will receive 88% of the revenue generated by ads next to search results on its web page.

The deal is the result of a long mating dance which started in February last year when Microsoft made a \$44.6 billion takeover bid for Yahoo!, later raising its offer to \$47.5 billion. But Yahoo!'s bosses rebuffed Microsoft, saying the offer undervalued their firm. Instead Yahoo! made an agreement with Google on advertising, only to see it scuppered by concerns that antitrust objections could lead to protracted legal wrangling. Talks between Microsoft and Yahoo! were rekindled after Ms Bartz took the helm at Yahoo! in January. She is less emotionally attached to maintaining its independence than her predecessor, Jerry Yang, one of the company's founders.

Despite Ms Bartz's cheerleading, investors were disappointed. Yahoo!'s share price fell by 12% after the announcement. The firm is said to have pushed for an upfront payment of billions of dollars, but has not received one. What is more, the deal covers only text ads displayed alongside search results and not other forms of online advertising. On the plus side, Yahoo! will sell higher-priced search ads for both firms, allowing it to maintain rela-

tionships with advertisers.

The combination may in time be able to threaten Google's dominance in web search. The deal will mean that Microsoft handles nearly 30% of searches in America, compared with Google's 65%. As it is, Bing is gaining ground, and Microsoft will now have more data with which to improve it. Even more important will be the challenge to Google's lucrative business in search-related ads, a market which it dominates even more with a share of over 70% in America.

Earlier this month, Google announced that it is developing a free operating system for personal computers called Chrome OS, thus mounting a direct attack on Microsoft and Windows. With the Yahoo! deal, Microsoft is now pushing into Google's heartland. The battle lines between the technology titans are becoming ever clearer. ■

Spotify v illegal downloads

Free but legal

Advertising-supported music will not save a troubled industry. But it helps

CAN legal free music compete with the illegal stuff? It seems so. Firms such as Spotify, founded by Swedish programmers, and we7, based in Britain, stream music on demand to European computers in return for nothing more burdensome than the odd advertisement. Together they have quickly amassed 8m users. On March 24th Spotify asked Apple to authorise an application for the iPhone that would take music-streaming mobile.

It is a bright spot in the music industry's long, perilous journey to the digital world. Worldwide sales of music in the form of CDs and DVDs fell by 15% last year, according to the International Federation of the Phonographic Industry (IFPI). Digital revenues, though rising, are not making up the shortfall. Most worrying is the rise of a generation used to obtaining music illegally through file-sharing, particularly in Europe (see chart). Lawsuits and crackdowns

have displaced file-sharing from public networks into more secretive ones and into things like e-mail, from which it will be virtually impossible to root out.

Which is why outfits like Spotify and we7 are so important. If 95% of music downloads are illegal, as the IFPI believes, there is a huge potential market for legitimate music. Free streaming appears to be tapping it. Rob Wells of Universal Music reckons that 60-70% of Spotify users have resorted to file-sharing in the past. It is doubtful that all of them have been weaned from piracy: after all, pirated music has the immense advantage that it can be saved and transferred from one device to another. But it is a start.

Gartner, a research firm that has polled file-sharers, finds that Britons and Americans mostly resort to illegal sources not because they want to stick it to the music companies but simply because the websites are free and have a good selection of tunes. (By contrast, illegality is part of the appeal in Italy.) Ad-supported streaming competes well on both counts. Although there is still more music available for illegal downloading than for streaming, the lawful websites are at least free of viruses, and of decoy files put there by the music firms.

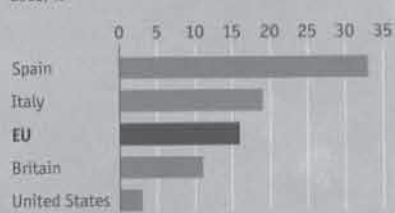
But it is not clear that streaming services can generate profits. "Nobody is making money from the ad-funded models," says Steve Purdham, the head of we7. The rise of music-streaming websites in the past year has coincided with a sharp drop in spending on advertising in general. Although royalty rates have come down they are a hefty burden on companies that have attracted customers at such a rate. They are burning venture capital.

At present a little more than 40,000 Spotify users pay a monthly subscription to obtain better sound quality and avoid advertisements—a puny number compared with the 6m who have installed the free application. The company sorely needs to raise the proportion of premium subscribers. Hence its mobile ambitions. The new iPhone application, which allows users to store songs temporarily, would be available only to paying customers. Being mobile, it would negate one of piracy's big advantages (although its cost would reinforce another one). As Mark Mulligan of Forrester, another market-research firm, points out, it also looks disturbingly like an alternative to Apple's popular iTunes online music store. That may persuade Apple to reject it.

Free streaming will not save the music business. But neither will anything else in isolation. As Paul Brown of Spotify puts it, the health of music depends on moving from one source of revenue—CDs—to perhaps a dozen. If the streaming websites can work out how to draw paying subscribers and lure more advertising, they may well become one of those sources. ■

Pirates of the Mediterranean

Self-reported file-sharing penetration rates 2008, %



Becalmed

Wind power in America

NEW YORK
After a record year, America's wind industry is suffering growing pains

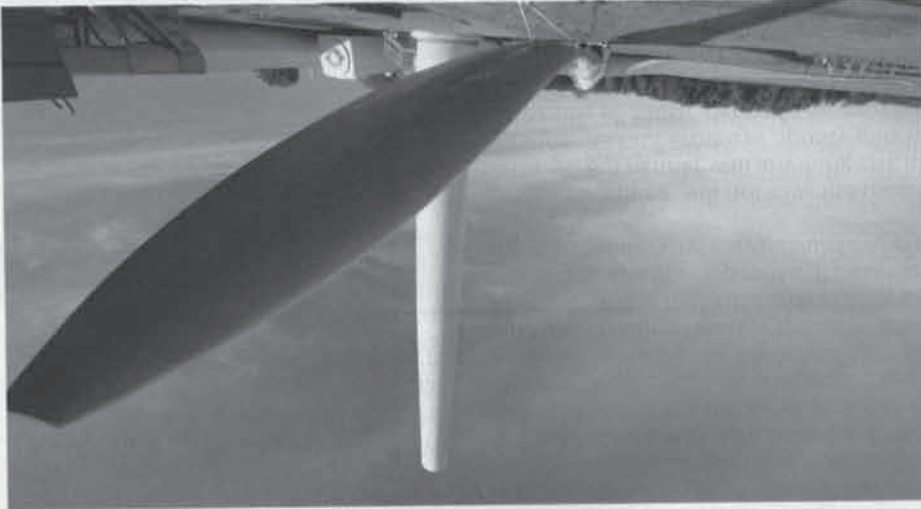
ON THE back of \$16 billion-worth of investment, America overlooked Germany to become the world's biggest wind power generator last year. Wind accounted for 42% of new generating capacity, up from just 2% four years earlier. America's states are ideal sites for turbines, so the country's wind industry seemed poised for big things.

But this year momentum has slowed. An indication of the way the wind is blowing came in July when T. Boone Pickens, an oilman turned clean-energy entrepreneur, decided to call off plans for the world's biggest wind farm, in Texas. His 687-giant turbines, ordered at a cost of \$2 billion, are now looking for new homes.

Mr. Pickens could not arrange for transmission lines to be built from his wind farm to areas where the electricity is needed. Because they dominate the landscape, big wind projects work best in places few people live. America's "wind belt" runs from Texas up to the Dakotas. Texas and North Dakota have both been called the "Saudi Arabia of wind". But unlike oil, Saudi Arabia cannot be put in a tanker and shipped. It requires expensive grid infrastructure, which in turn rests on a complex and time-consuming approval process.

The industry is hopeful that new legislation will give the Federal Energy Regulation Commission powers to speed things up (state authorities hold most sway and rules differ from place to place). But that is not the industry's only difficulty. The credit crunch has finally caught up with it.

The Obama administration is also firmly behind the industry. On July 16th Steve Chu, the secretary of energy, announced \$14m for wind research. February's fiscal stimulus bill also provides money for new projects on the ground. Until this year, the main spur to private finance was tax credits. But when the banks crashed, they could not claim the credit, as they had no profits to claim it against. The stimulus package allows firms to convert the tax break into upfront payments. Rules for applying were



Twirl, interrupted

Wind is a capital-intensive, heavy manufacturing industry with long lead times, which is why despite everything 2008 was a record year and many installations have gone ahead in 2009. However, a big slowdown is expected soon as customers who have made downpayments on new turbines fail to get the financing needed to complete their orders.

Last year generating capacity surged by 50%. This year the American Wind Energy Association (AWEA) forecasts growth of only 20%. The AWEA says that although 2,800 MW of new capacity was installed in the first quarter, just 2,000 MW went in during the second.

But everything is relative. The AWEA's Liz Salerno notes that 2009 is still on track to be the industry's second-best year ever. She adds that wind is contributing not only generating capacity, but also much-needed manufacturing jobs. Nordex, a German company that is one of the world's biggest turbine manufacturers, recently announced a new factory in Arkansas, creating 700 jobs in an economy that is shedding them by the hundreds of thousands. GE reported dismal results for its second quarter, but GE Energy, which includes the conglomerate's wind business, was a bright spot, with profits up by 13% to \$1.8 billion. It is establishing a new research facility in Michigan, where the unemployment rate is 15%. Including GE, seven of the world's ten biggest wind-turbine-makers have factories in America.

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Nothing to shout about

NEW YORK
Things are still getting worse for the advertising industry

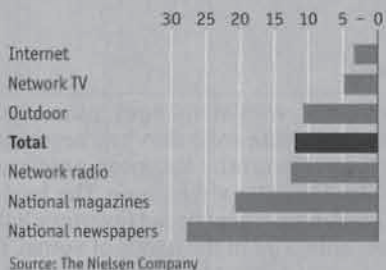
WE LED into the downturn, we'll lag budgets tend to be one of the first things cut when times get difficult, he sighs, though it often costs firms more in the long run to recover the resulting lost ground. WPP had expected a hard 2009, budgeting for a 2% decline in revenues. But that now looks wildly optimistic, after a 5.8% year-on-year decline in the first quarter, and an even worse April and May.

These are global numbers, buoyed in part by WPP's strong presence in emerging markets such as China, which have weathered the economic crisis better than most. In America, things are worse. Total advertising fell by more than 10% in the first quarter (see chart on next page) and predictions for the full year are even more dire. Spending on advertising will fall by a "normalised" 14.5% this year in America, from \$189 billion to \$161 billion, according to the latest forecast by Magna, a research arm of Interpublic Group, another big advertising company. The actual decline is even bigger, which is why Magna has adjusted the numbers to reflect the lack of big quarterly Olympic games and American elections. The outlook is so bleak that some agencies have resorted to outlandish tactics to raise revenues (see box on the next page).

For many businesses that carry ads the pain is even greater still. Advertising in magazines is expected to fall by 18.3%. Radio advertising is predicted to plunge by

Pitching downwards

US advertising spending
Q1 2009, % decrease on a year earlier



Source: The Nielsen Company

► 21.8% and newspaper advertising by 26.5%, which is why so many papers are struggling to survive. Even the much hyped rise of online advertising has been reversed, with spending forecast to decline by 2.2% in America this year.

Next year Magna projects a further decline in total spending of 2.1%—or of only 0.4% if spending related to the winter Olympics and America's mid-term elections is added to the mix. But even this scenario depends heavily on a return to economic growth, says Magna's Brian Wieser, who prepared the forecast. Unlike WPP's Sir Martin, Mr Wieser believes that advertising spending moves in line with economic growth, rather than lagging behind it as the economy recovers.

Others in the advertising industry fear that when the economy does eventually pick up, the old link between GDP and ad spending will prove to have been broken, because the cyclical downturn will have accelerated several structural trends that were already hurting conventional advertising. One is that clients are becoming far more demanding. They increasingly want evidence that their expenditure is worthwhile. In April Coca-Cola said it was adopting a system of "value-based compensation" for the advertisers that work on its 400 or so brands, rather than paying them for time spent. This would cover the ad agencies' costs, with a "performance" bonus of up to 30%. Procter & Gamble had earlier announced a similar scheme for 12 of its brands. If this catches on, it will spell the end of the billable hour.

At the annual gathering of the advertising industry in Cannes at the end of June, all the talk was of the accelerating shift away from established forms of advertising, especially the 30-second commercial, towards newfangled social media. The winner of the coveted Titanium prize was Barack Obama's election campaign, which was a combination of "lousy advertising, but great marketing," says Marian Salzman of Porter Novelli, a unit of Omnicom, another huge advertising group. This inspired much debate about how to turn every customer into an evangelist, and how to drive grassroots campaigns using Facebook and

Advertising firms seek sidelines

Stretching the accordion

NEW YORK

The recession forces agencies to branch out

ADVERTISING agencies have been worrying for years that advertising alone will not pay enough to keep them afloat. This year their clients' slashed ad budgets have heightened that anxiety. As a result, many have branched out. Richard Kirshenbaum, co-chairman of Kirshenbaum Bond + Partners (KBP), a New York-based agency, says the industry's "business model is more like an accordion. We keep stretching it to meet our clients' needs." KBP has expanded by adding several divisions that are separate from its core business, including a public-relations unit and Varick Media Management, a data-analysis and investment-management firm launched last year.

KBP is not alone. Euro RSCG, a unit of Havas, a French advertising group, acquired its own music label, called The Hours, in 2008. It has signed budding artists and is hoping for their stardom, not least because it will help fill the firm's coffers. Havas, too, has branched out into an area not typically associated with advertising by acquiring Cake, a British entertainment and event-planning agency. In May Ogilvy & Mather, a subsidiary of WPP, an advertising conglomerate, launched OgilvyEarth, which advises firms on greenery. It also started a sep-

arate Recession Marketing Practice this year to counsel companies on how to use their marketing budgets wisely.

Some agencies have tired of coming up with clever ideas for clients without winning a share of the resulting revenues. So BBH, a global advertising firm, has set up a unit called Zag, which designs, markets and distributes its own products. Its successes include a range of prepackaged vegetarian food sold at Tesco, a British supermarket, and a security device that imitates the sound of a woman's scream. BBH hopes Zag will provide a quarter of its revenue within two years, though that target remains distant. Another agency, Anomaly, has decided to focus on developing its own intellectual property; advertising accounts for less than half of its revenue.

Moonlighting may sound appealing. But it will not be the singular solution to the industry's troubles, argues Miles Young, Ogilvy's boss. He believes it is "downright dotty" for agencies to expand into areas that are not an extension of their core expertise. Besides, the grim economic climate does not favour such dabbling. It takes cash and time to develop a fledgling unit. Those are two things that many agencies do not have.

Twitter. A forthcoming book by Mr Obama's chief campaign strategist, David Plouffe, seems destined to become the ad industry's new bible.

Not everyone is convinced that a revolution is under way. John Deighton of Harvard Business School claims that social media were crucial to the Obama campaign only in the first half of the primaries, because using them is well suited to "insurgency". After that, he says, the campaign reverted to a fairly standard effort dominated by television advertising. Indeed, Mr Deighton believes that the television commercial will remain the mainstay of the advertising industry for years to come. Magna's Mr Wieser seems to agree, noting that, contrary to reports of its demise, America's viewing habit continues to grow, and ad spending on national campaigns is likely to fall this year by only 6.3%—a triumph, in the circumstances.

Local television advertising in America has been hit much harder, owing to the car industry's woes, especially the bankruptcies of Chrysler and General Motors. Car dealerships, which are closing in large numbers, are big advertisers. But Benjamin Swinburne, a media analyst at Morgan

Stanley, is forecasting a surprisingly strong rebound in advertising, especially on television, because dealers' spending on car and truck ads has fallen implausibly low: down by 65% in the first quarter of 2009 compared with the same period last year.

Perhaps the sharpest divide in the advertising industry is between those who think that as the economy revives consumers will rediscover their old spending habits and those who disagree, such as Ms Salzman of Porter Novelli. She says that American consumers "have changed in the same way there were Depression Babies who as adults would drive a car into the ground before replacing it." Fast-food restaurants have been one of the few sources of higher ad spending this year, as they tap into newly value-conscious consumers, says Annie Touliaos of Nielsen, a media research firm.

Sir Martin, too, thinks that American and European consumers have been "scarred", and will take a long time to rediscover the joy of splashing cash around. But as Mr Swinburne points out, advertising has done so badly of late that "it doesn't have to come back all the way to have a strong recovery". ■

Face value | A Viennese grind

The troubles of Julius Meinel V illustrate the complicated consequences of the property crash



raise around €4 billion of capital, with Meinel Bank again handling the transaction. But the subprime crisis that had begun in America was beginning to infect the central European property market, making the role of underwriter a risky one. The bank says the entire issue was placed with international investors. But a large number of certificates ended up in the hands of Somali, Netherlands Antilles subsidiary of Julius Meinel AG, a Liechtenstein trust founded by the family.

Anyone left holding the certificates would have faced big losses as property values plunged had Meinel not decided to support its sagging share price by buying back 52m of them, which it did between April and August 2007. When Meinel announced the plan (but mostly already executed) buyback to the Vienna Stock Exchange on July 27th 2007, its share price nosedived anyway. Investors were in uproar at a general meeting a month later and the Meinel affair became a full-blown scandal. By that stage Meinel had apparently frittered away €1.8 billion in a vain attempt to support its share price, without investors' approval.

The questions still raging in Austria and Jersey are authorized the buyback and was it legal under the island's law? Two members of Meinel's board at the time, who are Jersey lawyers, told the Jersey Financial Services Commission (JFSC) that they had been kept in the dark about the buyback. Other board members sought legal opinions, but, it seems, only after the fact, according to e-mails published recently in *Formal*, an Austrian weekly, which appear to have been leaked from the prosecutor's office. The opinions were contradictory. Bedell Cristin, a Jersey law firm, said a buyback would need shareholder approval. Yet a senior English barrister opined that since the buyback involved certificates not shares, approval was not needed, though "it would be appropriate and desirable". An investigation by the JFSC continues. But Austria's Financial Market Authority (FMA), has fined Meinel's board members €20,000 each for misleading the market. Citicorp Trustee Company, which acts as trustee for bonds issued by Meinel, wrote in June that it regarded the buyback as illegal.

Setting accounts

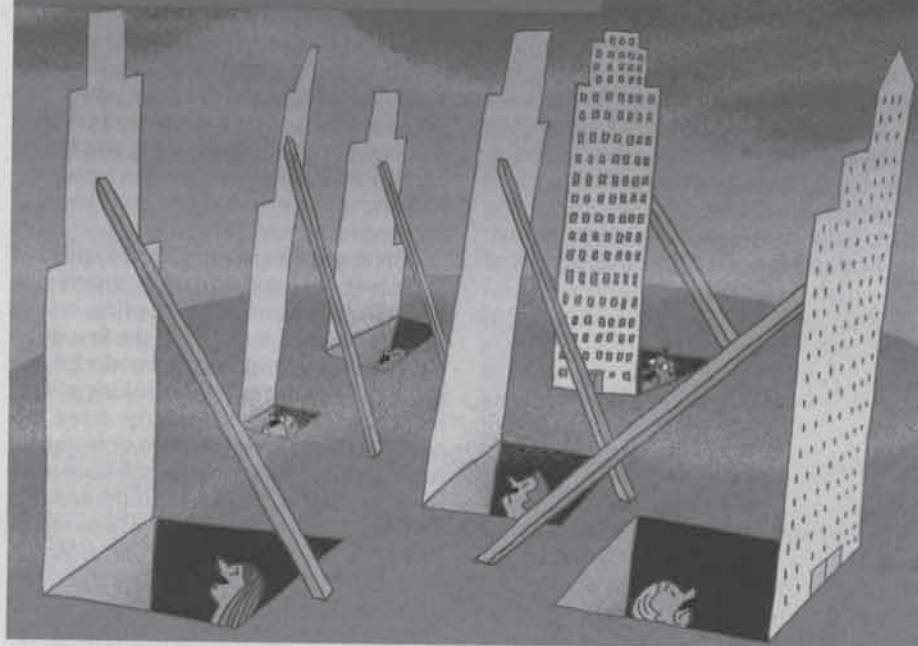
Underlying these questions is the suspicion, frequently aired in the Austrian press but emphatically denied by Meinel, that the buyback was intended to benefit Meinel Bank at the expense of Meinel's shareholders. The FMA asked the central bank to investigate Meinel Bank. The Vienna prosecutor swung into action this February, ordering raids on various premises in Austria and Slovakia relating to the bank or Meinel. Six weeks later Meinel was called in for questioning and arrested.

Mr Meinel and his bank are fighting to defend their reputation. On July 2nd they scored a small victory when one of the prosecutors was taken off the case for having penned an anti-Meinel article in September 2007. A string of press releases and full-page advertisements have refuted all the allegations that have appeared in the newspapers. Mr Meinel argues that his bank performed honest work on Meinel's behalf, at market rates, and made no attempt to influence Meinel's management. The buyback can be construed as part of Meinel's strategy to sell a stake to a strategic investor (a year later two investors did indeed buy into Meinel, changing its name to Artium and paying severance and other fees to Meinel Bank of €240m). Investors, meanwhile, got back a fraction of their money. Some say Mr Meinel's €100m bail, paid by a source in Liechtenstein, should be used to defray their losses. He, naturally, demurs. The legal grind continues. ■

The Britishness is an accident of history. While Julius II kept the firm going under the Nazis, Julius III and his Jewish wife fled to Britain in 1939, along with their son Julius IV. Julius V was born there in 1959. Julius IV sold the Austrian stores in 1998, but kept one landmark food emporium in Vienna and the family's property portfolio in central Europe. Julius V went into investment banking in London and New York, after an education in Vienna and St Gallen, Switzerland. In 1983 he took over Meinel Bank, the family banking arm, and gradually changed it from a small savings bank into an investment bank and fund-management firm.

By 1997 Mr Meinel had found a new way to make the bank money: he spun much of the family property portfolio into Meinel European Land (MEL), a company domiciled in Jersey but listed in 2002 on the Vienna exchange. MEL, at which Mr Meinel had no formal role, then sold shares (in the form of certificates enshrining a claim on a share) to a wide public. For Meinel Bank, providing investment-banking services to MEL was a gold mine, yielding €322m between 2003 and 2007. In 2006 it accounted for 60% of the bank's earnings. But the ties between MEL and Meinel Bank attracted little scrutiny as long as the property fund prospered.

In February 2007 MEL issued 75m new share certificates to



The collapse in commercial property

Towers of debt

Concerns are switching from the residential to the commercial sector

FROM a distance Potsdamer Platz looks a bit like its old self. Once the central hub of Berlin, before it was turned into a rubble-strewn no-man's-land divided by the Wall, it is now surrounded by shiny new towers. Get a little closer, however, and it becomes clear that many buildings are just façades painted onto giant hoardings that rise ten stories high between actual office blocks.

This subterfuge makes for a far more pleasant view than that provided by vacant lots. It also points to an unusual degree of restraint among developers in Europe's second-largest property market (by transactions). The commercial-property market in most other parts of the developed world is in deep trouble.

Unlike other property busts, this downturn has not been driven by speculative overbuilding but by investors' overenthusiasm. Commercial property was a popular asset class for much of this decade. Institutional investors who lost a lot of money when the dotcom bubble burst were persuaded that switching from the stockmarket into property would diversify their portfolios and reduce their risk. Cheap finance was plentiful. Investors could indulge in a version of the "carry trade"—borrowing at a low interest rate to buy buildings and counting on the rental yield and capital growth to more than cover their financing costs.

That strategy looked smart when rents and capital values were rising and vacancy rates were low. But as cheap financing has dried up and economies have tumbled into recession, investors have become badly exposed. According to Marcus & Millichap, an estate agent, the office-vacancy rate in Manhattan climbed by more than three percentage points in the first half of the year, to 11.2%. As tenants have disappeared, rents have fallen too—by 16% over the past year, Marcus & Millichap reckons.

Property prices have also been badly hit. Moody's, a rating agency, estimates that American commercial-property prices dropped by 7.6% in May alone, leaving them almost 35% below their peak in

October 2007. Prices would have gone down even further had not transactions dried to a trickle (see chart). Owners are loth to sell into a falling market, although some distressed sales are occurring.

All this sounds like a replay of the downturn in the residential-property market, where easy borrowing terms allowed homebuyers to push prices to extreme levels. To add to the sense of déjà vu, property loans have also been bundled into complex financial instruments, known as commercial mortgage-backed securities (CMBSS). The riskiest of these, mainly those issued between 2005 and 2007, are now running into trouble.

Realpoint, a credit-rating agency, says that nearly \$29 billion of CMBSS, around 3.5% of the total, have become delinquent (ie, borrowers have not kept up interest payments) in the past 12 months. It thinks the delinquency rate could reach 6% by the end of the year. Richard Parkus of Deutsche Bank reckons the default rate could eventually reach 12%. Together with bad construction loans, that could push the losses of American banks on commercial property to \$200 billion-230 billion. Many small banks will go under as a result.

European banks are exposed to property, too. The good news is that the two biggest euro-zone economies, France and Germany, have seen only modest declines in rents and prices. But one of Italy's biggest property companies, Risanamento, is fighting to stave off its creditors. And pain is being felt all around the periphery of the euro area. In Spain (see box on the next page) and Ireland vacancies are surging, property prices are plummeting and cranes are standing idle.

Prices are plunging across central and eastern Europe, too, although the volume of transactions remains slim. Yields in

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Not moving

Moody's/REAL US commercial-property price index



Source: Real Capital Analytics

many of these markets were driven down by hopes that they would, in time, converge with those in mature European markets. Vacancy rates in cities such as Budapest have surged to about 15% while those in Prague have almost doubled (to roughly 10%) over the past year. Some of the biggest falls in rents are taking place in Russia. Rents in Moscow have fallen by 63% in the 12 months to the end of June although they

Tricks and mortar

Spain's property market

The central bank makes life a little easier for lenders

MADRID

are still the third-highest in Europe (after the West End in London, and Paris). With almost one-fifth of office space empty, further falls in rents and prices seem likely. Asia has not been spared either. The June 2009, according to Cushman & Wakefield, a consultancy. Hong Kong was not far behind with a 43% drop in the same period. Mumbai (down by 40%) and Shanghai (32%) were the next hardest hit.

There are some signs that the speed of the downward adjustment is slowing. In Hong Kong, office rents in the prime central district declined by 20.1% in the first quarter. The fall was much more moderate, but still 10.4%, in the second. Looking ahead, Singapore seems particularly dicey, because 8.3m square feet (770,000 square metres) of new office space will be coming into the market by 2013. According to CISA, a broking firm, oversupply will also weigh heavily on office property in China. Vacancy rates in Shanghai and Beijing could rise to 35% in 2010 from around 17% and 22% respectively today.

A year ago everyone was worried about losses on residential-property loans. If the latest data are any guide, both American and British house prices may be finding a bottom. Concerns are now switching to the commercial sector. History suggests downturns in that market last for years, rather than months. Almost 20 years have passed since the Japanese property market peaked. Prices still fell by 4.7% last year. ■

SPANISH banks have been doing their best to shield themselves from the bursting of the country's property bubble. By buying properties before the loans on them go bad, lenders can mask their worst bets. Restructuring loans has the same effect. Help is now at hand from an unlikely source: the normally sober Bank of Spain. In July the central bank circulated guidance that relaxed provisioning rules on risky mortgages.

The change makes some sense. Until now, banks have had to make provision for the full value of high-risk loans—those above 80% of the property's value—after two years of arrears. That was far too demanding, since property values rarely fall to zero. Under the new rules, they only have to allow for the difference between the value of the loan and 70% of the property's market value.

Yet the timing is terrible, mainly because the move follows heavy lobbying from the banks. The Bank of Spain maintains that the net effect on the system will be neutral since it is also tightening rules for bad consumer loans. But the impression is that Spain's central bank—one of the few to emerge from the crisis in credit—has moved the goalposts to help banks deal with the onslaught of bad property loans.

For Spain's two largest banks, Banco Santander and BVA, which have diversified abroad and reported decent second-quarter results this week, the new guidance will probably have only a marginal effect. But it will be a boon to smaller lenders with greater exposure to risky loans. Inigo Vega, an analyst at Iberian Equities, estimates that the new rules would relieve banks of the need to make provisions of about €2.2 billion (\$3.1 billion) in coming months (assuming non-performing loans reach 8% by the end of 2010). To put that into context, Spain's savings banks, which are heavily exposed to developers, are expected to make profits of only €16 billion before provisions this year.

The new accounting guidelines will help Spanish lenders smooth out the effects of the property bust over time. But the risk is that the problems are merely postponed. The ratio of bad loans to the total, property included, has tripled to 4.6% over the past 12 months as unemployment appears to head inexorably towards 20%.

The true picture is worse still. Commercial banks have bought about €10 billion in debt-for-property swaps, according to UBS. Spain's savings banks do not disclose the figure. Assume it is similar to their commercial peers and reclassify all these property purchases as bad loans, and then the non-performing loan ratio would be 5.7% (before any further adjustments for loan restructuring). Deferring losses to *mana* doesn't change the extent of the difficulties facing Spain's financial system.

Spain's financial system



Wobbling

Financial reform in America

Barack Obama's financial reforms meet political reality

NEW YORK

“IN THESE efforts we seek a careful balance,” Barack Obama declared as he unveiled his financial reforms on June 17th. Not equitable enough for some, it seems. With lawmakers, regulators and bankers blowing raspberries at crucial parts of the package, the odds are moving against its becoming law by the end of the year, as originally envisaged. Worse, passage looks increasingly dependent on the most contentious bits being rewritten.

The Treasury's work rate cannot be faulted. It has sent hundreds of pages of proposed legislation to Congress in recent weeks on pay, securitisation, hedge funds, rating agencies and more. The final piece, House of Representatives was expected to approve the compensation bill, curbing egregious pay-offs and giving shareholders a vote on pay, on July 31st.

But the overall timetable is slipping. There is no consensus on who should su-

▷ pervise the largest financial firms. The administration wants the Federal Reserve to do this, supported by a council of regulators that keeps a lookout for emerging risks. But lawmakers on both sides worry that the central bank is already too powerful, or that expanding its role would undermine its monetary credentials. Barney Frank, the House financial-services committee's ebullient chairman, has criticised plans to draw up a list of firms that are "too big to fail", fearing it will entrench them.

The loudest opposition has been reserved for a proposed consumer-protection agency, which would write and en-

force rules for mortgages, credit cards and so forth. This is needed, the administration argues, because bank regulators are inclined to focus on safety rather than the treatment of customers—even if they have recently become, in Mr Frank's words, "born-again consumer advocates", rushing out new curbs on predatory lending as their turf has come under threat.

Lawmakers would like to support the new agency—there are votes in championing the little guy. But banks, including politically powerful community lenders, have stoked fears that the new regulator could become an unwieldy monster and that its

mandate to make products simpler could constrain credit. Existing regulators have weighed in too, arguing that separating prudential regulation from consumer protection could make the system less safe. A House vote on the agency, scheduled for July, has been postponed until September because of lukewarm support.

All this cacophony is good news for industry lobbyists, who are also encouraged by the delays plaguing health-care reform, Mr Obama's top priority. This will distract Chris Dodd, who is essential to getting the financial reforms through the Senate as head of its banking committee but must ▶▶

Buttonwood | With one bound...

The stockmarket recovery still faces some serious tests

FACING certain death, Batman can always produce just the right tool from his utility belt and leap to safety. The stockmarket seems to be working on the same trick. In March shares were spiralling relentlessly downwards. But the Dow Jones Industrial Average climbed back above the 9,000 level on July 23rd and London's FTSE 100 index rose for 11 trading days in a row to July 27th, equalling its best-ever run. Most of the world's stockmarkets are now in positive territory for the year.

Such rises need to be set in context. The Dow passed 9,000 for the first time back in April 1998 and it is still a long way below its peak of 14,165, reached in October 2007. The speed of this year's rally in part reflects the scale of the previous decline. Nevertheless, the change of mood is remarkable, given that earlier this year many feared a repeat of the Depression.

Two factors are commonly cited as being behind the rally. The first is a growing conviction that the worst of the economic downturn is over. Although second-quarter GDP data have so far been mixed (disappointing in Britain, better than expected in Singapore), forward-looking data such as purchasing managers' surveys are generally encouraging.

The second factor is the second-quarter reporting season in America. According to Morgan Stanley, 57% of companies in the S&P 500 index to have reported results have beaten expectations. Only 25% have disappointed. It is worth remembering, though, that profits are still depressed. Earnings were 28.8% lower than in the same period of 2008. Leaving out financial firms, they were still 16.7% down.

The rally may also be benefiting from at least two virtuous circles. The first is that leading economic indicators usually include the stockmarket itself as a key



component. Recent improvements in these indicators—the euro-zone figures rose by 1.5% in June, for example, on the back of similar increases in April and May—are in turn taken by equity investors as a bullish signal.

The second factor is more technical. David Shairp of JPMorgan Asset Management says that lower stockmarket volatility is reducing the perceived risk of investing in equities, relative to bonds. In turn, volatility tends to fall when the stockmarket is rising.

The relative attraction of equities may be the key to the rally. The return on cash is many countries is virtually zero. Long-dated government bonds yield 3-5% in America and the euro zone. Many investors are nervous about the volume of issuance and the potential for inflation. At the end of 2008 these low yields did not matter: investors were more concerned with the return of capital than the return on it. They are now becoming less risk-averse and heading back to equities and to corporate bonds, where spreads (the excess interest rate paid to investors to reflect higher risks) have fallen despite more defaults.

How long-lasting will the recovery be? Its scale has hurt one bullish argument for shares: that they are historically cheap. At their March lows they did appear attractive on two long-term measures—the cyclically adjusted price-earnings ratio (which averages profits over ten years) and the "q" ratio (which compares the market value of companies to the replacement cost of their assets). After the rebound, Andrew Smithers, an economist, reckons the American market is about 20% overvalued on these gauges.

The period when shares were a bargain was remarkably short. As Jeremy Grantham, a veteran investor, has remarked: "After 20 years of more or less permanent overpricing of the S&P, we get five months of underpricing. There is no justice in life." Mr Grantham's lament reflects an underlying problem: valuation often fails to be a good short-term guide to the stockmarket's prospects.

The big issue for the market may arrive, ironically, if the bulls are right. If economic recovery does occur in 2010, it will be because the authorities have thrown everything, from tax cuts to quantitative easing, at the problem. At some point they will have to withdraw the stimulus. How will consumers cope if both taxes and interest rates are rising at the same time? American consumer confidence has already declined in each of the past two months, even though rising share prices are normally good for sentiment.

If governments and central banks do not tighten policy, government-bond investors may take fright, pushing up yields and tightening monetary conditions on their own. In short, there are plenty of risks. Batman may win every hand but equity investors should still fear the Joker.

What goes up

Remittances to developing countries

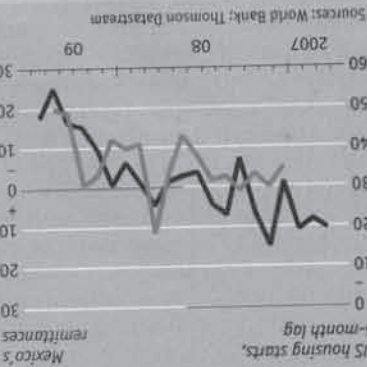
Remittances rose in 2008. This year will be different

THINGS that grew rapidly in 2008 included home foreclosures, government deficits and the ranks of the jobless. More encouragingly, remittances to developing countries also expanded. The World Bank reckons that migrant workers sent \$328 billion home to their families last year, 15% more than in 2007. This continued growth is particularly striking because it came in a year when other private financial flows into the developing world declined dramatically. The net inflows of private capital to these economies dropped by nearly two-fifths, from \$146 trillion in 2007 to \$70.7 billion, as patently rich-world investors turned inward and foreign banks became increasingly reluctant to lend across borders. Dilip Rathna of the World Bank wryly remarks that migrants are being "thrust into the role of a sort of lender of last resort."

However, the chances that remittances will continue to hold up this year are slim. Some argue that these payments are less affected by downturns than others kinds of financial flows because they are sent primarily to support people's families. But whatever their motives, migrant workers must earn before they can remit. And this crisis has hit countries where migrants work harder than the countries they come from.

The continued growth in remittances in 2008 may not reflect their resilience to recession so much as the fact that it takes a few months for changes in host economies to have an effect. Remittances to Mexico, which are dominated by money

When America sneezes



going awry. Many believe that last year's extreme market volatility was heightened by high-frequency traders. According to Nassim Nicholas Taleb, an author and investor, HFT "magnifies changes and ultimately makes the system weaker". The market can correct some of these problems. Institutions are developing their own algorithms to confuse high-frequency traders. Bigger investors are moving to "dark pools", electronic trading venues that conceal an order's size and origin. The London Stock Exchange announced in July that it was abolishing liquidity rebates. Regulators are also rolling up their sleeves. On July 27th Charles Schumer, a Democratic senator, urged the Securities and Exchange Commission to ban flash orders. As trading moves from milliseconds to microseconds, everyone is learning to act more quickly. ■

Asymmetric information is nothing new. Even its critics concede that most HFT is perfectly legal. But some of the advantages that accrue to high-frequency traders look unfair. Flash orders, a type of order displayed on certain exchanges for less than 500 microseconds, expose information that is only valuable to those with the fastest computers. By locating their servers at exchanges or in adjacent data centres traders can maximise speed. "It appears exchanges are conspiring with a privileged group of high-frequency traders in a massive fraud," says Whitney Tilson, a fund manager. Requiring orders to be posted for at least a second would nullify the value of flash orders and of probing the market.

A group that accounts for nearly 50% of a market also introduces systemic risk. Lime Brokerage, a technology provider, has raised the prospect of a rogue algorithm

microseconds (or millionths of a second). changes can process trades in less than 500 microseconds per second; ex-may execute 1,000 trades per second; ex-mind-boggling. High-frequency traders of options held by traders. The speeds are increase volatility, which increases the value backing on sharp price movements to in-both trades. Other tactics include piggy-backing on sharp price movements to in-both trades. Other tactics include piggy-backing on sharp price movements to in-both trades. Other tactics include piggy-backing on sharp price movements to in-

Another popular HFT strategy is to collect rebates that exchanges offer to liquidity providers. High-frequency traders will quickly outbid investors before immediately selling the shares to the investor at the slightly higher purchase price, collecting a rebate of one-quarter of a cent on both trades. Other tactics include piggy-backing on sharp price movements to in-both trades. Other tactics include piggy-backing on sharp price movements to in-

Algorithmic trading causes concern among investors and regulators

Rise of the machines

High-frequency trading

THE arrest of a former Goldman Sachs employee in July for allegedly stealing the firm's proprietary computer codes thrust the arcane world of high-frequency trading (HFT) into the spotlight. The glare of attention is intensifying. High-frequency traders are essential providers of liquidity—accounting for roughly 50% of trading volume on the New York Stock Exchange—and can claim to have squashed bid-ask spreads. But many claim HFT comes at the price of gouging other investors.

The basic idea of HFT is to use clever algorithms and super-fast computers to detect and exploit market movements. To avoid signalling their intentions to the market, institutional investors trade large orders in small blocks—often in lots of 100 to 500 shares—and within specified price ranges. High-frequency traders attempt to uncover how much an investor is willing to pay (or sell) for by sending out a stream of probing quotes that are swiftly cancelled until they elicit a response. The traders then buy or short the targeted stock ahead of the investor, offering it to them a fraction of a second later for a tiny profit.

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longer this drags on, the less draconian the outcome should be, as long as markets continue to mend," says one lobbyist.



Rebalancing the world economy: China

The spend is nigh

HONG KONG

The second article in our series on global rebalancing asks whether China can reduce its trade surplus by consuming more

AREBALANCED global economy requires America to consume less and save more. That means the world's three big surplus economies—China, Germany and Japan—will have to save less and spend more. None is under more scrutiny than China, whose vast current-account surplus has been fingered by some as the ultimate cause of the financial crisis. The case against China is exaggerated but a surplus of more than \$400 billion in 2008, or 10% of GDP, was clearly too big. Can China right its trade imbalances, and if so, how will it achieve rapid growth in future?

The good news is that the surplus is already shrinking. The strong rebound in China's economy in the second quarter—pushing GDP 7.9% higher than a year ago—came entirely from domestic demand. This sucked in more imports, while exports continued to slump. China's merchandise trade surplus narrowed to \$35 billion in the same quarter, 40% down on a year earlier. Yu Song and Helen Qiao of Goldman Sachs calculate that the decline is even more impressive in real terms (adjusting for changes in export and import prices), with the surplus shrinking to less than one-third of its level a year ago (see chart 1). They even suggest that a monthly trade deficit is possible within the next year.

Another way to look at the huge swing in China's trade is that net exports (exports minus imports) contributed 2.6 percentage points of the country's GDP growth in 2007, but shaved almost three points off its

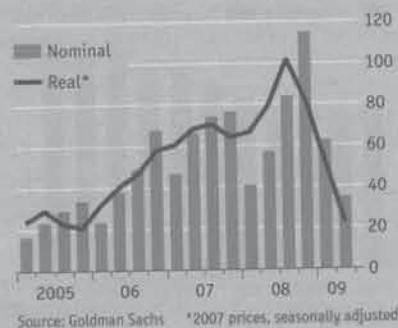
growth in the first half of this year.

Most economists think that China's trade surplus will remain large. The jump in imports in the second quarter included heavy stockpiling of commodities, which will not last; copper imports, for example, were 150% higher than a year ago. Yet the underlying surplus is clearly shrinking. Paul Cavey of Macquarie Securities forecasts that China's current-account surplus will fall to under 6% of GDP this year and 4% in 2010, down from a peak of 11% in 2007. Exports amounted to 35% of GDP in 2007; this year, reckons Mr Cavey, that ratio will drop to 24.5%.

On the surface, therefore, China is fulfilling the long-standing demand of Western governments that it shift its engine of growth from exports to domestic demand.

Shrinking at last

China's trade surplus, \$bn



Thanks to the biggest fiscal stimulus and loosening of credit of any large economy, China's real domestic demand is likely to grow by at least 10% this year. In fact, the popular perception that China has always relied on export-led growth is rather misleading. Its current-account surplus did soar from 2005 onwards but until then was rather modest. And over the past ten years net exports accounted, on average, for only one-tenth of its growth.

The problem is more that the mix of domestic demand between consumption and investment is unbalanced, and becoming even more so. In 2008 private consumption accounted for only 35% of GDP, down from 49% in 1990 (see chart 2 on the next page). By contrast, investment had risen from 35% to 44% of GDP. This year the bulk of the government's stimulus is going into infrastructure, further swelling investment's share. Chinese capital spending could exceed that in America for the first time, while its consumer spending will be only one-sixth as large. This is China's most glaring economic imbalance.

Spending lots of money on building railways, roads and power grids is the most effective way for the government to prop up demand in the short term—especially since China, as a poor country, needs better infrastructure. However, the pace of investment is unsustainable. Even before this year's infrastructure boom capital spending was too great, causing many economists to worry about excess capacity and the risk that bank loans could sour.

China deserves credit for the speed with which it responded to the global downturn. Now it needs to focus on structural reforms not just to keep domestic demand growing strongly and to reduce its trade surplus further, but also to derive more of its growth from consumption and less from investment.

Before exploring how China can do so, it is important first to clear up a misunderstanding. It is often argued that China runs a current-account surplus because its consumer spending has been sluggish. On the contrary, China has the world's fastest-growing consumer market, increasing by 8% a year in real terms in the past decade. Retail sales have leapt by 17% in real terms in the past 12 months, although this figure may be inflated by government purchases. Even so, China's consumer spending has grown more slowly than the overall economy. As a result consumption as a share of GDP has fallen and is extremely low by international standards: only 35%, compared with 50-60% in most other Asian economies and 70% in America.

Economists disagree about the main reason why the consumption ratio has fallen—and hence about the best way to lift it. The most popular explanation is that Chinese households have been saving a bigger slice of their income because of an in-

adequate social safety net. They have squandered away more money to cover the future cost of health care, education and pensions. According to Eswar Prasad, an economist at Cornell University, the saving rate of urban households has jumped from 20% to 28% of their disposable income over the past decade. After exploring all the possible causes, he concludes that uncertainty about the private burden of health care and education is indeed the main culprit. The effect has been worsened by an undeveloped financial system, making it hard for households to borrow.

The Beijing government is acting: it doubled spending on health care, education and social security between 2005 and 2008. But the total amount remains low at only 6% of GDP, compared with an average of around 25% in OECD countries. This year the government has increased pension coverage and payments to low-income households. It has also pledged to provide basic health care for 90% of the population by 2011, although the new spending appears to be less than 0.5% of GDP each year. If such measures ease households' worries about future health care, they could encourage them to save less. But it will take years for them to have much effect on consumer behaviour.

Slicing up saving

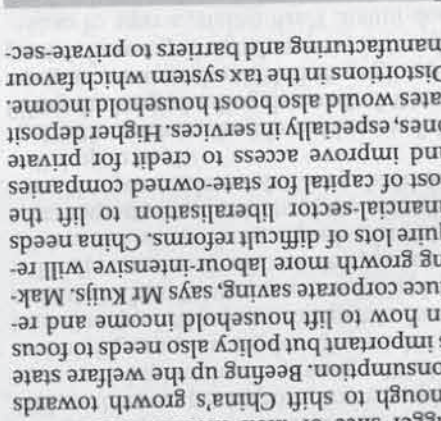
More to the point, an inadequate welfare state does not fully explain why consumption has fallen as a share of GDP. The first niggle is that most workers lost their state-provided health care and education almost a decade ago, after the reform of state-owned firms, so this cannot really explain why saving has continued to rise more recently. Louis Kuijs, an economist at the World Bank in Beijing, suggests that the extra saving may owe as much to greater income inequality as to the lack of a welfare state. Rich people save a lot more and their numbers have increased.

A second flaw in the thesis is that although urban households have been saving more, rural households have become less thrifty over the past decade. As a result China's average household-saving rate has risen more modestly. Mr Kuijs calculates that total household saving has risen from 21% of GDP in 1998 to 24% in 2008. Households accounted for only one-fifth of the increase in total domestic saving over the period. Most of the increase in saving came from companies (see chart 3).

This matters for two reasons. First, if anyone saves too much, it is companies, not households. Second, you need to look elsewhere for the cause of China's falling consumption ratio. The drop in consumer spending as a share of GDP over the past decade has been almost four times larger than the rise in household saving.

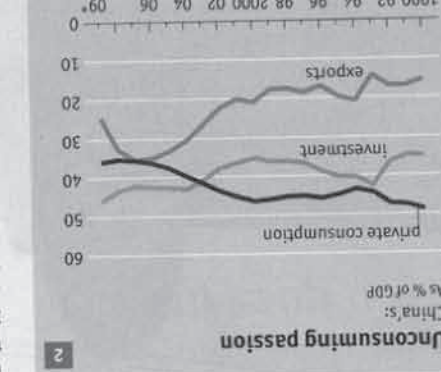
The more important reason why consumption has fallen is that the share of na-

The world's biggest squirrels
China's domestic saving as % of GDP



Simply urging households to spend a bigger slice of their income will not be enough to shift China's growth towards consumption. Beeing up the welfare state is important but policy also needs to focus on how to lift household income and reduce corporate saving, says Mr Kuijs. Making growth more labour-intensive will require lots of difficult reforms. China needs financial-sector liberalisation to lift the cost of capital for state-owned companies and improve access to credit for private ones, especially in services. Higher deposit rates would also boost household income. Distortions in the tax system which favour manufacturing and barriers to private-

Unconsuming passion
China's As % of GDP



for participation in some service industries should be scrapped. State-owned firms ought to be forced to pay bigger dividends. The prices of subsidised industrial inputs should be raised. Land reform and the removal of restrictions on migration from rural to urban areas would also help to lift incomes and thus consumption.

China has barely started on these important reforms. That may be because they involve much harder political decisions than creating a welfare state. They require the government to loosen its control over the economy, something which Beijing will do slowly and reluctantly.

Last but not least, China needs to allow its exchange rate to rise. This would lift consumers' real purchasing power, discourage excessive investment in manufacturing and help to reduce the trade deficit further. It would also alleviate the risk of a protectionist backlash abroad. From July 2005 (when China abandoned its dollar peg) in February 2009, the yuan rose by 28% in real trade-weighted terms, according to the Bank for International Settlements. But alarmed by the collapse of exports, China has virtually repegged the yuan to the dollar over the past 12 months. As the greenback fell this year, it dragged the yuan's value down with it. Since February the yuan's real trade-weighted value has lost 8%.

Economists disagree about the extent to which the yuan is undervalued. In the IMF's "Article IV" assessment of China, published on July 22nd, officials were split over whether the currency was "substantially undervalued". Morris Goldstein and Nicholas Lardy, of the Peterson Institute for International Economics, have done some of the most extensive work on China's exchange rate. In a new study, they estimate that the yuan is undervalued by 15-25%, based on the adjustment needed to eliminate the current-account surplus.

The American government has softened its demands for revaluation, largely because it needs China to keep buying Treasury bonds to fund its own stimulus spending. At the Strategic and Economic Dialogue meeting between American and Chinese officials on July 27th and 28th in Washington, D.C., the yuan's exchange rate was barely discussed. However, the case for appreciation remains strong.

China's recent efforts to boost domestic spending have helped to maintain robust growth and reduce its trade surplus. But excessive levels of investment are not a recipe for sustained rapid growth. Unless it is prepared to embrace difficult structural reforms and to allow the yuan to climb, China's commitment to rebalancing will remain half-hearted. In the long run that will be bad news for China itself as well as for the rest of the world.

Video: See the changing face of China's economy at Economist.com/video/geographics

Economics focus | Waist banned

Does a tax on junk food make sense?



ECONOMISTS have long recognised the arguments for imposing special taxes on goods and services whose prices do not reflect the true social cost of their consumption. Such taxes are known as “Pigouvian” after Arthur Pigou, a 20th-century English economist. Environmental taxes are an obvious example. There is also a Pigouvian case for duties on cigarettes, alcohol and gambling. Smoking increases the risk of cancer for those in the vicinity of the smoker; alcohol abuse and gambling are strongly associated with violence and family breakdown. Moreover, all three habits lead to higher medical costs. In theory governments can make up these costs, or “externalities”, with a tax that adjusts the prices people pay to puff, booze or punt. Such a tax might also encourage consumers to live healthier lives.

Support for another such tax, on junk food, is now spreading, especially in America. Congress is considering a tax on sugary drinks to help pay for the planned expansion of health-care coverage. Some analysts would like to see broader duties on junk food. On July 27th the Urban Institute, a think-tank in Washington, DC, proposed a 10% tax on “fattening food of little nutritional value” that, it claimed, would raise \$500 billion over ten years.

The logic for a tax on fattening food may seem obvious. About one-third of Americans are obese, up from 15% in 1980. Fat people are more prone to heart disease, diabetes, bone disorders and cancer. An obese person’s annual medical costs are more than \$700 greater than those of a comparable thin person. The total medical costs of obesity surpass \$200 billion a year in America, which is higher than the bill for smoking. These costs are not all borne by the obese. When health-care costs are shared, obesity becomes a burden for everyone. Thanks to government health-care plans such as Medicare half of America’s obesity-related health costs land on taxpayers. In private employer-sponsored health plans the slim pay similar premiums to the overweight.

But would a fat tax affect behaviour? Numerous studies have shown a relationship between the price of food, especially junk food, and body weight. As fast food has become relatively cheaper, so people have become fatter. A new paper* from the RAND Corporation, another think-tank, suggests that taxing calories could have a sizeable, if gradual, effect on people’s weight. The authors of the study look at changes in the weight and height of a

large group of Americans aged over 50 between 1992 and 2004. They then calculate food-price indices that are skewed towards calorie-dense foods (so a change in the price of butter has more impact than a change in the price of vegetables). By controlling for individual and environmental influences on weight, such as income and health, they then measure whether food-price changes affect body-mass index (BMI). BMI, the ratio of weight in kilograms to the square of height in metres, is a common, if imperfect, gauge of whether someone is over- or underweight.

A person’s BMI turns out to be hard to shift in the short term. A 10% increase in the calorie-heavy price index is associated with a small decline, of 0.22, in BMI within two years. But the effects are greater over the longer term. A 10% increase in the price of calories results in a fall in BMI of one to two points over 20 to 30 years. Such a drop would eliminate about half of the observed increase in obesity in America since 1980.

Even so, the idea of tackling obesity via the tax system has some serious flaws. First, there is the question of what to tax. Sugary drinks may not be nutritious, but hamburgers contain some protein along with their fat. More important, junk food is not itself the source of the externality—the medical costs that arise from obesity. Unlike smoking, or excessive gambling and drinking, eating junk food does not directly impair the well-being of anyone else. And because obesity is determined by lack of exercise as well as calorie intake, its ultimate relationship with health costs is more tenuous than that of, say, smoking. It is possible to eat a lot of fatty food, exercise frequently and not generate any externalities. A more direct, though controversial, approach would simply be to tax people on the basis of their weight.

Fat chance

The distance between junk food and the medical costs of obesity means that a calorie tax could have unintended consequences. A new theoretical paper in the *Journal of Public Economics* even suggests that a tax on junk food could increase obesity, especially among physically active people. If junk food, which is quick and easy to obtain, becomes relatively dearer, people will spend more time shopping for fresh ingredients and preparing food at home. That could leave less time for exercise.

Even if perverse consequences of this type look improbable, a junk-food tax may have less impact than its advocates expect. New studies on the effect of cigarette and alcohol sin taxes suggest heavy users are less influenced by price changes than others. An analysis of data from the National Longitudinal Study of Adolescent Health shows that American teenagers who smoke more than five cigarettes a day are only one-third as responsive to cigarette prices as lighter smokers. A complementary study of data from America’s Health and Retirement Survey shows that alcohol taxes are far less effective for the large minority of heavy drinkers. The biggest consumers of fattening food may prove similarly resilient to price increases, so a fat tax may do little to improve health, at least for today’s junk-food addicts. If these same consumers are poorer on average, it would also be regressive. One reason for this is that in some poorer neighbourhoods there may be little fresh food on sale. If junk is all there is, putting up its price will reduce real incomes and make little difference to eating habits and health. Like the foods they aim at, fat taxes look appetising but can have nasty effects. ■

* A full list of sources is available at Economist.com/fattaxes



Another look inside

Modern X-ray technology

The way medical X-rays are generated is over 100 years old. Time to update it

WHEN Wilhelm Röntgen, a German physicist, was carrying out some experiments in 1895, he stumbled across a type of radiation which he labelled simply as X, because he did not know what it was.

His X-rays did not remain unknown for long, however. Doctors seized on them to look inside living bodies and, later, engineers used them to examine the interiors of mechanical components. What has not changed much since Röntgen's day, though, is how they are made.

Most electronic devices have moved into the era of silicon chips and other solid-state technology. Not X-rays. The machines used to generate them still rely resolutely on vacuum tubes. But that will change shortly if Otto Zhou of the University of North Carolina has his way. Dr Zhou and his colleagues are bringing X-radiography into the world of modern electronics. In doing so they hope to create X-ray machines that are smaller, simpler and able to produce more detailed pictures. These could be used to enhance security screening at airports, to allow engineers to check the structure of materials more easily and, especially, to enhance medical images in a way that would improve cancer therapy.

At the moment, X-rays are produced by heating a negatively charged metal filament inside a vacuum tube. The combination of heat and charge releases electrons, which

accelerate through the tube and strike a positively charged electrode at the other end. The rays are created by the energy of the impact. X-ray machines of this type have progressed over the years (the computer tomography, or CT, scanners used in hospitals collect hundreds of X-ray images taken from different angles and convert them into a three-dimensional picture of a patient's internal anatomy). But they are still, fundamentally, a century old.

Fields of endeavour
Dr Zhou's method, by contrast, employs a process called electron-field emission. This dispenses with the heat. Also, instead of having a single metal filament release electrons, it relies on myriad carbon nanotubes to do the same thing. The result is a compact source of X-rays that can be controlled with great precision.

Such sources can then be built into an array, each element of which is programmed to fire whenever required. That will allow for more accurate CT scans. Existing scanners usually have but a single X-ray tube. This is rotated around the patient, taking pictures as it goes. Though the rotation takes only a few seconds, the overall image will be blurred if the patient moves. An array of field-emission devices, however, will take their exposures simultaneously, so the resulting image should always be pin sharp.

And the precision of the new technology is remarkable. Dr Zhou's colleagues have, for example, built tiny scanners that can X-ray a mouse's heart and lungs by taking a series of exposures at exactly the same point in the heartbeat. They are even trying to produce beams so precise that they can be aimed at individual cells. That would allow a tumour to be destroyed cell by cell—probably not a practical anti-cancer therapy, but something which would allow researchers to learn more about how cancer cells interact with one another, and thus reveal their vulnerabilities in a way that was previously unimaginable. ■

Conventional CT scans are used to work out the shape of the place where a dose of radiation needs to be concentrated in order to attack a tumour without damaging nearby healthy tissue. But the scan and the treatment cannot usually be done at the same time, because they interfere with each other. There are, however, no interference problems with field-emission X-ray sources, so these can be used to take high-resolution pictures while treatment is proceeding. This means those administering the treatment will know with precision when to continue and when to stop.

Dr Zhou has set up a joint venture with Siemens, a German company that builds CT scanners, to develop his technology for diagnostic imaging. A prototype machine, which has 52 field-emission X-ray sources arranged in a ring, is due to begin trials later this year. It was described to the annual meeting of the American Association of Physicists in Medicine, held this week in Anaheim, California. The new machine will be attached to a linear accelerator, a device used for radiation therapy, to allow simultaneous imaging and treatment, according to Sha Chang, who will lead the team that tests it.

Techview, our online column on personal technology, appears on Economist.com on Fridays. The columns can be viewed at Economist.com/techview

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Also in this section

Morality and colour

Dark for dark business

The association of white with virtue and black with sinfulness is deep

THE virtuous are often said to be as "pure as the driven snow" while villains are frequently described as having hearts of coal or blackened souls. And the metaphor is made flesh (or, at least cloth) in many plays and films where the baddy wears black and the goody white. But how deep does the metaphor actually run, psychologically speaking?

That is the question which was asked by Gary Sherman and Gerald Clore of the University of Virginia. They were pondering a well-known tendency, called the "Macbeth effect", for people to want to clean themselves physically if they have acted unethically or even had thoughts of corrupt behaviour. (The name comes from the scene in Shakespeare's play in which Lady Macbeth desperately tries to wash phantom bloodstains from her hands after encouraging her husband to murder the king.) This association of cleanliness with moral probity is further bound up with the now well-established link between moral disgust (eg, at unusual sexual practices) and physical disgust (eg, at handling dirty objects or eating polluted food). The researchers' ponderings led them to wonder if the moral roles of black, which is roughly the colour of dirt, and white, which shows up the dirt so well, were connected with the Macbeth effect.

To explore this, they devised an experiment involving 27 Caucasian, six Asian, three African-American and two Hispanic students at the university. The students were all asked to state the colour of words that they were presented with as quickly as they could.

Such a technique is not new. Psychologists have long known that if people are presented with, say, the word "blue" printed in a blue font, they will be able to state the colour of the font much faster than if the word "red" is printed in the same blue font.

The study conducted by Mr Sherman and Dr Clore presented words of moral goodness, like "virtuous" and "honesty", and of badness, like "cheat" and "sin", in either black or white fonts on a computer screen. As they report in *Psychological Science*, the two researchers found that when "good" words were presented in black it took the participants about 510 milliseconds to state the colour of the word. When these same words were presented in white it took roughly 480 milliseconds—a significant difference. A similar effect was seen

Improving scientific publishing

Huddled maths

An academic journal provides haven for rejected work

PAUL LAUTERBUR, the father of magnetic-resonance imaging, had his seminal paper rejected when he first submitted it to *Nature*. Peter Higgs, eponymous predictor of physics's missing boson, faced similar trouble with *Physics Letters*. But Lauterbur went on to win a Nobel prize for his work, and Dr Higgs is an odds-on favourite to get one soon. A good, rejected paper, then, is by no means an oxymoron.

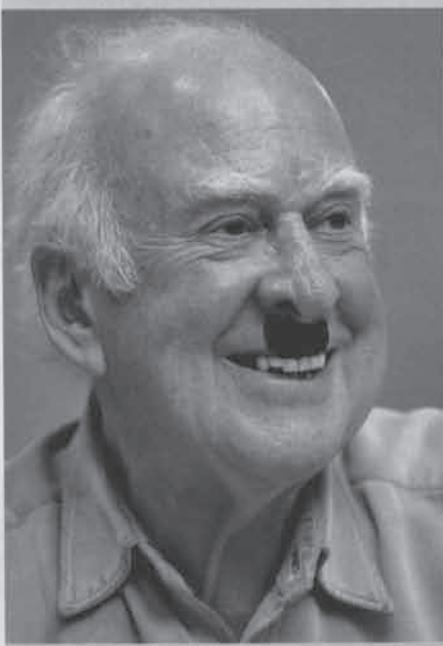
And that observation is the basis of *Rejecta Mathematica*, an open-source academic journal that recently went online. As its name suggests, the new journal publishes only papers that, like Lauterbur's and Dr Higgs's, have been

previously submitted to, and rejected by, others. With *Annals of Mathematics*, one of the best, denying entry to more than 300 last year alone, *Rejecta* could be busy.

Rejecta was conceived three years ago by four graduate students at Rice University, in Houston, Texas. Two of its founders, Michael Wakin and Christopher Rozell, had just had a paper on card counting in blackjack rejected. Good work, said the reviewers, but find some other place for it. When they could not, they, along with Mark Davenport and Jason Laska, decided to cut out the middle man and found their own journal.

If *Rejecta* is a joke, it is a well-executed one. The serious aim is to highlight papers that, although perhaps flawed, may still be interesting. It manages that well. The inaugural issue (www.rejecta.org) includes topics ranging from image enhancement to condition numbers of matrices (don't ask). All come with an "open letter" in which the paper's author outlines in lay terms why the work was rejected (extra points awarded for bitterness), what has been done since and why it still has merit.

Rejecta's larger purpose, then, may be a light jab at academia's bureaucracy and the rigmarole to which it is necessary to submit in order to get published. Whether conventional journals are necessary in the internet age is a matter of active debate. Refereeing maths papers, in particular, requires serious expertise that few have. Those who do, usually receive no pay for their refereeing services. Mistakes can be made. Academia as a whole, some say, could do a better job. But peer review is still necessary. And yes, the editors claim that they too have had to reject some submissions.



Second time lucky for Dr Higgs

with "bad" words. Responding to white ones took around 525 milliseconds, whereas black ones needed only about 500. These results are remarkably similar to those found when words are printed in colours that clash with their meaning.

Besides illuminating an interesting corner of the Macbeth effect, Mr Sherman and Dr Clore suggest that their findings may have implications for understanding racial prejudice. Given that their work hints that blackness and immorality are psychologically connected, and that the labels "black" and "white" are often applied to race, dark skin might thus easily be associated with immorality and impurity.

Because most of the study group were

white, and only three black, there is no way of detecting from the original data whether black people react in the same way as others, and thus whether the link between colour and disgust is independent of race. As a result, the two researchers are now conducting a follow-up study to look for racial differences.

That study is not yet complete but, according to Mr Sherman, "initial results are suggesting that this effect is not confined to Caucasians". Perhaps, then, one reason that so many black Americans get a bad rap is not just that their skin colour differs from that of the majority, but that their psychology, being the same as everybody else's, does not. ■

Thaw point

Global warming and the permafrost

Tundra is among the least-studied types of terrain on Earth. That is about to change

TOOLIK LAKE, ALASKA

THE Arctic tundra is one of the world's most extensive ecosystems, and the frozen soil known as permafrost, which underlies it, can be hundreds of metres deep. But as the world warms up in response to the millions of tonnes of carbon dioxide and other greenhouse gases being poured into the atmosphere each year, so does the permafrost. As the permafrost thaws, bacteria start chewing up the organic matter it contains. This releases yet more carbon dioxide, as well as methane, another greenhouse gas, which has 25 times the warming potential of CO₂. Edward Schuur of the University of Florida in Gainesville, a dozen of the field, estimates that the world's permafrost contains twice as much carbon as its atmosphere. If even a fraction of that were released as CO₂ and methane, it would be bad news.

Not is that all. Thawing permafrost also leaks nitrates and phosphates into the tundra, allowing novel plant species to get a foothold in what was, to start with, a fairly spartan habitat. It distorts the Earth's surface, too, creating a landscape of domes and pits known as thermokarst because of its resemblance to the karstic terrain of limestone-rich parts of the world. This changes the tundra's ecology. It also plays havoc with human structures, such as buildings, roads and pipelines, that sit on top of it. For all of these reasons, then, more research is needed into this icy realm. And that is the object of a project with the unsappy name of Spatial and Temporal Influences of Thermokarst Failures on Surface Processes in Arctic Landscapes, which was kicked off by a group of scientists who gathered in late June at the Toolik Field Station in northern Alaska.

The project, which is led by Breck Bowden of the University of Vermont in Burlington, involves 17 research groups from America and Canada. To start with, they will use a combination of aerial photography, field measurements, and ground-based satellite sensors to compile a map of all the thermokarstic areas of Alaska. This will provide a reference point from which changes can be measured.

The team will then try to work out how the development of features such as "retrogressive thaw slumps" and "active-layer detachments" (different ways in which thawing permafrost can cause a hillside to slip) are associated with the local climate,

Karsting the first stone

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will monitor the growth of this vegetation grass, moss and lichens. The researchers shrubs on land that is now dominated by tents is likely to encourage the growth of the soil and the consequent release of nutrients in the tundra's vegetation. The softening of it will also help them forecast changes the worst come to the worst.

Dr Bowden and his colleagues also hope to understand the impact of thermokarst activity on the structure of the soil, and its nutrient content. They will concentrate on a few sites that can be studied intensively and which are affected by different types of activity. They will measure the amount of carbon, phosphate and nitrate in the soil, together with the rate of plant growth and microbial decomposition. That will let them work out just how "leaky" thawing permafrost is and thus how big its contribution of greenhouse gases to the atmosphere might be, should the worst come to the worst.

It will also help them forecast changes in the tundra's vegetation. The softening of the soil and the consequent release of nutrients is likely to encourage the growth of shrubs on land that is now dominated by grass, moss and lichens. The researchers will monitor the growth of this vegetation

Muddy waters

It is not only natural habitats and future generations that are threatened by the thawing of the permafrost. People in the here and now are affected, as well. Sedi-ments from a huge thermokarstic area have, for example, dammed the Selawik River in north-western Alaska, interfering with fish and threatening the livelihood of nearby villages. Elsewhere in the state, a combination of melting sea ice and thawing permafrost has exacerbated the erosion of several coastal villages, which will have to be relocated at a considerable cost.

Whether anything short of reversing climate change can be done about all this is a moot question. But at least when the project reports, in five years' time, the size of the threat will be clearer. The news it brings may not be welcome. But it is surely better than living in ignorance about one of the world's most important habitats. ■



The beautiful and the dammed



The US-Mexican border

A battle of wills and water

A cult writer explores the secret world of migrant workers in America

TEN years in the making, William Vollmann's latest book, "Imperial", weighs in at a back-cracking four pounds (1.8kg). Were the author to devote the same attention to all the other 3,140 counties in America that he has to Imperial County in the extreme south-eastern corner of California, the result would stretch to more than 4m pages. Even for Mr Vollmann, that would be a tall order.

But perhaps nothing is impossible for a man who, despite being only 50, has already written around 20 books, including a seven-volume history of the idea of violence, which he promptly republished in a condensed version that runs to more than 700 pages, and who churns out novels as well as his peculiar blend of history-cum-reportage-cum-philosophy (he is still at work on "Seven Dreams", a cycle of seven novels about different aspects of the settlement of the Americas).

Is all this a symptom of logorrhoea or of genius? Possibly both. The reader's first impression on opening "Imperial" is that the publisher really ought to have assigned an editor to Mr Vollmann. Written in a mishmash of typefaces, its chapters alternately sprawling over 60 or 70 pages or just a couple of lines, "Imperial" leaps back and forth in time and geography like a maddened ping-pong ball. One has to wonder in what sense it really is a "book" at all, as opposed to the collection of jottings, musings, notes, documents and interviews that an author might assemble before settling down to the arduous busi-

Imperial. By William T. Vollmann. Viking; 1,306 pages; \$55

ness of selection and structuring involved in actually writing a book. It is, in short, a tall order to read.

But persevere. Skip huge tracts if you want to, dip in, dip out and don't worry about disrupting the narrative; there isn't one. Mr Vollmann has penetrated the soul of a place that is like few others on earth, but whose hardships and triumphs tell you something universal about the durability and ambition of the human spirit.

"Imperial" (and its companion volume of 200 pages of photographs that Mr Vollmann took as part of his research) is about two vast battles: the struggle for water, and the struggle for work. The struggle for water is the anterior theme. Until the Alamo canal, commissioned in 1901 and later replaced by the All-American Canal, brought water from the Colorado River to this arid inland part of southern California, precious little would grow there and only a few hundred exceptionally hardy settlers were able to eke out a living. The county now numbers 160,000 souls.

Water, its supply and its rationing, runs through the book. WATER IS HERE, Mr Vollmann interjects in capital letters from time to time. But it is on this subject that the disjointed style is most problematic. The development of canals and irrigation and the consequent explosion of farming in the near-desert call for something much

Also in this section

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Art.view, our online column on art markets, appears on Economist.com on Saturdays. Past and present columns can be viewed at

Economist.com/artview

more linear than the author is constitutionally capable of providing.

Mr Vollmann's other big theme is the struggle for jobs and for a better life by Latino people on both sides of the border. It is here that his ability to talk, it seems, to anyone, stands him in best stead. Mr Vollmann has a well-known fascination with the seamier side of life, and "Imperial" gives him plenty to work with. Drug-runners and prostitutes, people-smugglers and border patrol-guards, sweatshop workers and private detectives fill his pages as he boldly goes where none of those who write the laws in faraway Washington, DC, has dared to tread. The best parts of this rambling opus are the ones where Mr Vollmann gives full vent to his conversations with other people.

Although "Imperial" is centred on the county of that name, it is not limited to it. Given that one of the author's themes is the arbitrariness of lines on a map, that is appropriate. So Mr Vollmann extends Imperial northward to the Salton Sea, a stinking lake sustained only by polluted run-off from the irrigation channels of Imperial County, and westward as far as Los Angeles. Most important, he ranges south too, into the Mexican borderland. He is constantly struck by the disparities that this particular artificial line creates. As an American he can cross the border as freely as a bird. For everyone he meets on the Mexican side the corresponding journey north is fraught with danger and obstacles. On the "Southside", as he calls it, Mr Vollmann walks "like a lord". On the "Northside" Mexicans slink like fugitives.

Profound though the author's sympathies are for the Mexicans he meets in the cities of Calexico and Mexicali, which straddle the Imperial County-Mexico border like lopsided twins, Mr Vollmann is an impressively honest observer. One of the best longer sections in the book is his investigation of the *maquiladoras*, factories ▶▶

set up on the Mexican side of the border to take advantage of low wages and easy access to American markets.

Reflexively accused of abusing the environment and workers, the *maquiladoras* are, nonetheless, also a source of jobs for people who would otherwise have no option but to work in the fields for less money and in the scorching heat. Mr Vollmann interviews dozens of *maquiladora* workers, tries with a comical lack of success to obtain damning photographs from inside the factories and is fair-minded enough to conclude that the charge of exploitation cannot really be sustained.

Some of the places "Imperial" takes the reader to are downright strange. There are the grim flophouses that Mr Vollmann enthusiastically frequents, doing his bit for Mexicali's hookers. But oddest of all are the Chinese tunnels in the Mexican city that he doggedly seeks out. Chinese immigrants used to live down there to escape notice and the heat, and they equipped themselves with restaurants, gambling dens and drinking clubs. All are gone now, but Mr Vollmann still manages to persuade a few suspicious landlords into letting him probe their fetid remnants.

What comes across most strongly is Mr Vollmann's love for the spirit he finds on the Mexican side of the border, and the disappointment he feels with the more sterile life on the American side. El Centro, the county town of Imperial, may have the highest unemployment rate of any metro-pollan area in America, yet "Southerners" are still desperate to make the crossing. Of course, that may be because they find the picturesque poverty of Mexicali a little less engaging than Mr Vollmann does. ■

Asia's quest for wealth

Going for growth

The Miracle: The Epic Story of Asia's Quest for Wealth. By Michael Schuman. Harper Business, 464 pages; \$29.99 and £16.99

SOMETHING remarkable has swept through Asia in recent years, enriching literally billions of people far beyond even what optimists would have imagined just a few decades ago. In "The Miracle", Michael Schuman, Asia business correspondent for *Time* magazine, attempts to discern who and what emerged each country, and beyond the obvious differences, whether certain features are common to them all.

The book explores some rich veins, beginning with the compelling, yet often flawed, people who forced their nations forward. These were men of broad vision,



Digging in their heels

who were usually obsessed with micro-managing details. The leading exemplar was probably Park Chung-hee, president of South Korea from 1961 until 1979. Park would fly off by helicopter before dawn to inspect the construction of a highway project he believed was critical in linking together his country, only to find the project manager, Chung Ju-yung, subsequently better known as the founder of Hyundai, already at work, having slept at the site in the back of a jeep.

As Mr Schuman illustrates, the men who led Asia's growth typically came out of slums and jungles, carving out their careers from what initially were trivial opportunities in regional militias or factories and accounting houses. Just a few, Azim Premji of India's Wipro, Akio Morita of Sony, and perhaps (more quietly) Li Ka-shing of Hong Kong, had ties to wealth. These men saw business as a noble calling. All of them were fiercely nationalists; they took huge risks and occasionally came to a brutal end, as was the case for Chung's longtime rival, Kim Woo-choong, who created and destroyed Daewoo.

Mr Schuman goes to some lengths to show that many of Asia's successes happened after different industries threw off the heavy hand of the state. This was true even in Japan, the birthplace of the miracle, whose economy was heavily influenced by bureaucrats. Sony survived by circumventing government obstacles to American technology and Honda's car division made a point of resisting a government-imposed consolidation. India and China began to prosper once they emerged from under the influence of regulators and planners.

Despite that, the heavy role of the state makes its way through Mr Schuman's book, for better and worse, providing an essential aspect of the narrative. Its influence was felt directly, through support for heavy industries like steel, shipbuilding, and car manufacturing, and also indirectly, through the creation of targeted economic development zones that were exempt from taxes and regulation, and lavished with subsidies. Most controversial were protectionist policies that were almost universally applied.

It is beyond argument that Asia benefited from globalisation and an emphasis on exports that were happily consumed by other countries. However, benefiting from free trade is not the same as practising it. Japan, Taiwan, South Korea, Indonesia, Malaysia and China all built complex filters to allow the import of critical ingredients for production, including technology, capital equipment (when necessary) and energy, while protecting favourite domestic industries from foreign competition. In return for protective laws, local Asian manufacturers were supposed to be obliged by their governments (or by the regulated bank that executed government policy through the allocation of credit) to produce goods that could compete in open markets against any others. Managers or companies that were not up to this task were swiftly meant to be allowed to fall away. In practice, though, as Mr Schuman shows time and time again, the state, or its regulated banks, often lacked the strength or wisdom to impose such discipline.

Mr Schuman also draws attention to the crucial role America played. Willingly and unwillingly, it provided critical technology, from the transistors at the core of Japan's televisions and radios to the semiconductor designs produced in Taiwan's factories. It accepted products from Japan, South Korea and Taiwan when none of the three showed any reciprocity (something still true in many areas of China's economy today). Moreover, many of America's most dynamic companies were prepared both to open manufacturing operations throughout the region and to place critical initial orders with Asian companies so as to help them launch industries such as India's data outsourcing centres.

Whether America will continue to play a similar role is unclear. Trade imbalances are less tolerated than they once were. Tensions over intellectual property theft are likely to discourage American manufacturers from revealing and licensing technological innovation. Within Asia, friction is growing over self-interested nationalist policies that pit one country's manufacturer against another. These tensions are likely to grow over time. Surmounting them will require a miracle. But as Mr Schuman's book makes clear, that is surely no reason to be discouraged. ■

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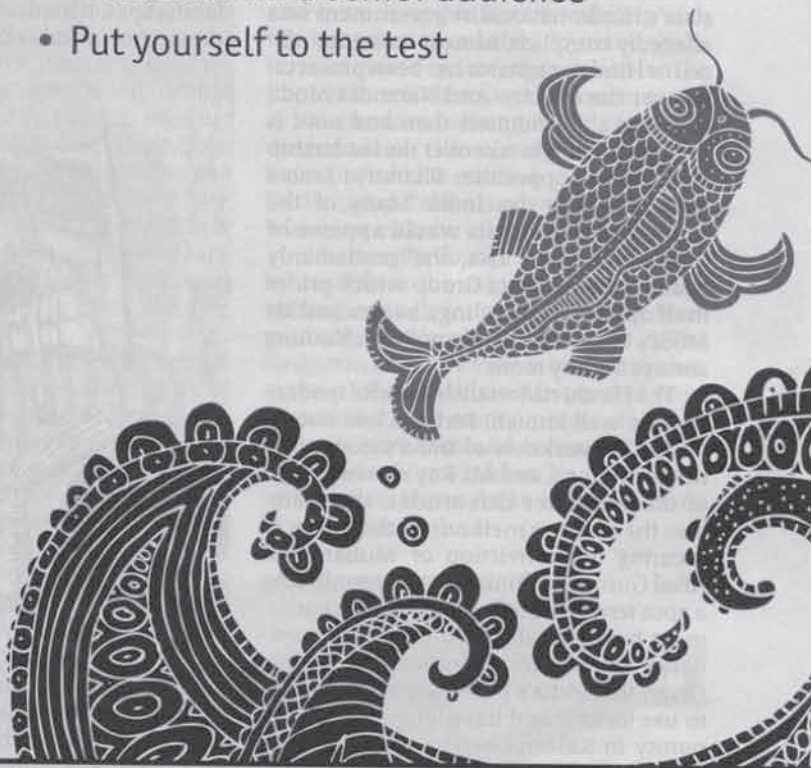
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Necessary, but wrong

Arundhati Roy

Listening to Grasshoppers: Field Notes on Democracy. By Arundhati Roy. Hamish Hamilton: 256 pages; £14.99. To be published in America as "Field Notes on Democracy" by Haymarket Books in October

IT IS impossible not to admire Arundhati Roy. Despite her flawed reporting and analysis, her left-wing prejudices and sided portentous writing, the author who carried off the 1997 Man Booker prize for her novel, "The God of Small Things", is just the sort of brave and energetic critic that India needs.

Not for her the national image projected by India's smug elite, of a nascent super-power lifting off. Ms Roy's India is a truer one—a poor, rural country beset by grave problems, where, notwithstanding the holding of regular elections, wretched injustices are perpetrated by a corrupt and often brutal state.

As prime evidence of democracy's failure to protect Indians, in this collection of her recent journalism and other writings, Ms Roy cites a massacre of perhaps 2,000 Muslims in Gujarat in 2002, in which the state's Hindu-nationalist government was allegedly complicit. Almost no senior official or Hinduist agitator has been prosecuted over the atrocity. And Narendra Modi, Gujarat's chief minister then and now, is currently vying to take over the leadership of the main opposition Bharatiya Janata Party, and one day India. Many of the country's industrialists would approve of that; even Ratan Tata, the gentlemanly head of the vast Tata Group which prides itself on its ethical dealings, has praised Mr Modi's business-friendly policies. Nothing annoys Ms Roy more.

The Hindu nationalists' hateful tendencies are well-known. Perhaps less notorious is the weakness of India's non-political institutions, and Ms Roy skewers most in three deft articles, she examines the dubious methods of the police in securing the conviction of Muhammad Afzal Guru, a Kashmiri, for masterminding a 2001 terrorist attack on the Indian parliament building—allegedly by planting evidence and torturing him into confessing. Given that India's police are often alleged to use torture, and have long enjoyed impunity in Kashmir, where Mr Guru was picked up, this would not be surprising. But neither India's complacent judiciary nor its often-carven journalists shows much interest in reinvestigating his case. Mr Guru remains on death row.

Whether or not he is guilty, Ms Roy does laudable work in defending Mr Guru

Lovin' a cold climate

Low temperatures

Cold: Adventures in the World's Frozen Places. By Bill Streever. Little, Brown: 292 pages; \$24.99 and £18.99

COLD has long had negative connotations—cold-hearted, cold feet, cold comfort, the cold war. Humans struggle to isolate themselves from it, hiding in overheated houses, taking winter holidays in hot climates. Cold kills the old and vulnerable, Christopher Robin-style wheezes and sneezes flourish in cold weather. Swine flu is expected to tighten its grip this winter. "Cold! If the thermometer had been an inch longer we'd all have frozen to death," wrote Opie Read in "Mark Twain and I".

Drawing on his experience of living in Anchorage, Alaska, Bill Streever, a biologist, takes the reader on a celebratory tour of the science, history, geography and ecology of cold temperatures. Humans, he writes, "fail to see cold for what it is: the absence of heat, the slowing of molecular motion, a sensation, a perception, a driving force."

Cold has a huge impact. It shapes landscapes. It herds animals along migration routes or forces them to hibernate. It fills his book with entertaining facts. Around one-fifth of the world's land area lies within the permafrost zone. The heart rate of active bears is around 100 beats a minute; for hibernating bears it can drop to eight beats a minute. Blood circulation to the skin and hands is greater in Inuit people than in Europeans, protecting them from frostbite. It is possible for a moose to starve to death with its stomach full. Four-fifths of the world's fresh water is frozen.

The book's final chapter, however, takes on a more regretful tone as the author turns his attention to climate change and what it means for cold places. "Even in a warming world, a world choked by carbon dioxide and methane, much longer is anyone's guess."



when others—including at times India's legal fraternity, according to Ms Roy—would not. On other issues, however, she is not always a reliable witness. Her claim that in Kashmir last summer protesters were as likely to call for union with Pakistan as freedom from India is probably wrong; most seemed to want to be shot of both countries.

But that faulty observation was at least

noted by Ms Roy in the field. More typically, she appears to gather her facts from newspapers (her articles strike the reader rather as "lounge notes"), before selectively arranging and then exaggerating them to suit her own ends. For example, about 25% of India's territory is alleged to be affected by a Maoist insurgency, but that does not make it, as Ms Roy writes, "out of government control". Beyond India, her grasp of

her subject-matter gets looser. If Ms Roy believes, as she writes, that a good portion of Africa's "contemporary horrors" are caused by America's "new colonial interests", she would do well to pay a visit to the continent.

So entrenched is the anti-globalisation that informs her world view, she would be tough to dissuade. But what alternative strategies does she advocate for improving India? Hard to say. A rare suggestion for better governance—the formation of a shadow parliament "that keeps an under-

ground drumbeat"—does not seem terribly serious. On economic policy, Ms Roy has even less to offer—other than to slam recent governments for aspiring to rapid economic growth. This is a "project" she considers to be "encrypted with genocidal potential". For a more measured analysis, Ms Roy should perhaps turn to the finance ministry's recently published Economic Survey. There she would read that, "High growth is critical to generate the revenues needed for meeting our social welfare objectives." Ms Roy should take note. ■

Kampala. "I remember it like a film," he says fondly. After making a success of Pangolin, Mr Kingdon and Ms Koenig decided to try to put something back into Uganda.

A number of British artists have supported the venture. Mr Hirst recently travelled with Mr Kingdon to Kampala and donated a sculpture that was sold for £313,250 (\$514,300) to help fund the building costs. Mr Buck is one of the foundry's first resident artists. Mr Kingdon says the plan is to build something on the scale of Pangolin, "but belonging wholly to Africa."

A first step has been to train Ugandans in bronze casting, mostly skipping silicon-rubber treatments in favour of more traditional beeswax models. Several students were chosen from the same art department at Makerere where Mr Kingdon was first inspired. Having served a three-year apprenticeship in England, they recently returned to Uganda to build the first rudimentary foundry on the Kasese site.

Uganda has no tradition of sculpture: nothing like Kenya's popular Kamba carvings, still less the sophisticated wood and stone sculptures of Benin or elsewhere in West Africa, which brought bold lines into the work of Constantin Brancusi and other modernists. The Ugandan tradition, instead, is in music. The Buganda people have musical signatures for each of their 52 clans. The clans also have a visual representation in the form of animals, plants, and even dung. Mr Buck is working with the Ugandan apprentices to make sculptures of some of the clan symbols. The hope is to sell these small bronzes to oil-rich Bugandans in Kampala for a few hundred dollars. Other early commissions have included a crested crane, now in Buckingham Palace, and trophies for BBC television awards.

Whether the foundry, which is 450km by road from the capital, succeeds in attracting enough interest to make it commercially viable remains to be seen. The long-term aim, however, is to use it to train a group of world-class African sculptors. By introducing a casting process that few Africans have seen and fewer still can afford, the foundry's backers hope to inspire and give employment to hundreds more local people. ■

Rwenzori Sculpture Foundation

African bronze

RWENZORI MOUNTAINS, UGANDA

The challenge of building central Africa's first arts foundry

THE Rwenzori mountains straddling Uganda and Congo are dark green and shrouded in rain clouds and mists which part only rarely to reveal dazzling equatorial glaciers. There is plenty of clean water rushing down from the peaks and the loamy valley floors are thick with banana, coffee, cassava—and silver-backed gorillas. On one of the foothills on the Ugandan side, not far from the town of Kasese, an impressive architectural project is beginning to take shape.

A London firm, Cullum and Nightingale, has won a competition there to design and build central Africa's first foundry for casting bronze sculptures. Once finished, it will also include an art gallery, a café, housing for visiting artists and a medical clinic to serve the needs of the local Bakonjo people. Richard Nightingale, who was born in Kenya, says his firm is best known for its architecture on sensitive sites and its attention to eco-design, as well as the care it takes in trying to replace imported cement and corrugated iron with locally sourced building materials—mud bricks and roofing made out of fuel drums. The firm has experience in Africa, having built the well-received British high commission buildings in Nairobi and Kampala.

On a recent visit, workers were painstakingly cutting a platform the size of a football pitch out of a hill using handpicks and shovels. The foundry will sit there, with panoramic views over the Rift Valley. The shape of an upturned galleon (see the model, pictured right), it will have a metal roof made of used oil drums beaten flat, and a keel-like beam running the whole length of the building, from which sculptures can be moved about on rails. The intention is to make the building dissolve from a distance into the black and green hillside, "like an elephant dissolves in the

bush", Mr Nightingale says. Besides the views it offers, the site was chosen for the opportunity to buy copper from a local mine, the promise of reliable power from a nearby hydroelectric project and the chance of attracting tourists.

The foundry has been commissioned by the Rwenzori Sculpture Foundation, a British charity which aims to improve the quality of sculpture in Uganda and elsewhere in Africa, particularly bronzes. The main force behind the project is Rungwe Kingdon, who runs the largest bronze foundry of its kind in Europe, together with his wife, Claude Koenig. Their Cotswolds foundry, called Pangolin (after the scaled African antelope with a bronzy patina) has worked closely with some of Britain's leading sculptors and conceptual artists including Phillip King, Jon Buck, Ann Christopher, Damien Hirst and the late Angus Fairhurst.

Mr Kingdon's fascination with bronze dates back to his childhood growing up in Uganda, the son of a noted English zoologist and artist, Jonathan Kingdon. As an eight-year-old boy, he was given permission to help pour a first casting in the art department of Makerere University in



Looking for bronze in them hills



Leszek Kolakowski

Leszek Kolakowski, a Polish-born Oxford philosopher, died on July 27th, aged 81

HIS life was learning—about history, about his times, about himself. Like

some other erstwhile true believers, he became one of most cogent critics of his for-

mer faith. Having spent his youthful years

as an ardent communist and atheist, Les-

zek Kolakowski, one of the great minds of

the modern era, turned into Marxism's

most perceptive opponent, and one with a

profound respect for religion.

His intellectual life started in the misery

of Nazi-occupied Poland—he had to study

in secret, mostly alone—and finished in

one of the nicest places imaginable: Ox-

ford's All Souls college. In a university tai-

lormade for gifted misfits, Mr Kolakowski

opment, attractiveness and shortcomings

of political ideas and systems, particularly

the communism invented by Karl Marx

and practised across the Soviet empire.

His magnum opus was the three-volume

"Main Currents of Marxism: Its Rise,

Growth and Dissolution", published in the

1970s. It calmly and expertly demolished

the pillars of Marxist thought: the labour

theory of value, the idea of class struggle,

historical materialism and the like. He also

pointed out, again without unnecessary

in polemics, the practical shortcomings of

communist systems. Stalinism was not an

aberration, he argued, but the inevitable

consequence of pursuing a communist

utopia. For that, powerful left-wing voices

such as the historian E.P. Thompson beat-

ed him as a traitor to the noble socialist ide-

als that he once espoused.

Against the devil

Both his experience and beliefs made such

criticism seem patronising. Mr Kolakowski

had lived under two kinds of totalitarian-

ism, Nazism and communism; his ideas

had been censored even in the supposedly

more liberal communist Poland of the late

1950s and 1960s. What finally drove him,

and his Jewish wife Tamara, to emigrate

was the communist-inspired anti-semitic

campaign of 1968. Few if any of his leftist

succeed, but to know who we are." ■

known aphorism: "We learn history not in

achievement, that he coined his best-

Jefferson lecture, the highest honour the

America regularly, though, and it was in his

to bring up his daughter, he felt. He visited

leftism "pathetic and disgusting"; no place

to America but found the radical campus

entirely. In the late 1960s, he made his way

faith in Poland's socialist system to erode

there, though it took two decades for his

"material and spiritual desolation" he saw

the delights of Soviet rule.

That backfired. He wrote later of the

with a trip to Moscow in 1950 to experience

the rulers saw the brainy, determined young-

ster as a prize prospect and rewarded him

Indeed his country's post-war communist

system of semi-authoritarian capitalism,

ritism and to the failures of Poland's pre-war

nism as an alternative both to Nazi milita-

the young Kolakowski accepted commu-


their murder during the Nazi occupation,

of assassination. Remembering his fa-

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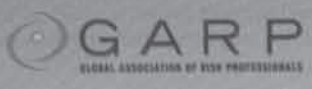
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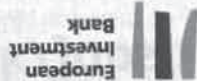
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Deputy Head of the Communication Department

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⇒ At least 5 years' professional experience in a bilateral or multi-lateral context with donor-funding activity in transition or developing countries and associated procedures

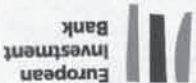
⇒ Proven track-record in implementation and/or supervision of consultancy services, preferably outside the EU

⇒ Excellent knowledge of English and/or French and a good command of the other.

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The Mekong-IWRM Project will strengthen the framework and capacity for IWRM in the Lower Mekong Basin, and explore and establish MRC's role as a facilitator of significant water resources development projects, guided by IWRM principles. The project will be implemented at regional, national and transboundary levels.

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For information, job description and application details, please visit MRC's web site at www.mrcmekong.org.

Closing date for applications: 20 AUGUST 2009

**CHIEF, SERVICES DEPARTMENT
ITU, Geneva, Switzerland**



The International Telecommunication Union (ITU) is inviting applications for the post of Chief, Services Department, Telecommunication Standardization Bureau (TSB), at ITU headquarters in Geneva, Switzerland. Standards from the ITU are at the heart of modern information and communications technologies. For more information see: <http://www.itu.int/ITU-T/info>.

ITU is the leading United Nations agency for information and communication technology issues, and the global focal point for governments and the private sector in developing networks and services. ITU coordinates global use of the radio-frequency spectrum, promotes international cooperation in assigning satellite orbits, works to improve telecommunication infrastructure in the developing world, and establishes worldwide standards that assure seamless interconnection of a vast range of communication systems.

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A detailed vacancy notice and application form including remuneration can be downloaded at www.itu.int/employment. Applications using the form must be sent to recruitment@itu.int or by post to ITU Human Resources Administration Division, Place des Nations, CH-1211, Geneva 20, Switzerland.

**INTERNATIONAL TRIBUNAL FOR THE LAW OF THE SEA
TRIBUNAL INTERNATIONAL DU DROIT DE LA MER**



The International Tribunal for the Law of the Sea, an international court with its seat in Hamburg, Germany, has the following vacancy:

**Senior French Translator/Reviser -
Head of Linguistic Services (P-5)**

For qualifications and experience required, as well as further details, please see the vacancy announcement on the Tribunal's website (www.itlos.org).

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OFFICE OF THE INSPECTOR GENERAL (OIG)

The Office of the Inspector General (OIG) at the Global Fund is looking for an experienced Senior Legal Adviser, who will be based in Geneva. The OIG Senior Legal Adviser will report to the Inspector General, but is expected to coordinate closely with the Global Fund Office of the Legal Counsel.

**I. Senior Legal Adviser - Vacancy CD/09/IRC272
(closing 13 August 2009)**

The incumbent will:

- Provide advice in connection with audits and investigations carried out by the OIG, including advice on the merits of particular cases.
- Provide support to relevant national investigatory authorities and public prosecutors.

Essential: Law degree. Admission to the bar, lawyer's association.

Experience: At least 10 years experience (public prosecutors office, criminal and civil litigation in a legal office, financial fraud). Significant experience working with investigators and auditors in fraud and corruption matters.

Terms and conditions: The Global Fund offers a competitive compensation package net of tax.

Further information on key responsibilities, qualifications, technical skills, competencies and the application process can be obtained on:
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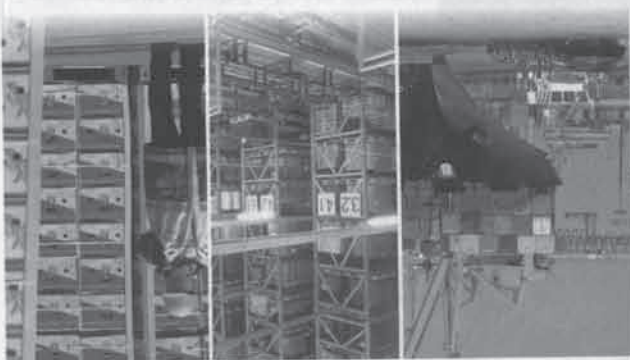
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Issue of RFP Document	From 24.07.09 to 24.08.09 (1100 IST)
Pre-proposal Conference	07.08.09 (1100 IST)
Due Date for Submission	24.08.09 (upto 1600 IST)

The complete RFP document may be obtained from the following address or

downloaded from NHAI website www.nhai.org

Amendments/Corrigendum, if any, would be hosted on the website only.

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The Economist August 1st 2009

Overview

There was some good news from **America's housing market**. Sales of new single-family homes increased by 11% in June to an annual rate of 384,000. However, this was still 21.3% lower than in June 2008. The prices of houses in the 20 largest cities rose by 0.5% in May, according to the S&P/Case-Shiller index, the first increase since July 2006. Prices were 17.1% lower than a year before.

An index of **American consumer confidence** fell to 46.6 in July from 49.3 in June, said the Conference Board, a research group.

New orders for **durable goods in America** declined by 2.5% in June to \$158.6 billion, after rising in both April and May. The biggest declines were in orders for transport equipment. Orders for other durable goods increased by 1.1%.

Japan's industrial output went up by 2.4% in June. Although this was the fourth monthly rise in a row, output was 23.4% down on a year earlier.

Britain's GDP fell by 0.8% in the three months to June, having declined by 2.4% in the first quarter. The economy shrank by 5.6% in the year to the second quarter, the largest contraction since comparable records began in 1955.

The annual rate of consumer-price inflation in **South Africa** fell to 6.9% in June from 8% in May.

Hungary's central bank lowered its key interest rate by a percentage point to 8.5%.

Indicators for more countries, as well as additional series, can be found at

Economist.com/indicators

Output, prices and jobs

% change on year ago

Country	Gross domestic product				Industrial production latest	Consumer prices			Unemployment rate†, %
	latest	qtr*	2009†	2010†		latest	year ago	2009†	
United States	-2.5 Q1	-5.5	-2.7	+2.0	-13.6 Jun	-1.4 Jun	+5.0	-0.4	9.5 Jun
Japan	-8.8 Q1	-14.2	-6.1	+1.0	-23.4 Jun	-1.1 May	+1.3	-1.1	5.2 May
China	+7.9 Q2	na	+7.2	+7.6	+10.7 Jun	-1.7 Jun	+7.1	-0.5	9.0 2008
Britain	-5.6 Q2	-3.2	-3.7	+1.1	-11.9 May	+1.8 Jun	+3.8	+1.7	7.6 May††
Canada	-2.1 Q1	-5.4	-2.2	+1.9	-9.9 Apr	-0.3 Jun	+3.1	+0.6	8.6 Jun
Euro area	-4.9 Q1	-9.8	-4.4	+0.6	-17.0 May	-0.1 Jun	+4.0	+0.4	9.5 May
Austria	-3.5 Q1	-10.6	-3.2	+0.2	-10.9 Apr	nil Jun	+3.9	+0.5	4.3 May
Belgium	-3.0 Q1	-6.2	-3.5	+0.4	-19.9 Apr	-1.1 Jun	+5.8	+0.4	11.0 May††
France	-3.2 Q1	-4.8	-2.9	+0.7	-13.4 May	-0.5 Jun	+3.6	+0.2	9.3 May
Germany	-6.9 Q1	-14.4	-6.0	+0.6	-18.1 May	-0.6 Jul	+3.3	+0.2	8.3 nil
Greece	+0.3 Q1	-4.6	-3.0	-0.9	-7.2 May	+0.5 Jun	+4.9	+0.4	9.4 Apr
Italy	-6.0 Q1	-10.1	-5.0	+0.4	-19.8 May	+0.6 Jun	+3.8	+0.9	7.3 Q1
Netherlands	-4.5 Q1	-10.7	-4.5	+0.7	-12.7 May	+1.4 Jun	+2.6	+1.3	4.7 Jun††
Spain	-3.0 Q1	-7.4	-3.8	-0.6	-22.3 May	-1.4 Jul	+5.3	-0.3	18.7 May
Czech Republic	-3.4 Q1	-12.9	-3.0	+1.2	-22.0 May	+1.2 Jun	+6.7	+1.7	8.0 Jun
Denmark	-4.1 Q1	-4.2	-3.7	+0.6	-16.5 May†††	+1.2 Jun	+3.8	+1.2	3.8 Jun
Hungary	-6.7 Q1	-9.6	-6.3	-1.0	-22.1 May	+3.7 Jun	+6.7	+4.3	9.8 May††
Norway	+1.5 Q1	-1.8	-2.0	+0.5	-7.8 May	+3.4 Jun	+3.4	+2.1	3.1 Apr***
Poland	+0.8 Q1	na	-0.8	+1.5	-4.3 Jun	+3.5 Jun	+4.6	+2.5	10.7 Jun††
Russia	-9.5 Q1	na	-7.0	+2.5	-12.1 Jun	+11.9 Jun	+15.2	+12.1	8.3 Jun††
Sweden	-6.5 Q1	-3.6	-5.1	+1.1	-21.9 May	-0.6 Jun	+4.3	-0.3	9.8 Jun††
Switzerland	-2.4 Q1	-16.0	-2.2	+0.4	-9.4 Q1	-1.0 Jun	+2.9	-0.5	3.8 Jun
Turkey	-13.8 Q1	na	-5.6	+2.2	-17.4 May	+5.7 Jun	+10.6	+6.2	14.9 Apr††
Australia	+0.4 Q1	+1.5	-0.2	+1.7	-3.6 Q1	+1.5 Q2	+4.5	+1.8	5.8 Jun
Hong Kong	-7.8 Q1	-16.1	-6.0	+1.1	-10.2 Q1	-0.9 Jun	+6.1	+1.0	5.4 Jun††
India	+5.8 Q1	na	+5.5	+6.4	+2.7 May	+8.6 May	+7.8	+5.2	6.8 2008
Indonesia	+4.4 Q1	na	+2.4	+3.1	+1.8 May	+3.7 Jun	+11.0	+4.2	8.1 Feb
Malaysia	-6.2 Q1	na	-5.2	+3.4	-11.1 May	-1.4 Jun	+7.7	-0.3	4.0 Q1
Pakistan	+5.8 2008*	na	+3.7	+2.8	-14.1 Apr	+13.1 Jun	+21.5	+12.0	5.2 2008
Singapore	-3.7 Q2	+20.4	-8.6	+1.3	-9.3 Jun	-0.5 Jun	+7.5	-0.2	3.3 Q1
South Korea	-2.5 Q2	+9.7	-4.4	+0.5	-9.0 May	+2.0 Jun	+5.5	+1.6	4.0 Jun
Taiwan	-10.2 Q1	na	-6.5	+0.6	-11.4 Jun	-2.0 Jun	+5.0	-1.3	5.9 Jun
Thailand	-7.1 Q1	-7.3	-4.5	+1.9	-10.0 May	-4.0 Jun	+8.8	-1.0	2.4 May
Argentina	+2.0 Q1	+0.2	-3.5	+0.5	-12.2 May	+5.3 Jun	+9.3	+7.0	8.4 Q1††
Brazil	-1.8 Q1	-3.3	-1.2	+2.7	-11.3 May	+4.8 Jun	+6.1	+4.9	8.1 Jun††
Chile	-2.1 Q1	-2.4	-1.0	+2.2	-14.2 Jun	+1.9 Jun	+9.5	+2.1	10.2 May††††
Colombia	-0.6 Q1	+0.9	-1.2	+2.5	-6.5 May	+3.8 Jun	+7.2	+5.0	11.7 May††
Mexico	-8.2 Q1	-21.5	-7.1	+2.8	-11.6 May	+5.7 Jun	+5.3	+5.5	5.2 Jun††
Venezuela	+0.3 Q1	na	-4.1	-2.7	-11.3 Feb	+27.4 Jun	+32.2	+30.2	8.1 Q1††
Egypt	+4.3 Q1	na	+4.0	+3.8	+5.7 Q4	+10.0 Jun	+20.2	+9.7	9.4 Q1††
Israel	+0.6 Q1	-3.6	-1.0	+1.6	-9.8 May	+3.6 Jun	+4.8	+2.7	7.6 Q1
Saudi Arabia	+4.2 2008	na	-1.0	+3.1	na	+5.5 May	+10.4	+4.3	na
South Africa	-1.3 Q1	-6.4	-2.2	+3.1	-17.1 May	+6.9 Jun	+12.2	+6.6	23.5 Mar††

*% change on previous quarter, annual rate. †The Economist poll or Economist Intelligence Unit estimate/forecast. †National definitions. †SRPI inflation rate -1.6 in June. **Year ending June. ††Latest three months. †††Not seasonally adjusted. ***Centred 3-month average

Output gaps

The output gap is the difference between actual economic output and the most an economy can sustainably produce, given the amounts of capital, technology and labour available. The OECD forecasts that in 2010 it will average 5.7% of potential GDP for its mostly rich member countries. At 8.2%, Spain's output gap will be one of the largest. The crisis is also affecting potential output, mainly through the collapse in investment. The OECD reckons that Mexico's potential GDP will grow by 2.8% per year between 2011 and 2017. Growth in potential output will average 2.1% in Spain and Poland, and 2% in America. But Japan's potential output will grow by a mere 0.8% a year during this period, and Italy's by only 0.9%.

Difference between actual and potential GDP
As % of potential GDP, 2010 forecast



The Economist commodity-price index

2000=100

Index	Index value		% change on	
	Jul 21st	Jul 28th*	one month	one year
Dollar index				
All items	183.1	186.7	+2.0	-25.6
Food	196.8	197.7	-2.8	-21.8
Industrials				
All	165.5	172.6	+10.2	-30.5
Nfa†	136.8	137.4	+12.6	-31.4
Metals	181.1	191.9	+9.3	-30.2
Sterling index				
All items	168.7	171.9	+2.0	-10.5
Euro index				
All items	119.0	121.8	+1.0	-18.2
Gold				
\$ per oz	949.00	953.65	+1.7	+3.9
West Texas Intermediate				
\$ per barrel	64.78	67.31	-3.8	-44.9

*Provisional †Non-food agriculturals.

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